

26th February 2016

New Zealand Shareholders Association Submission in Respect of the Options Paper

Review of the Financial Advisers Act 2008 and the Financial Service Providers (Registration and Dispute Resolution) Act 2008

Relationship of Submitter

The New Zealand Shareholders Association (NZSA) is the only independent national group that represents the interests of retail investors in the equity markets.

One of our major concerns is the need to engender confidence in the regulation and operation of the New Zealand capital markets. We therefore, take a close interest in the “public good” aspect of legislative changes or amendments of existing legislation as part of our core function. The availability of quality investment advice is a key component in the mix.

This submission is written to present the perspective of the prudent, but non expert retail investor. To a degree, our opinions will be slanted towards the listed equity and debt market areas. While these are a narrow part of the range of services covered by the FAA, they do frequently involve larger sums of money and are more complex than many transactions as decisions rely on assessments of risk and transactions frequently involve a number of financial service providers. This means the need for high quality advice is arguably more critical. However, financial advice needs to be available across a broad spectrum of investors from those with small amounts to others with millions. Any regime must be flexible enough to cover this wide range and should not restrict access only to those who can afford large fees.

NZSA's specific responses to the questions in the Discussion Document are set out in table format in Appendix A.

Summary of Views

NZSA considers the objectives that have been identified in the earlier part of this review to be appropriate. The relative pros and cons of each are well set out and the conclusions and preferred options are generally supported.

We have concerns around the proposals in some options to remove the concept of an expert advisor capable of assisting with complex and high risk products and make some suggestions for hybrid models that address this situation in a cost effective way.

We believe that simplification of disclosure and terminology will improve access for smaller investors which is a clear and identified need. Standardisation of documentation in a prescribed form will ensure cost efficiency and relieve some of the regulatory burden on smaller firms while at the same time making it more likely that investors and other users of financial services are not put off by being faced with masses of legalise in small type faces that they neither understand or feel inclined to read..

We would like to see more emphasis on simplifying the way people can access information about advisors who are appropriate to their needs and suggest some ways this could be achieved. as part of this topic we also consider it important to recognise the role of on line information and advice while alerting investors to the potential risks.

We recognise the need to take a holistic view to achieving the objective of the review. It will not be possible to accommodate all points of view without reverting to a complex and confusing process - what we currently have and which is exactly what needs to be removed by this review.

The final packages that MBIE have suggested all have advantages and disadvantages, but one is the most appropriate. Never-the-less, we have suggested a hybrid version which we think provides even wider coverage of the concerns that have been raised about the current Act and does so with very little extra complication.

We urge MBIE to give this proposal careful consideration.

John Hawkins

Chairman, NZSA

Appendix A

NZSA responses to submissions in the FAA Options Paper February 2016

Question	Response
1. Do you agree with the barriers outlined below? If not, why not?	NZSA broadly agrees with the barriers identified although we would suggest that the flow chart box and heading "certain types of advice are not being provided" could be more accurately identified as "certain types of advice are not readily accessible"
2. Is there evidence of other major barriers not captured here? If so, please explain.	We consider the key barriers have been identified.
3. Which options will be most effective in achieving the desired outcomes and why?	We support both Option 3 and Option 4. See Q 4 below.
4. What would the costs and benefits of the various options be for different participants (consumers, financial advisers, businesses)?	<p>The discussion paper identifies the main costs and benefits for each option. While we accept that option 3 includes an element of complexity, we do not believe that for a number of complex products (for example futures options) that an advisor without specialist skills could give the appropriate advice. However, we do not consider that many of the current category 1 products (such as straightforward equity trading advice) need necessarily be included in this high risk/high complexity category. Therefore, the vast majority of transactions could be achieved without resort to such specialist advice.</p> <p>We strongly support the intent of option 4 and question the assumption that this</p>

	would add much cost or complexity.
5. Are there any other viable options? If so, please provide details.	In view of our answer to Q4, we suggest that a hybrid of Option 1 and Option 3 would achieve the greatest protection with the least complexity and cost. this should be overlaid with the wholesale opt-in requirement under option 4 to achieve the best outcome for a wide range of prudent, but non expert investors.
6. What implications would removing the distinction between class and personalised advice have on access to advice?	This would greatly increase the access to limited personalised advice which is currently the area that misses out, primarily due to cost and complexity. In our view, the other safeguards proposed as part of a complete package will achieve a more balanced outcome. For example, seeking advice on whether to buy or sell a specific share should not need the services of an AFA and a full assessment of the individuals financial situation and risk tolerance. Currently that is certainly the situation that many investors face and it is a disincentive to seeking informed advice. On the other hand, by retaining a "complex" category where specialist advice is needed, people who might rush into futures trading or other derivative products will be provided with expert advice.
7. Should high-risk services be restricted to certain advisers? Why or why not?	Yes for the reasons outlined above. However the type of product considered high-risk could be much more limited than currently.
8. Would requiring a client to 'opt-in' to being a wholesale investor have negative implications on advisers? If so, how could this be mitigated?	No. If they are suggesting these types of products, opting in would ensure that their clients understood the implications. Opt in could be as simple as a single page document witnessed independently - minimal cost. The negative effect would be on those offering such wholesale products who are unwilling to adequately disclose sufficient detail to allow a proper risk assessment. The result could be an improvement in disclosure in order to attract sufficient investment which we see as a positive for prudent but non expert investors. In our view the

	current limit captures far to many people who may have cash (from the realisation of property in an estate for example), but little or no investing experience.
9. What ethical and other entry requirements should apply to advice platforms?	The same general standards with requirements broadly similar to those applying to advisers (where applicable) should apply.
10. How, if at all, should requirements differ between traditional and online financial advice?	No additional comment other than an observation that it is not possible to turn back the tide of internet based services and legislation and regulation needs to recognise the reality...
11. Are the options suggested sufficient to enable innovation in the adviser industry? What other changes might need to be made?	We favour the hybrid model suggested. This is similar in concept to on-line banking or insurance services where access to a help line remains available. It may be appropriate to make it a requirement that NZ based services are identified as such, and that offshore services who claim to be NZ based are committing a crime. The object being to encourage the use of local regulated services.
12. If the ethical obligation to put the consumers' interests first was extended, what would the right obligation be? How could this be monitored and enforced?	Option 1 as written is sufficient providing that in the case where documentation is provided that this is spelt out. Education of the public and a simple free complaints portal (like the ombudsman service) is essential. Repeated complaints could be drawn to the FMA for investigation.
13. What would be some practical ways of distinguishing 'sales' and 'advice'? What obligations should salespeople have?	The paper as a whole canvasses this topic satisfactorily in our view. Sales imply a single or very limited selection of option only from the employees firm. Advice implies consideration of a range of products and an independent choice of the most appropriate option from those.
14. If there was a ban or restriction on conflicted remuneration who and what should it cover?	As we noted in an earlier submission, we do not think that at this time it is possible to remove commission based payments in NZ Both MBIE and our NZSA research shows many investors are loathe to pay relatively high up-front fees. Instead, disclosure including the percentage or amount if requested should be required.

<p>15. How can competency requirements be designed to lift capability, without becoming an undue barrier to entry and continuation in the profession?</p>	<p>We prefer a composite model that combines elements of all three options.</p> <p>a) Advisers could commence work under supervision while studying towards a qualification and building up experience.</p> <p>b) Be required to achieve a minimum qualification requirement through assessments or examinations within a defined time frame.</p> <p>c) to undertake ongoing training to help maintain competence, gain new knowledge and skills, and keep up to date with relevant developments. This could be internal or external depending on the type of product being advised on. The advantage of this model is that there is a pathway which enables people to find their appropriate level, allows for advancement and reduces barriers to entry.</p>
<p>16. Should all advisers be subject to minimum entry requirements (Option 1)? What should those requirements include? If not, how should requirements differ for different types of advisers?</p>	<p>See Q 15</p>
<p>17. What are the benefits and costs of shifting to an entity licensing model whereby the business is accountable for meeting obligations (Option 1)? If some individual advisers are also licensed (Option 2), what specific obligations should these advisers be accountable for?</p>	<p>Entity licensing is appropriate for companies offering a limited scope of products. This could include most insurance and banking products other than those that are high risk and complex. (See our answers to Q4 and Q5.) This also puts the onus on the entity to maintain standards or risk their license. And it has a significant advantage in that FMA can more easily assess and monitor a few hundred entities rather than thousands of individuals. For their part, advisors should carry a duty of care to the entity that employs them.</p>
<p>18. What suggestions do you have for the roles of different industry and regulatory bodies?</p>	<p>It should be permissible for companies to outsource CPD and training to industry bodies where appropriate systems are established (and potentially approved by the FMA) In the same way, industry bodies could have some complaints role, but would need to have a significant number of independent people on such complaints panels to avoid perceptions of bias and conflict of interest (such as plagued the real Estate Institute when it had responsibility for agent discipline - and failed miserably). There would need to be an option to revert to the court</p>

	<p>system where dissatisfaction remained.</p> <p>We favour a approach that aligns with the general approach taken in the FMCA</p>
<p>19. What do you think is the most effective way to disclose information to consumers (e.g. written, verbal, online) to help them make more effective decisions?</p>	<p>Strongly favour Option 1 with the provision that disclosure documents be brief (maximum one page) in a minimum font size (at least 10pt) and in plain English. We believe a series of standardised disclosure statements for different main product types could be developed to cover most if not all typical transactions. A more complex and longer document may be required or "complex and high risk" products.</p> <p>If there was any divergence from the standard format, it should be subject to a disclose and explain regime and could potentially require approval of the FMA.</p> <p>Written documentation is essential in face to face interaction and on-line (with the "accept" button at the end of the documentation) is sufficient for robo-advice or online interaction. We do not favour any reliance on verbal disclosures.</p> <p>We are aware of the criticism that documents are not read and are therefore unnecessary, but we consider this is an argument without merit. the solution is to make the easy to read and understand.</p>
<p>20. Would a common disclosure document for all advisers work in practice?</p>	<p>See Q 19</p>
<p>21. How could remuneration details be disclosed in a way that would be meaningful to consumers yet relatively simple for advisers to produce?</p>	<p>Could be two boxes on the disclosure form filled in at the time it is provided. One indicating as a percentage or dollar value, the up- front commission or potential bonus the advisor gets and the other relating to trailing commissions if any. using generic documents as discussed in Q 19 overcomes cost and complexity arguments.</p>

<p>22. Is there any evidence that the existence of multiple schemes is leading to poor outcomes for consumers?</p>	<p>No specific knowledge in this area. However we note that the ombudsman and the banking and insurance ombudsman which are single services are the only well known ones - which indicates that multiple services often don't have the critical mass to be widely recognised</p>
<p>23. Assuming that the multiple scheme model is retained, should there be greater consistency between scheme rules and processes? If so, what particular elements should be consistent?</p>	<p>The discussion document covers this in a satisfactory manner and we agree with the need to achieve greater consistency. We do not agree that \$200,000 is still appropriate as a maximum and advocate this being increased to at least \$400,000 with the ability to revise the figure periodically by regulation.</p>
<p>24. Should professional indemnity insurance apply to all financial service providers?</p>	<p>Yes. We expect that most advisors and the companies in this area would have insurance and therefore the cost will already be factored in. The reality is that any smaller advisory without insurance is unlikely to be able to meet the costs of a complaint that is upheld and the investor will be out of pocket. The cost of the advisory carrying insurance is minimal per individual that is advised.</p>
<p>25. What is the best way to get information to consumers? Who is best placed to provide this information (e.g. Government, industry, consumer groups)?</p>	<p>All of the groups noted have a role. However, a single on-line repository which consolidates (or provides a free source for others to link to) is the ideal. A small cost for each listing would mitigate setup and running costs. It should be run by FMA, but should stand alone and have a simple and easy to remember title.</p> <p>The biggest issue that we come across is "how do I find a good financial advisor and we have no answer to this question. Any central database therefore needs to allow for performance indicators and areas of particular knowledge and expertise to be placed on it. These would be provided by the individual advisors or the firm and it would need to be an offense to fabricate the data.</p>
<p>26. What terminology do you think would be more meaningful to consumers?</p>	<p>We prefer "Expert financial advisors", "Financial advisors" and "Financial sales advisors" assuming the option we suggest in Q 32 is adopted.</p>
<p>27. Do you have any comments on the proposal to retain the current definitions of financial adviser and financial adviser service?</p>	<p>We think the current definitions are satisfactory</p>

28. Are those currently exempt from the regime posing undue risk to consumers through the provision of financial advice in the normal course of their business? If possible, please provide evidence.	Generally we consider the current regime satisfactory. We do have concerns that some real estate agents are close to crossing the line in respect of transactions such as syndicated property ownership schemes.
29. How can the FA Act better facilitate the provision of international financial advice to New Zealanders, without compromising consumer protection? Are there other changes that may be needed to aid this, beyond the technological options outlined in Chapter 4.2?	While the current law looks good on paper, it is ineffective in practise as cross jurisdictional enforcement is next to impossible. We favour all NZ resident providers having this clearly stated on their disclosure documents and an educational program explaining the importance of using local regulated suppliers. It would be an offense for a non NZ resident firm, advisor or robo-advisor to claim they were NZ resident. See also the answer to Q 11.
30. How can we better facilitate the export of New Zealand financial advice?	No comment
31. Do you have any comments on the proposal to retain the current approach to regulating broking and custodial services?	While we are satisfied with the current approach, we remain concerned that broking and custodial services can be parts of the same organisation. We consider that these should be independent of each other.
32. What are the costs and benefits of the packages of options described below?	We favour package 2 as the best unmodified option of those proposed. We believe this will significantly reduce costs (particularly in time cost for all parties) for most forms of advice, while still capturing the most complex and most risky products in a more advanced category. We expect greater access for smaller investors on the one hand and an uplift in standards on the other. The inclusion of competency and ethical requirements will address key concerns for most transactions and should stop actions like churning and recommending entirely unsuitable (but high commission) products. A worthwhile alternative to consider would be a modification of package 3 with the addition of an "Expert" subset to the financial advisor category. This package

	<p>has the advantage of clarifying the "sales" nature of many so-called advisors and may be easier for the average person to understand. However as it stands, it may give the impression that "Financial advisors" are experts in all areas including complex and high risk products. Refer to our response to Q4 also.</p>
<p>33. How effective is each package in addressing the barriers described in Chapter 3?</p>	<p>Package 1 fails because it retains the confusing terminology and separations that are responsible for the current problems. It also fails to differentiate advisors who can provide advice on complex or high risk products. It has some merit in retaining the QFE format but we feel this can be accommodated in packages 2 and 3 in a satisfactory manner.</p> <p>Package 2 is the best unmodified version of the three proposed</p> <p>Package 3 fails as a stand- alone because it does not recognise the complexity of some products and on the face of it opens up advice on these to people who may not be sufficiently specialised. Our suggested modification to package 3 detailed in Q32 would address this shortcoming.</p>
<p>34. What changes could be made to any of the packages to improve how its elements work together?</p>	<p>See Q 32 above in regard to option 3.</p>
<p>35. Can you suggest any alternative packages of options that might work more effectively?</p>	<p>See Q 32 above.</p>