



Financial Adviser Associations of New Zealand (FAANZ)

Submission on the
Second Interim Report of the
Financial Advisers Bill

Prepared for the Finance & Expenditure
Select Committee

August 2008

CONTENTS

1. Terms of Reference	3
2. Introduction	3
3. Timing	3
4. Lack of Detail	4
4. Definition of Financial Advice	4
5. Tiered Approach	5
5.1 Simplistic classifications.....	5
5.2 Cross category inequity.....	5
6. Industry Representation.....	6
7. Certified Financial Institutions	7
8. Summary.....	7
Appendix (i) – FAANZ.....	9
Objectives	9
Key Principles.....	9

Our contact details are:

Richard Thomas

Chairman

FAANZ

Email richard.thomas@paa.co.nz

PO Box 905

Dunedin

Phone 0274 742427

1. Terms of Reference

This paper has been prepared by the Financial Adviser Associations of New Zealand (FAANZ) to provide feedback on the second interim report (The Report) from the Finance and Expenditure Committee on the Financial Advisers Bill. FAANZ represents 2000 advisers in the investment, life insurance and mortgage sectors and is composed of four professional associations (IFA, LBA, PAA and SiFA).

2. Introduction

FAANZ has identified seven key points in the report. It is important to emphasise that these are not the only issues FAANZ has with the Financial Adviser Bill – our previous submissions (as independent organisations and as a group) have identified additional issues such as details of disclosure requirements etc. These are not repeated in the current submission for the sake of brevity.

The issues relating to the report are:

- Timing,
- Lack of detail,
- Definition of financial advice,
- Tiered approach,
- Categories of advice,
- Industry representation, and
- Certified financial institutions.

3. Timing

We recognise the importance of continuing to build and promote public confidence in financial advice and financial products. We also understand the need for New Zealand to comply with international best practice regarding the regulation of financial advisers.

However we are increasingly concerned that the apparent haste to pass legislation is undermining the credibility and quality of the legislation. The scope of this legislation is broad and the potential effects for financial advisers and consumers is of such magnitude to warrant getting this legislation correct rather than rushing the legislation through prior to the election.

The marked changes in the proposed definition of financial advice and the repeated changes to the categorisation of advisers are symptoms of a complex piece of draft legislation that is struggling to match the requirements of the market. Any attempt to pass the legislation in its current form would be a disservice to the consumer and the wider financial advice industry.

Preferred outcome

Urgency to pass the legislation must be replaced by a goal to ensure the key facets of the legislation to create parity across industry sectors and provide meaningful protection to consumers. Time spent on getting the legislative design correct could have a payoff in reducing the implementation phase of the legislation i.e. the current “authorisation” date could be still be met by appropriately in the design phase.

4. Lack of Detail

Industry is being asked to provide feedback on crucial aspects of the legislation which in many instances lack detail or clarity in the report. For example the report proposes that credit products would fall into category two but the paper provides no information on whether this specifically includes or excludes mortgages. Clearly there is considerable difference between a small hire purchase contract and a large property loan but the reader is left unsure whether the intent of the Bill is actually to treat the credit advice in the same way. Similarly the report is silent on which category risk insurance would be assigned to.

It is fundamentally unsound to make major changes to the proposed structure of the Bill in a report that lacks sufficient detail for readers to be clear on the intent of elemental issues such as proposed categorisation of products like risk insurance (a billion dollar industry). This piece of legislation is too important to be potentially undermined by requiring stakeholders to commit to analysis based on ambiguous design.

Preferred outcome

The report is insufficiently detailed to provide accurate industry assessment of the proposed changes to the legislation. A new paper which fully details critical areas such as coverage, disclosure, and categorisation of products should be circulated to industry for comment.

4. Definition of Financial Advice

The definition of financial advice forms the heart of the legislation because it determines the scope of coverage. Previous iterations have proposed using “activity” (i.e. the activity of giving financial advice), and “occupation” (i.e. the predominant occupation of a potential adviser). The latest suggestion is to adopt a “product” based definition.

While a “product” based definition is preferable to one based on “occupation”, there are still potential problems. Adopting a “product” based definition would also exclude situations where a consumer receives advice without a product recommendation. This situation is relatively common in Financial Planning. Additionally there is the potential for suppliers to design new products to deliberately avoid the regulations.

Preferred outcome

Consumers are exposed to the possible risks of poor financial advice through the process of receiving financial advice. Not using an advice based definition reduces the capacity of the legislation to mitigate poor financial advice. Our preference is to use “advice” as the

basis for definitions. However if “product” is to be used as the basis for defining the boundaries, then greater care needs to be taken to ensure coverage of the right areas. We want to see that all financial products are covered by the definitions so they need to be considerably more comprehensive than at present.

5. Tiered Approach

The tiered approach (Category one and two) contains many common facets with the three groups of intermediary originally proposed in the Discussion Document (no advice, product marketer, high level intermediary). Unfortunately the ‘new’ tiered approach brings with it similar issues to the old approach. In particular:

- Simplistic classifications, and
- Cross category inequity.

5.1 Simplistic classifications

The complexity of the financial services industry is not well suited to a broad classification of products. For example, advice on credit spans from advice on small, simple hire purchase agreements through to advice on the single largest financial instrument most New Zealanders encounter (home mortgage). While poor advice on a \$500 interest free consumer product has a low scope for harm. Inadequate advice on a mortgage can result in interest charges over the life of a mortgage being twice what they might otherwise be – amounting to literally hundreds of thousands of dollars worth of harm. Similarly incorrectly insuring a car might result in a potential loss of \$10,000 but failing to correctly insure a home might result in a loss of hundreds of thousands of dollars. It appears that the Bill intends to treat all of these situations as simple products when this is clearly not always the case.

Secondly the report does not specify how a number of the larger product categories would be grouped. In particular risk insurance is not specifically noted. As with credit products, risks products span a wide range of complexity from simpler products such term life insurance through to relatively complex products such as income protection. Some products might quite comfortably fit into category two while others would be more appropriate in category one.

5.2 Cross category inequity

Possibly the biggest constraint with a tiered approach is the likelihood of cross category inequity of the treatment of advice between categories one and two. The creation of separate categories with different compliance costs makes it more complex and expensive for category one advisers to operate their businesses. It could be argued that most category two products will be distributed by suppliers who have the greatest capacity to pay for compliance while independent advisers will largely fall into category one where the highest compliance costs will be encountered i.e. there is an inverse relationship between likely compliance costs and capacity to pay.

Preferred Outcome

Our preference is for one category of advice but that the competence requirement for giving that advice is proportionate to the risk of poor advice. On this basis simple credit contracts such as hire purchase might require a low level competence qualification, , leaving the more complex advice processes (investment planning, risk, mortgages, and real estate) at a higher qualification level.

Otherwise we suggest the default position for authorisation of adviser should be category one, with advisers having to submit to the regulator their restrictions that limit them to category two. We consider that category two advisers should also be required to meet a relevant, but lower, competency level.

6. Industry Representation

The establishment of a Commissioner and industry led committees is a sound concept. However, there are potential issues that must be considered. Specifically, the scope of the financial services industry is so broad that it is improbable that any one individual will have direct knowledge of more than two or three of the sectors being covered. On this basis the appointee would need to have strong relationships across the sectors and would be very reliant on the Rule-Making and Disciplinary Committees.

Additionally, we consider it important to have role separation as it would be inappropriate 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.

Preferred Outcome

Our preferred structure is the originally proposed co-regulatory model. However, if the Securities Commission is to be adopted as the regulatory body then we support the appointment of a Commissioner of Financial Advisers. On the same basis we support the establishment of a Rule-Making Committee and a Disciplinary Committee. However the functions of these committees need to be more than just advisors to ensure that industry recommendations are enacted.

We also have some reservations as to the wisdom of the disciplinary functions being performed by the Securities Commission and the Commissioner of Financial Advisers. Our preference would be for the disciplinary function to be separate from the rule setting and registrations functions.

7. Certified Financial Institutions

We are generally supportive of the concept of “certified financial institutions” within some specific parameters. Certified Financial Institutions should not replace the function of the Securities Commission in authorising category one advisers. Rather they should only authorise advisers selling simple category two products.

We also have concerns about including “agents” within the certified finance institution model unless this is restricted to “tied agents” who sell only the institutions products i.e. no products from other institutions.

Preferred Outcome

Our preferred approach would be to restrict “certified finance institutions” to the Category two products provided by the institution i.e. more 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 one products would still need to be individually “authorised” by the Securities Commission as a consumer protection measure.

8. Summary

A key objective of this legislation is “the promotion of a sound and efficient financial sector in which the public have confidence in the professionalism and integrity of advisers: regulation that is well targeted and does not impose unnecessary costs; and encouraging innovative and competitive markets.” (Financial Advisers – A new Regulatory Framework, Paragraph 22, Office of the Minister of Commerce, June 2007).

Unfortunately the structure proposed in the report produces considerable competitive advantage to suppliers such as banks and insurance companies: this has the potential to reduce levels of competition and choice for consumers. The proposed structure provides an inequitable environment where suppliers are given the potential to increase their distribution strength. Clearly this is an outcome in direct conflict with the key objective of the Bill. While the initial loser could be seen to be advisers, the ultimate loser will be consumers who will have restricted product choice as supplier distribution channels seek only to distribute their own products.

In its current form this Bill can not deliver on the key goal of the legislation. We urge the Select Committee to take time to pause and reflect on the progress of the Financial Advisers Bill. The financial advice industry is complex and diverse so it is not surprising that the path of this Bill has been difficult. The effects of the Bill (whatever its final format) will impact on the industry for coming decades.

It is rarely prudent to place urgency before accuracy; and this is especially true of this legislation. Both industry and government have still got considerable consultation to undertake before the key facets of the Bill can be agreed. We must accept that a consensus will not be reached prior to the 2008 election.

We request the opportunity to appear before the Select Committee to discuss our concerns.

Appendix (i) – FAANZ

Objectives

FAANZ was formed in 2008 to:

- Work within boundaries that protect the public's and consumers' interests, and
- Provide industry expertise to government and regulators.

Key Principles

FAANZ operates with nine key principles or values. These are:

- A consumer is better off with an adviser in their financial process than without one.
- A two-way process between the adviser and the consumer produces the best results.
- All advisers should belong to a professional association.
- Consumers should only deal with advisers who belong to a professional association.
- Advisers have a responsibility to provide competent financial advice and comply with a code of ethics.
- There should be one independent industry body to hear complaints (separate from disciplinary function).
- All financial advisers should be competent to provide financial advice and strive for ongoing professional development.
- Promote a level playing field across the financial services industry.
- Disclose the full cost to the consumer of purchasing product and advice.