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Regulating and Supervising Financial Advisers Discussion
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Staff Paper on Regulating and Supervising Financial Advisers

The Investment Savings and Insurance Association ("ISI") appreciates the opportunity to comment on the Securities Commission staff paper on *Regulating and Supervising Financial Advisers.*

ISI provided a submission on the previous staff paper on AFA competence and supported the development of QFEs as the first level of supervision of registered advisers and with a prominent role in the regulation of financial adviser competence.

We have appreciated the opportunity to discuss these issues with Securities Commission staff and look forward to the opportunity for further input as the new regime develops.

We have set out below some general comments, followed by responses to the specific questions in the paper.

General Comments

The staff paper covers two issues under the Financial Advisers Act that are very important to the effective and efficient implementation of financial adviser regulation and supervision.

- the role of QFEs, and
- the scope of 'financial planning',

As noted above, ISI has previously recommended development of the QFE role and our submission on the first staff paper identified the following advantages:

- The maintenance of standards for the benefit and protection of consumers will be more easily achieved within a QFE.

- A financial service provider that uses advisers who are agents or employees to deliver its financial adviser services will be responsible for the advice given by them, so the expense of training and compliance monitoring will be incurred whether or not it is a QFE.
- It would assist with the significant organisation that will be needed to ensure that what could be as many as 15,000 financial advisers needing to be authorised meet the initial competence standards.
- The Securities Commission will need to set up a process to monitor QFEs but that will be a much simpler, more effective and timely process than directly monitoring thousands of advisers.
- The administrative processes of dispute resolution schemes will be simplified if those schemes have a limited number of QFE members rather than thousands of individual members.

Unfortunately, the role of QFEs outlined in the current staff paper appears to provide more costs than benefits to entities that may be considering applying for QFE status. It appears that QFEs would incur all the costs of compliance with additional reporting requirements without achieving any significant reduction in the compliance burden for their advisers.

ISI fully supports the objective of a professional basis for financial advice. We believe it will encourage public confidence in the use of financial advisers and provide material support to improved financial decisions and outcomes for New Zealand households. However, in meeting this objective effectively, the overall regulatory framework (Act, regulations and active supervision) needs to take account of actual industry structures, relationships and incentives. In this respect there remains a fundamental inconsistency in the Act between the developed concept and responsibilities of QFEs and the implicit responsibilities of employers or principals of financial advisers under Section 18.

While financial advisers need to be individually competent, the overall regime needs to clearly recognise the modern reality of advice and adviser support systems and processes. Although there are different distribution models, they are typically provided in a corporate environment with the corporate and individual adviser jointly providing advice and, as recognised in the staff paper, responsible for the advice provided. Both the adviser and the principal or employer have a financial interest in the advice provided and financial products sold. We agree with the point made in paragraph 26 that organisational capacity is an important factor in the provision of professional financial advice.

We support the clear responsibilities of a QFE outlined in paragraph 75 of the staff paper but we are concerned that having to 'demonstrate' these quite reasonable requirements to the Securities Commission will be seen as onerous, intrusive and offering little benefit to a significant portion of the financial advice industry and may result in entities simply not applying for QFE status.

If that happens, those entities will still need to be registered under Section 18 but that will not provide the public with the clear line of responsibility for the actions of advisers that would be there if the entity was a QFE. For example:

- What is the nature of the relationship between the adviser and the corporate entity under which they apparently operate?
- Who is actually responsible and stands behind the advice – the individual or the corporate entity?

- If I have a complaint, where do I go?
- Is there really a corporate entity or is it simply a brand?
- Is the entity actually responsible for *this* adviser?

The regime needs to be simple, clear and easily understood by consumers. We agree that 'responsibility' for financial advice is a key concept under the overall regulatory regime. However, under section 18 this concept is indirect, potentially inconsistent and not clear for consumers dealing with entities that choose not to apply for QFE status.

The staff paper is largely silent on how it will regulate entities that are not QFEs. If the reason is to see how many entities apply for QFE status before making any changes to the Act, we believe there is a risk of continuing the present uncertainty in relationship and responsibility between individual advisers and their principals.

Whether or not an entity applies for QFE status will also depend on its business model and we are not arguing for a competitive advantage for QFEs. However, we strongly support balancing the costs and benefits of the role in order to attract the involvement of as many as possible. As the Government has indicated that the costs of running the regulatory regime will, in large part, be borne by the industry, fees charged to QFEs need to reflect the activity undertaken by them in ensuring their advisers meet requirements. The staff paper gives no indication on how registration and authorisation fees for advisers operating under a QFE will compare with those who are not.

In terms of the Financial Advisers Act and the proposals outlined in the staff paper, there is currently little compelling reason to apply for QFE status.

Specific Questions

A Do you have any comments on the suggested approach to interpreting "financial planning services"?

We acknowledge that the suggested approach is intended to clarify the boundary between the categories of adviser working in different segments of the industry:

- A person giving financial advice but only in relation to low risk (category 2) products such as pure risk insurance
- A person giving financial advice in relation to both low risk and high risk (category 1) financial products, including savings products
- A person providing a financial planning service which may or may not include giving advice on specific financial products.

We consider, however, that the suggested approach would need further refinement and amendment of the legislation in order to provide clear and binding guidance. In our view it will be difficult in practice to distinguish between providing a quality advice service and a financial planning service and it would be preferable to have anyone providing financial advice required to become an authorised financial adviser.

As the Staff Paper notes, authorisation may be for different classes of advice depending on competence in different areas and an adviser who gives advice only on risk products may seek authorisation only for that class of advice.

This would require amendment of the definition of financial planning service to recognise the reality that, as currently defined, it is an integral part of giving good advice and cannot be isolated as a separate service.

The regime also needs to recognise complicated personal and property risk advice, typically in relation to owners of small businesses, which requires a higher level of skill and exposes the customers to greater risk from poor advice. These advisers will need to be both authorised and attain specialist skill levels.

B Do you have any comments we should take into account as we further develop the approach – outlined in summary above – for supervising financial advisers?

This section of the paper does not cover supervision of all entities that need to be registered under section 18. It is inconsistent if the Securities Commission is not interested in the organisational capacity of employers or principals of financial advisers that need to be registered under section 18 but which do not apply for QFE status, particularly if the behaviour of the corporate entity gives rise to less than professional levels of financial advice. It is also notable that the Act provides no direct obligations for employers or principals of financial advisers similar to those in section 76 for QFEs and the obligations under section 76 only apply where an entity has voluntarily applied for QFE status.

We agree that the level of supervision of a financial adviser should depend on the assessment of the risk posed by that adviser. An adviser who is covered by a QFE would require less direct supervision by the Securities Commission.

It is not clear from paragraphs 30 – 41 whether the Commission intends that AFAs working within a QFE would need to apply directly to the Commission for periodic renewal of their authorisation or whether that could be done through the QFE. We recommend that the authorisation and renewal process should be streamlined for authorised advisers working within a QFE.

We agree that any AFAs and registered but not authorised advisers who are not under the supervision of a QFE should be subject to more targeted supervision by the Commission.

C Do you think this approach, centred on the concept of responsibility, creates any difficulties for QFEs?

With regard to Complaints and Enforcement (paragraphs 42 – 48), we believe there is still some lack of clarity around the boundaries between complaints to the Commission under the Financial Advisers Act and complaints to an approved disputes resolution scheme under the FSP Act. It appears to be possible for a policyholder to complain to both bodies, which could result in double jeopardy for an adviser.

We note that in paragraph 54 the Commission proposes to authorise AFAs for specific services and that an AFA may be authorised to provide some services but not others. As noted above, we believe it would be difficult in practice for any financial adviser to provide an acceptable level of service without crossing the boundary into providing a financial planning service. Consequently, we believe that the majority of advisers will need to become authorised. We recommend that general authorisation should allow the AFA to cover financial advice, investment transactions and financial planning, but that authorisation may be limited to specific classes or extended to additional classes of business depending on the level of competence that has been attained.

We agree that enabling QFEs to take on the frontline compliance role may facilitate the efficient regulation of individual advisers. That will be an advantage for the Commission but the regime must also provide advantages for advisers and those organisations that choose to become QFEs.

All advisers, including AFAs, must be accountable for their actions but there should be an administrative advantage for advisers within a QFE in having the QFE report to the Commission on their behalf. There is likely also to be a marketing benefit in being able to advertise their relationship with the QFE.

In most cases organisations that are granted QFE status will not be taking on any more responsibility for the actions of their advisers than they have at present through general employment and agency law and the indirect outcomes of needing to be registered under section 18. There is potential for some branding benefit for those organisations but this will need to be further developed, possibly with some form of qualmark. At present it will be difficult for consumers to distinguish between the relative merits of 'registered', 'authorised' and 'QFE'. We recommend that the Commission plans for extensive public education to ensure consumers understand the new regime.

Paragraph 18 specifies that financial service providers will need to belong to an approved dispute resolution scheme but their adviser employees will not need to separately belong to a scheme. Any of their advisers who are not employees will need to be individually registered with an approved disputes resolution scheme, whether or not they are part of a QFE.

Paragraphs 55 – 59 specify that QFEs will need to assume responsibility for the actions of their nominated advisers and the advice given. Consequently, we consider that any adviser working within a QFE, whether employed or not, should be covered by the QFE's membership of an approved dispute resolution scheme. That should apply to AFAs and advisers who are registered but not authorised. If the QFE has assumed responsibility for the actions of the adviser it is appropriate for any disputes to be heard by the scheme of which the QFE is a member.

D Do you have any suggestions for alternative ways of delivering more certainty about which agents a QFE is responsible for under the Act?

We recommend that the registration details for each adviser, including the name of any relevant QFE, should be available on a public register maintained by the Registrar

of Financial Service Providers. In addition, the QFE's registration details on that register should include a current list of the agents for whom it has accepted responsibility.

It needs to be possible for a financial services entity that is a QFE to differentiate between advisers that are its agents for advice (and for which it is responsible in terms of the Financial Advisers Act) and other forms of agency, e.g. in terms of the Insurance Law Reform Act 1977 or customer due diligence in terms of the proposed Anti-Money Laundering and Countering Financing of Terrorism Act. A QFE that is also a financial product provider should also be able to distribute financial products through advisers it is not responsible for.

E Do you agree that there should be a standard QFE term and condition that the entity establish and maintain a list of agents it has assumed responsibility for?

Yes, see above. However, it should be noted that this is another responsibility for QFEs which does not apply to those who do not have QFE status.

F Should the QFE be required to publish the list of agents it is responsible for?

It should be sufficient for the QFE to ensure that the list supplied to the Registrar is up-to-date. The Commission and any other person interested can access the list on the public register.

G Do you agree that it is appropriate to streamline the authorisation and supervision of AFAs in some or all of the circumstances discussed and in the manner suggested?

Yes. We believe a QFE should be able to run all necessary checks on applicants for registration or authorisation and the Securities Commission should accept the QFE's certification that the applicants are suitable for registration or authorisation.

Development of a template for recording the checks and information that a QFE would need that could also be shared with the Commission could also be considered.

The same process should apply for renewal of authorisation.

If streamlining means anything less than simply notifying the registrar and the Commission that those advisers who meet registration and authorisation requirements have done so (perhaps including supporting information in a standard format as suggested above), there is a real question as to the benefit of QFE status. Apart from the arguable 'quality mark' of being a QFE, streamlining of authorisation and supervision is the only area of tangible benefit in being a QFE. These sections do not give any concrete indication of how significant these benefits will be particularly in relation to the additional obligations and supervision of a QFE.

H Do you have any comments relating to the scope of the QFE framework, e.g. whether there should be any restrictions as to the types of businesses that may apply for QFE status and, if so, why?

We have no objection to any organisation being granted QFE status but it is important that any such organisation has sufficient capacity to cover the responsibility it is taking on, although in most cases the organisation will already be responsible for the actions of its employees and agents.

We can't see much incentive for retailers and motor vehicle dealers in relation to consumer finance arrangements, or travel agents in relation to travel insurance, to become a QFE. However, if the organisation's employees are giving financial advice it will need to register as a financial service provider and as a member of an approved dispute resolution scheme whether or not it becomes a QFE.

We believe there will need to be clear differentiation for the public between QFEs (which must comply with the criteria in paragraph 75) and other entities that are financial service providers but not subject to the same requirements.

As we have noted earlier, the public should be able to distinguish between advisers who are covered by a QFE and those who are not.

I Do you have any comments in relation to the matters that we propose the Commission take into account in considering an application for QFE status?

We agree that the criteria set out in paragraph 75 are appropriate. However, the crucial aspect will be how onerous and time consuming it will be for the applicant to 'demonstrate' the criteria to the Commission, particularly as there is no necessity to apply. The benefits of the streamlined authorisation and supervision process, including the supervision of the QFE, are an obvious trade-off.

J Are there any standards or certification processes we might consider relying on when assessing a prospective QFE's policies and procedures?
ASIC Regulatory Guides 104 and 105 would provide a useful basis.

K Are there any other matters you think the Commission should take into account in considering an application for QFE status?

We consider that financial capacity is an important factor. A QFE must be able to demonstrate that it can back up its responsibility for the actions of advisers.

L Do you agree with the proposed policy of promoting the voluntary adoption of standardised competence measures across QFEs?

Yes, we agree that there need to be standardised competence measures across QFEs as the dispute resolution schemes will need to apply a measure of competence in considering complaints and it will be preferable to have a consistent measure used.

There will, however, be no way of applying the standardised competence measures to registered (but not authorised) advisers of entities that are registered financial service providers but choose not to apply for QFE status. This is a gap in the legislation that needs attention as it allows for the possibility of consumers receiving advice from advisers who do not have sufficient competence.

As a minimum we recommend that the Code Committee define standards of care, diligence and skill which can then provide a benchmark for registered but not authorised advisers. In particular, we would like to see a standard in respect of 'churning' of life insurance policies.

M Further to any submissions you make on MED's discussion document, do you have any comments on QFE disclosure or on disclosure exemptions from the Commission?

We consider it essential that disclosure should enable consumers to see who is ultimately responsible for the advice that it is given. On the basis of current information, where an AFA works within a QFE it is unclear who is responsible for disclosing what and when an individual disclosure statement should be replaced by a QFE disclosure statement. We recommend development of a facility for joint disclosure statements.

We also consider it important that QFEs and advisers who operate as agents or employees of adviser businesses that are not QFEs should also disclose relationships with the adviser business.

N For specific adviser types (such as wholesale advisers) should disclosure requirements differ from those for other advisers? Should the answer depend on whether the adviser is employed by a QFE? We are interested in understanding any (financial and other) costs or benefits of different disclosure, and the practicality of implementation (for example, how a wholesale environment/customer can be clearly identified). Responses that include a client/customer viewpoint would be particularly helpful.

We believe it would be appropriate to assume that wholesale clients do not need the same level of disclosure as members of the public and an exemption from the disclosure obligations should be available. We would not consider a wrap account to be a wholesale product – wrap clients should be treated as retail customers. Examples of advice to wholesale schemes would include:

- A group life insurance scheme for a large employer
- Investment of a law firm trust account
- Trustees or managers of a collective investment scheme

O Do you have any other comments you would like to make about the implementation of the Financial Advisers Act?

We believe that all requirements for implementation of the FAA should be measured against the objective of benefitting the consumer and any that provide no obvious benefit to the consumer should be dropped. For example, consumers will benefit from the regulation and supervision of advisers whether the supervision is provided by

QFEs or directly by the Commission and the most administratively simple option should be chosen.

We would be happy to discuss these points with you if that would be helpful.

Yours sincerely,

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CHIEF EXECUTIVE