



**Submission on
Financial Intermediaries Discussion Document**

Financial Intermediaries

**Submission to
Ministry of Economic Development
29 September 2006
by Institute of Financial Advisers**

Privacy

The Institute of Financial Advisers (the Institute) does not seek to have any part of our submission withheld for privacy reasons. We are happy to have our submission available on the Ministry of Economic Development (MED) and other websites.

Advocacy

The Institute is keen to support our submission by participating in any further discussion forums.

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The Professional Body for Needs-Based Financial Advisers

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1. Institute Background

The Institute of Financial Advisers is the professional body for over 1,400 members, representing needs-based financial advisers in New Zealand. All these members are personal members, not corporate members.

Our members provide advice to their clients in the areas of insurance, investments, financial planning, and financial services generally.

Their professional practices reflect the broad spectrum of New Zealand businesses – they operate as local SME's, are part of large regional or national dealer groups, are associated with strong financial organisations, services companies in banking, funds management, or insurance, work in employee benefits organisations, or sometimes practice as lawyers, accountants and other professional advisers.

The Institute reinforces compliance with codes of ethics and practice standards, runs Dispute Resolution and Disciplinary Committees that are independently chaired, offers education pathways that can lead to tertiary qualifications and the attainment of internationally recognised adviser marks, maintains and ensures compliance with a continuing professional development programme, and provides networking, education, development, and business practice forums at a national and regional level for members. It represents its members with government, government agencies, and other stakeholders.

2. Why Change?

The result of any review of financial intermediaries must be that consumers have greater confidence in the quality of information and advice they receive. Such an environment will facilitate wealth accumulation and risk management, and will encourage participation by consumers, financial intermediaries, and market participants.

The Final Report of the Task Force (section 4), and the July 2006 Discussion Document (sections 5 & 6) clearly outlined outcomes to which any reforms should positively contribute.

The Institute seeks to achieve these outcomes from any reform:

Consumers

- Consumers have a better understanding of the role of financial intermediaries.
- Consumers have a better understanding of the co-regulatory regime that is developed to look after them, including:
 - Baseline competency and ethical standards of intermediaries
 - Disclosure of consumer relevant information about intermediaries, products, and product providers.
 - Access to dispute resolution schemes, and confidence that there are mechanisms in place to discipline market participants who substantially fail to meet standards.
- Consumers have reasonable grounds to use financial intermediaries with confidence
- Consumers increase their usage of competent intermediaries where it is suitable and cost effective to do so.
- Consumers have a better level of financial literacy so that they have a better understanding of financial markets, products, product providers, intermediaries, and the appropriateness of information and advice.
- Consumers have access to choice, competition, and innovation.
- As a consequence, consumers accumulate wealth, and manage their risks.
- The benefits for consumers outweigh the costs of the co-regulatory regime.

Financial Intermediaries

- Intermediaries have confidence to participate in the sector, so that they can invest in themselves and their businesses.
- Intermediaries have certainty, and can operate in a co-regulated business environment that is consistent, fair, and reasonable.
- Succession planning. New entrants are encouraged to join the adviser sector.
- Intermediaries, who chose to do so, can operate in Australia and New Zealand effectively and efficiently, within their area(s) of expertise and competency.

3. Consumers and Co-Regulation

As outlined in 'Why Change' above, the introduction of any co-regulatory regime must have positive outcomes for consumers.

- Any changes must be delivered in an environment where the benefits to consumers outweigh their costs.
- Structures and mechanisms must make it easy for consumers to use, and for them to gain value. A basic example is that disclosure documents must help consumers make reasonable, confident decisions, and as a consequence, should be easy to understand and short. They should not be long, complicated, prescriptive documents more useful for lawyers to argue about after the event, and hardly encouraging for any consumer to read.

4. Proportionate Regulation

The benefits to consumers and the community of introducing and maintaining any co-regulatory regime for financial intermediaries must outweigh the costs that consumers and the community must pay for and invest in such a regime.

As many groups pointed out in their submissions to the Task Force, the level of conflicts and concerns about the quality and outcomes of the advice that they receive is very low.

- There is no reference anywhere in the Final Report of this Task Force to any hard evidence of major concerns.
- Even when the Task Force sought input from consumers about negative advice outcomes they had received, the response to the well-advertised and promoted request was deafening in its silence.
- The level of complaints about advice to Ombudsmen is low
- The level of complaints about advice to professional and industry bodies is low.
- The March 2006 ANZ/Retirement Commission Financial Knowledge Survey commented that:

"... 94% of respondents who had received advice from an independent financial planner/broker found this advice to be useful or very useful ..."

"... 85% of the respondents who had received insurance advice from an insurance company agent/adviser found the advice useful or very useful ..."

We note and agree with the Final Report of the Task Force (section 4, Objectives and Outcomes) that “... it is possible to underestimate the costs of regulation, particularly the significant negative impact on long-term, dynamic efficiency outcomes. This underestimation, if coupled with overly risk adverse regulatory mechanisms, could hinder the achievement of the consumer benefits inherent in the Task Force’s objectives ...”

The Institute seeks to have a co-regulatory environment where compliance reflects and is embedded in accepted professional best practice, so that intermediaries automatically comply as they go about their daily interaction with consumers, providing useful advice and quality service. The system has failed if regulation and compliance procedures become ends in themselves, as they have in other international regulatory regimes.

5. Recognise the New Zealand Business Environment for Financial Intermediaries

The Institute is appreciative that the Task Force Final Report and July 2006 Discussion Paper both recognised the unique New Zealand business landscape in which consumers and financial intermediaries interact.

In particular, New Zealand is made up of many urban and rural communities. As a consequence, there is a large number of intermediary practices based on a wide range of business structures. As in other business sectors, there are many SME adviser practices in urban and rural locations. Our challenge is to ensure that the actual or perceived cost and impact of any co-regulatory regime does not force many of these people from their practices, as has happened with such dramatic, radical and negative consequences in Australia.

We recognise that all intermediaries will need to comply with any standards that will be set, and we will help our members and potential members to be part of a successful sector in any new regime.

6. What is “Financial Advice”

The Institute has major concerns with any proposed regime that attempts to define “financial advice” by reference to financial products, titles of financial intermediaries, or to employment status. Any such regime fails to look at issues from the position of a consumer.

The Institute recommends that “financial advice” be regarded as a process of interaction with consumers in a way that influences them to do something, (or in some cases, not to do something), that could have an impact on their current or future financial situation.

The Institute does not accept that financial advice is necessarily related to the sale of a financial product.

- *We have many members who design appropriate financial, investment, and/or insurance plans to fit the needs and circumstances of clients, but who do not provide any product execution services. They are selling their professional advice, not any particular product.*
- *An accountant who is asked to give a second opinion on, for example, a proposed insurance strategy, and advises “Don’t do that, stick with what you have” is clearly assessing the needs and circumstances of a client and giving financial advice.*

The Institute does not accept that financial advice is in some way linked to the title, profession, or employment description of an individual.

- A lawyer, accountant, tax agent, real estate agent, or business adviser who intends to influence a consumer in making a decision in relation to a particular financial product or class of financial products, or could reasonably be regarded as being intended to do so, is giving financial advice. It is not financial advice only if the advice given is given by that professional in his or her professional capacity, about matters of law, accountancy, tax, real estate or business.

(The ASIC Guide to Licensing, May 2005, and the licensing provisions of the Australian Corporation Act 2001, provide some useful guidance in this area).

- The UK Financial Services Authority has argued that some product companies such as banks and financial institutions may have been mis-selling products such as payment protection insurance. In November 2005 the FSA said that about half of all firms conducting “non-advice” sales did not have adequate systems to stop their staff giving advice. In other cases, the FSA argued that information being given to individuals was tantamount to advice.

The same report questioned the structure and amounts of inducements of some product companies, raising concerns that this could encourage mis-selling.

The Institute’s view is that in order to deliver the positive outcomes to consumers as outlined previously in ‘**Why Change**’, consumers need to have confidence that no matter what form of financial intermediaries they use, they should be able to expect that, in the absence of a clear, concise and effective health warning, any guidance or advice received will be competent, accompanied by full disclosure or relevant information, with the same minimum disclosure, access to dispute resolution facilities, and disciplinary processes.

The Institute’s view is that there can therefore only be two classification groups.

1. Financial Intermediaries who give advice
2. Financial Intermediaries who do not give advice e.g. information and execution only intermediaries who sell or provide information and/or who execute orders.

The second group would include most internet and direct marketing companies who take no account of the consumer’s personal situation and needs.

This group would still be subject to many other laws and regulations that relate to fair trading, and to financial product companies.

The Institute acknowledges that, as pointed out in the Discussion Document, most product providers have substantial amounts invested in their brand – this intellectual property is the sum, in most cases, of smart marketing, good well-trained staff, strong compliance programmes, and robust audit regimes. Many adviser practices do likewise, and professional bodies such as the Institute of Financial Advisers reinforce these programmes.

As highlighted recently by ASIC in Australia, major product providers can and do make mistakes, and their customers should have the same recourse as those who use other financial intermediaries.

Discussion Document Questions

Objectives

Q1. Please see our comments in Section 2 of our submission.

Application of Proposed Legislation

Q2. Yes

Q3. N/A

Q4. As mentioned on Page XX of our submission, discussions on whether products and services are “financial products” are not important. What is important is whether “**financial advice**” is being given or not.

Q5. N/A

Q6. No. As mentioned in our submission, obligations on financial intermediaries should relate to the giving of “**financial advice**”, not to the product involved.

Q7. Yes, where financial advice is being given relating to the customers situation and/or actual or perceived needs. We would define an investment property as any property, other than the primary residence, which the consumer purchases for capital gain, income, or some other benefit.

Q8. Why should consumers who receive financial advice about investment property be expected to have different rights in relation to their financial intermediary (disclosure, competency, dispute resolution, discipline, registration), than if they receive advice on other risk management and/or investment concerns scenarios.

Q9. As stated before, we do not see the type of financial product as being relevant. What is very relevant is whether the consumer receives “**financial advice**” or not.

Financial Advice

Q10. No. Please refer to Section 6 of our submission.

The Institute is attracted to the ASIC model for defining financial product advice

- Licensing : The scope of the licensing regime : Financial product advice and dealing. An ASIC guide, Reissued May 2005.
- This document needs to be read in conjunction with Section 766 of the Australian Corporation Act 2001.

Financial Advice is a recommendation or a statement of opinion, or a report of either of those things, that is intended to influence a person or persons in making a decision on a particular financial product or class of products, or could reasonably be regarded as being intended to have such an influence.

This clearly covers situations where a financial intermediary intends to influence a consumer to take, or not to take, a particular course of action, and situations where consumers are being advised to adopt a recommended insurance, investment or financial plan which will not be executed by that financial intermediary.

Q11. Yes. See answer to Q10.

Q12. Consumers would have consistent rights and protection

Exceptions

Q13. No. Consumers should have consistent rights and protection, irrespective of which financial intermediary provides them with advice. Please see our general comments in Section 6 of this submission.

Q14. N/A

Financial Intermediaries

Q15. No. The Institute believes that Financial Intermediaries either give financial advice, as defined, or do not give financial advice. Please see Section 6 of our submission.

Q16. See answer to Q15.

Classifications of Intermediary

Q17. Yes. These financial intermediaries do not provide financial advice.

Q18. Yes. Website operators, and No Advice Prospectus Shops, where no financial advice is given.

Q19. Agree.

Product Marketers

Q20. No. Please see Section 6 of our submission.

Again, we believe the ASIC approach to be appropriate, recognising that clients of product marketers have the same rights, and should have the same protection as other consumers. Section 1.3k of the ASIC Licensing Guide of May 2005 only provides an exemption to product marketers where

“... the conduct is the preparation of general advice by a product issuer about that issuer’s own product(s), but only where a third party licensee gives the advice to its recipients. In this situation, the licensee will be taken to be the provider of the financial product advice.”

Section 1.4.3 of the ASIC Guide covers the specific exemptions given to “clerks and cashiers”. These exemptions do not apply, when a consumer is given financial advice.

Q21. N/A

Q22. No. All consumers who receive financial advice should have the same rights and protection.

Q23. Strongly disagree.

High Level Intermediaries

Q24. No. Please see Section 6 of our submission. The distinction should be made on the basis of whether financial advice is given or not.

Q25. Disagree.

Execution Only Intermediaries

Q26. Yes. These financial intermediaries do not give financial advice.

Q27. Yes.

Individual or Business

Q28. No. Financial advice is given by an individual, not a business. The Institute has difficulty understanding how a business can be tested for competency, be required to meet conduct standards or be made subject to criminal penalties for serious breaches.

We note that professionals acting as lawyers and accountants are members of their respective professional bodies as individuals. Please note that this does not prevent businesses from requiring their employees, licensees, or franchisees, from requirements to comply with minimum specified standards.

Q29. See answer to Q28.

Conduct

Q30. No.

Q31. Yes. These statutory duties should apply to all financial intermediaries who provide financial advice.

Q32. See above.

Q33. Consumers would be more likely to benefit from the positive outcomes listed in Section 2 of our submission.

Q34. Censure, temporary or permanent banning, and criminal penalties in severe cases.

Money Handling

Q35. Any financial intermediaries who handle client funds.

- Insurance advisers or brokers
- Solicitors
- Accountants
- Real estate agents.

Q36. Yes.

Q37. Investment advisers. General insurance brokers, solicitors, accountants, stockbrokers, real estate agents.

Q38. Yes.

Q39. Unsure.

Q40. Unsure.

Disclosure

Q41-54.

1. The Institute believes that all financial intermediaries should be required to disclose a consistent level of information to consumers, to enable them to make confident decisions about their investments and risk management.
2. Disclosure should be helpful for consumers. Disclosure documents should therefore be easy to understand and short. As pointed out in Section 3 of our submission, they should be useful for consumers before and during the time they receive financial advice and service.

3. All Financial Intermediaries should have to meet the disclosure obligations outlined in Section 171 of the Discussion Document.
4. Investment advisers will have specific disclosure requirements under the Securities Legislation Bill. There are still issues to be sorted out in relation to on-going continuous disclosure, when for example, a client might have a regular investment facility or be “topping up” their investment.
5. The Institute believes that for non-securities financial products e.g. life insurance, only the fact that the Financial Intermediary is receiving commission needs to be noted. We agree with the suggestion of the Task Force that “... before determining the final content and form of disclosure, there is considerable value in researching consumer views on what they would consider useful information and what form of disclosure would be most effective in conveying that information.”

Disclosure must be of benefit to consumers. We are still of the view that disclosure of commissions for risk products might affect overall uptake of risk products and contribute to consumer under-insurance.

Powers of Securities Commission and the Minister

Q55. Yes.

Q56. No.

Securities Commission’s Proposed Role

Q57. No.

Q58. No.

Q59. No.

Powers of Approved Professional Bodies

Q60. The Institute agrees with the requirements outlined in Section 223 of the Discussion Document.

Q61. The Institute believes that an APB should be able to comment on all matters affecting members of the APB. There should be no restriction on lobbying. An APB should not be able to act as an aggregator, or have any contractual relationships with any financial product provider, except in the ordinary course of the APB’s business e.g. organising Directors and Officers insurance cover, or staff insurance cover.

Approved Professional Body to set Functions Register/List

Q62. The Register must cover all Financial Intermediaries who give financial advice.

Q63. No. However, it should be optional for the APB to include other information such as qualifications, professional marks etc.

Q64. No.

Q65. Our expectation is that the Ministry would establish and maintain the Register for all Financial Intermediaries who give financial advice.

The Companies Office has an easy-to-use website for Companies and Directors. It may well be that the same infrastructure could be used for this Register.

As with the Companies Office website, we would expect that consumers would be able to access the Register at no cost.

Q66 & 67. We have some concerns about the competency labelling as proposed in Section 246 of the Discussion Document.

- Consumers might assume, for example, that a Financial Intermediary is competent in all aspects of Life Insurance, but the Intermediary may in fact be competent in the area of personal life insurance, but not business life insurance.
- Competencies can change over time.
- There is no label for Investments.

The Institute does not believe the Register should provide the capacity for a consumer to “find an adviser”. We see this being the role of industry bodies. Rather, the Register should enable a consumer to verify that a particular adviser is in fact a member of an APB.

APB Functions

Competency Setting

Q68. Yes. The Institute believes that it is the role of APB’s and Industry Groups, not Government or the Securities Commission, to establish what initial and ongoing competency skills are required for a Financial Intermediary to be able to practice in a particular sector, and to set competency standards.

The Institute strongly believes that there should be mechanisms to allow for Financial Intermediaries who are practicing in good standing at the time regulations are introduced to recognise experience as one part of a measure of competency. It would be the role of the APB to set these competency tests.

The Institute is developing some practical concepts for competency testing, and for use in situations where experience is being recognised as one part of a measure of competency.

APB Functions

Conduct Standards

Q69. Yes.

APB Functions

Monitoring and Reporting

Q70-73 The Institute favours the low cost monitoring option outlined in Section 268 of the Discussion Document. The other options would involve considerable costs, and would therefore be out of proportion to the benefits that consumers might receive. Please see Section 4 of our submission.

We agree with the proposed reporting function of APB’s.

Discipline for Breach of Non-Statutory Standards

Q74. Yes.

Disputes Resolution

Q75. Yes. APB's need to be able to provide low level, initial dispute resolution facilities. These do not necessarily have to be provided in-house, but could be shared with other APB's and industry bodies.

Cross Sector Competencies

Q76. The Institute believes that a Financial Intermediary should only be required to be a member of one APB that represents their principal area of competence.

Businesses as an APB

Q77-79 Businesses should not be able to apply to be an APB

- If many businesses successfully apply to be APB's, the relatively small number of advisers who are left will be forced to join small APB's with little economic strength to be able to set and enforce standards, and with much higher entry and annual membership charges.
- Businesses are likely to directly or indirectly financially support their APB, exacerbating the situation referred to above.
- If lots of businesses successfully apply (even if only a few are successful at the start of the co-regulatory regime, this will encourage most other product providers and dealer groups to do so later on), the existence of many APB's will cause confusion in the eyes of consumers.
- Business employers are legally liable for the actions of their intermediaries. How can they also act as a regulator?
- Product providers might encourage or even require that non-employee intermediaries belong to their APB as a condition of recommending that businesses products. The Institute would see this as an unfair barrier to entry and as anti-competitive.

Process for being an APB

Q80. Agree.

Q81. Unsure.

Q82. Yes.

Q83. Three to six months. However, there may be a large number of applications for APB status at the start of the co-regulatory regime, particularly if businesses are able to become APB's. This may require a longer consideration time at the outset of the new regime.

Q84. One month.

Change of Rule Process

Q85. Agree.

Q86. Unaware.

Q87. Same as for process for being an APB.

Q88. No. APB's create their own rules which can be accepted or rejected by the Minister. It is the role of the Securities Commission, in this area, to make recommendations to the Minister.

Issuing Directions

Q89. Yes.

De-Regulation of APB

Q90. Agree.

Q91. Unaware of alternatives.

Education

Q92. APB's should not be required to provide and fund public education about financial intermediaries and the wider financial sector.

The proposed role of an APB is clearly outlined in Section 13 of the Discussion Document.

However, as with other professions, it is likely that APB's, Industry Institutes and Associations, product providers, businesses and individual advisers will promote the role of financial intermediaries.

Many product companies are already making substantial investments in financial literacy programmes, and the Retirement Commission has increased funding to do likewise.

Default Position Required

Q93. Agree.

Q94. Unaware.

Costs

Q95. The Institute believes that the government should fund and resource the setup of APB's. (It should be noted that the Institute, and probably other bodies, has incurred considerable expense already in developing submissions, meeting with government, government agencies, and other parties, and in consultancy costs).

APB's should be responsible for maintenance costs, assuming that the simple registration model we have outlined in response to questions about Section 13 of the Discussion Document are adopted. The Institute would expect Government to support APB's with funding and resources if a more prescriptive model is introduced, or if there are many APB's (as a result of businesses being able to form APB's), with consequent high costs for members of smaller APB's.

The Institute sees value in a central resource for APB's. While each APB should reflect the characteristics of its members, we see value in templates, systems, technology and reporting being available or shared through a central resource facility, both at a set-up stage, and for ongoing maintenance.