



## **FURTHER SUBMISSION ON THE FINANCIAL ADVISERS BILL**

To the Finance and Expenditure Select committee.

### **Introduction**

This submission is from the Institute of Financial Advisers and is a response to the second interim report on this Bill.

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## Key overall points

### 1. Don't rush this – it's important to get it right

The IFA is very keen to see regulation that will promote public confidence and increased consumer participation in use of financial advice and products. We are also keen to see regulation implemented as swiftly as possible.

However, we are very concerned that haste to pass legislation this year is compromising the quality of the legislation. We would argue for a little more time being spent on legislative design, with a shorter implementation timetable, rather than shortening the design period with a longer implementation period. We consider the target date for "authorisation" in late 2010 could still be met if the Bill became law in early 2009.

We are also concerned that there seems to be too much "noise" being created around who should be registered and who shouldn't and it's mainly coming from organisations like the product providers who have a vested interest in keeping compliance costs down (and not necessarily having the consumer's interests top of mind). The focus needs to remain on consumer protection.

This legislation will set the platform for regulation of financial advisers for the next 20 years or so. This means it is very important that the legislation gets the definitions correct as these will set the boundaries. Our view is that this shouldn't be rushed and the finance sector needs adequate time to carefully consider the full implications of the legislation wording.

### 2. Products versus occupations versus advice

Moving to definitions of "product" as the basis for boundaries is better than "occupation", but still has risks of missing products. While our preference is still to use "advice" as the basis for definitions, if "product" is to be used as the basis for defining the boundaries, then more care needs to be taken over the definitions to ensure coverage of the right areas.

Our interest is to see that all financial products are covered by the definitions so they need to be comprehensive. The list of "debt, equity, credit and risk products, as well as investment in real property" is a good start point.

### 3. Tiered approach

In concept, a tiered approach has merit as we agree that regulation needs to be proportionate. But, care is needed over what is in each category.

Investment in real property, life insurance and health insurance should be category 1 as mis-selling can have serious consequences. Mortgages and mortgage broking should also be Category 1 as mortgages should be sold in conjunction with life insurance to protect families.

### 4. Categories of advisory services

We agree that Category 1 advisers should be required to meet relevant competency levels and a "fit and proper person" test. They should be registered individually so that a consumer can search for them by name. We suggest the default position for authorisation of advisers should be Category 1, with advisers having to submit to the regulator their restrictions that limit them to Category 2.

We consider Category 2 advisers should also be required to meet a relevant, but lower, competency level. The industry training qualifications being developed have this in mind –

level 4 for Category 2 and level 5 as the minimum for Category 1.

**5. Certified finance institutions**

IFA's preferred approach would be to restrict "certified finance institutions" to the Category 2 products provided by the institution. This would restrict this to simple products and situations where the "institution" is able to directly take responsibility for consumer redress. Under this approach, financial advisers within a "certified financial institution" who provide advice on Category 1 products, would need to be individually "authorised" by the Securities Commission as a consumer protection measure.

Alternatively, if Category 1 products are to be included or coverage include advice or sales of another company's products, then we consider that a professional association such as IFA should also be allowed to become a "certified financial institution".

We are concerned at including "agents" unless this is restricted to "tied agents" who sell only the institution's products. Typically any financial adviser who is not an employee has an agency agreement but only some are under close control.

**6. Disclosure obligations**

The suggestion for varied disclosure obligations, depending upon the category of service seems sound. Obviously, we would wish to comment on the detail.

**7. Central supervision**

The recommendation of a Commissioner of Financial Advisers is a good one. However, we consider it important to have role separation as it would not be right for the same person to be responsible for rule-setting, registration and licensing, investigations and prosecutions for breaches, as well as discipline and appeals against disciplinary decisions.

## **Discussion in more detail**

### **Don't rush this – it's important to get it right**

The IFA is very keen to see regulation that will promote public confidence and increased consumer participation in use of financial advice and products. We are also keen to see regulation implemented as swiftly as possible.

However, we are very concerned that haste to pass legislation this year is compromising the quality of the legislation. We would argue for a little more time being spent on legislative design, with a shorter implementation timetable, rather than shortening the design period with a longer implementation period. We consider the target date for "authorisation" in late 2010 could still be met if the Bill became law in early 2009.

We are also concerned that there seems to be too much "noise" being created around who should be registered and who shouldn't and it's mainly coming from organisations like the product providers who have a vested interest in keeping compliance costs down (and not necessarily having the consumer's interests top of mind). The focus needs to remain on consumer protection.

This legislation will set the platform for regulation of financial advisers for the next 20 years or so. This means it is very important that the legislation gets the definitions correct as these will set the boundaries. Our view is that this shouldn't be rushed and the finance sector needs adequate time to carefully consider the full implications of the legislation. To do this, it needs to see the wording of the legislation.

The discussion paper proposes radical changes in definitions and in the way in which regulation would be enacted, yet lacks specific detail and does not include any draft legislation.

We are concerned at the suggestion that there will be a rush to pass this legislation before the General Election, but that significant changes will be made to the wording of the Bill without the finance sector seeing the wording before the select committee reports back to Parliament. This would mean that any suggested changes to wording could only be done through Supplementary Order Paper at the Committee stages.

### **Products versus occupations versus advice**

Moving to definitions of "product" as the basis for boundaries is better than "occupation", but still has risks of missing products. While our preference is still to use "advice" as the basis for definitions, if "product" is to be used as the basis for defining the boundaries, then more care needs to be taken over the definitions to ensure coverage of the right areas. For example, there are advisers who do not sell product, just advice (e.g. some financial planners). So, financial planning needs to be included as a "product".

If "product" is to be used as the basis for defining the boundaries, considerable care needs to be taken over the definitions as there is a risk that the response will be to re-label or re-design products to ensure that they are outside the coverage. Consider the issue of sale of alcohol by convenience stores and small grocery stores when Dairies were excluded. Some Blue Chip deals were sold as loans but were actually deposits for the purchase of a property. Some product designers will seek to develop products that are deliberately not covered by definitions so they can be sold by people who don't need to be "authorised" or registered.

Our interest is to see that all financial products are covered by the definitions so they need to be comprehensive. The list of "debt, equity, credit and risk products, as well as investment in real property" is a good start point.

## **Tiered approach**

In concept, a tiered approach has merit as we agree that regulation needs to be proportionate. But, care is needed over what is in each category.

Investment in real property, mortgages and mortgage broking, life insurance and health insurance should be Category 1 as mis-selling without process or reference to client need and tolerance to risk can have serious consequences.

Mortgages and mortgage broking should be Category 1 as mortgages should be sold in conjunction with life insurance to protect families. The current worldwide financial crisis has been caused by over-easy credit without the borrowers having ability to repay and without adequate protection such as credit or income protection insurance.

Life insurance and health insurance are not mentioned in the examples of products, so it isn't clear what category they are proposed to be. While some of these risk products may seem simple, the consequences of poor advice can be financially significant. For example, term life and health insurance appear simple, its application is complex and requires thorough process to determine levels required, appropriate policy ownership, etc. while other life insurance products like trauma cover or income protection can be quite complex products in themselves. If a client is advised to "switch" life or health insurance products, they may lose cover for any pre-existing conditions. So, poor advice may result in the consumer having no insurance cover for a major illness.

## **Category 1 Advisory services**

We agree that Category 1 advisers should be required to meet relevant competency levels, a fit and proper person test and be registered individually so that a consumer can search for them by name. We consider that all Category 1 advisers should be individually "authorised" and on the public register, including any who are employees or agents of certified financial institutions.

We also suggest the default position for authorisation of advisers should be Category 1, with advisers having to submit to the regulator their restrictions that limit them to Category 2. While most Category 2 advisers will be employees, probably within a certified financial institution, there may be significant numbers of Category 2 advisers outside certified financial institutions. For example, if all credit is Category 2, then mortgage brokers will be Category 2, unless they also advise on Category 1 products such as life insurance. Similarly, general insurance brokers will be Category 2.

## **Category 2 Advisory Services**

We consider Category 2 advisers should also be required to meet a relevant, but lower, competency level. The report is silent on this aspect, with the inference that there would be no specified requirement for competency for these advisers.

The industry training qualifications being developed have been developed with a tiered approach in mind – level 4 for Category 2 and level 5 as the minimum for Category 1.

The report is also silent about whether or not Category 2 advisers will be required to be listed on the public register of advisers – with the inference that they would not be registered. We recommend a single register of advisers as a consumer protection measure, enabling any consumer to verify that the adviser they are dealing with does meet the agreed minimum standards.

Since Category 2 advisers will largely operate within the certified finance institutions regime, the institutions will be required to identify all staff (or agents) who are authorised to be

advisers. A regular data feed of the names of these advisers to the registrar would not be a major impost.

Under the current proposed Category 2 products, mortgage brokers and general insurance brokers would not be listed on the register of advisers but would not work for a certified financial institution.

### **Certified finance institutions**

IFA's preferred approach would be to restrict "certified finance institutions" to the Category 2 products provided by the institution. This would restrict this to simple products and situations where the "institution" is able to directly take responsibility for consumer redress. Under this approach, financial advisers within a "certified financial institution" who provide advice on Category 1 products, would need to be individually "authorised" by the Securities Commission as a consumer protection measure.

Alternatively, if Category 1 products are to be included or coverage include advise or sales of another company's products, then we consider that a professional association such as IFA should also be allowed to become a "certified financial institution".

That is, option A – a restricted approach to "certified finance institutions" limited to Category 2 products or option B – a broad approach allowing a wider range of organisations to take responsibility for standards and compliance.

We are aware that ISI (the Investment Savings and Insurance Association – representing product companies) suggested a broad approach including individual adviser firms being able to become equivalent to a "certified finance institution". We suggest that a professional association is better placed to set standards (competency/education, practices standards, etc.) than an individual adviser practice.

We have concerns about including "agents" within the certified finance institution model unless this is restricted to "tied agents" who sell only the institutions products and no products from other institutions. Typically any financial adviser who is not an employee has an agency agreement with one or more product companies, but only some are under the close control required for this model to be effective.

### **Disclosure obligations**

The suggestion for varied disclosure obligations, depending upon the category of service seems sound. Obviously, we would wish to comment on the detail.

### **Central supervision**

The recommendation for a Commissioner of Financial Advisers is a good one but the proposed structure and roles of the Rule-Making Committee and Disciplinary Committee have not been described in sufficient detail to allow unqualified support.

We consider it important to have role separation as it would not be right for the same person to be responsible for rule-setting, "authorisation" and registration, investigations and prosecutions for breaches, as well as discipline and appeals against disciplinary decisions.

We recommend that disciplinary functions be separated out from the Securities Commission and Commissioner of Financial Advisers functions.

We also recommend that complaints processes also be done separately from the Securities Commission as complaints are about consumer redress, though it is conceded that some may involve issues that require discipline. We repeat our recommendation concerning the desirability for a single industry-wide dispute resolution service:

*IFA's preferred option is for a single industry dispute resolution service as this is likely to have the lowest costs and will also avoid problems of multiple agencies involved in what is essentially the same dispute.*

The purpose of a single dispute resolution service is most importantly to eliminate confusion in the minds of the consumer - after all isn't this what the whole exercise is all about – to protect the consumer?