Ministry of Economic Development
Manatū Ōhanga

FINANCIAL ADVISERS ACT 2008: DISCLOSURE REGULATIONS

Discussion Document

June 2009

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Competition, Trade and Investment Branch
Ministry of Economic Development
PO Box 1473
Wellington
New Zealand
http://www.med.govt.nz

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PART ONE: INFORMATION FOR SUBMITTERS

Submissions on the discussion document should be addressed to:

Rory McLeod
Director
Competition, Trade, and Investment Branch
Ministry of Economic Development

Queries about the review, requests for copies of the discussion document, and submissions in response to this discussion document should be sent care of one of the following:

Email: financialadvisers@med.govt.nz
With the subject: Financial Advisers Disclosure Regulations

Post: Walter McCahon
Competition, Trade, and Investment Branch,
Ministry of Economic Development,
PO Box 1473,
Wellington

Fax: 04 499 1791
Attention: Walter McCahon

It would be useful if submissions sent in hard copy or faxed were also provided in electronic form (PDF, Microsoft Word 2000, or compatible format).

The closing date for submissions is 12 August 2009.

Publication of submissions; the Official Information Act and the Privacy Act

Other than submissions that may be defamatory, the Ministry intends to publish all submissions on its website http://www.med.govt.nz. The Ministry will not publish your submission on the internet if you have any objection to its publication. However, any un-published submission will remain subject to the Official Information Act 1982 and may, therefore, be released in part or full. The Privacy Act 1993 also applies.

When making your submission, please state if you have any objections to the release of any information contained in your submission. If so, please identify which parts of your submission you are requesting to be withheld and the grounds under the Official Information Act 1982 for doing so (e.g. that it would be likely to unfairly prejudice the commercial position of the person providing the information).

Disclaimer

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QUESTIONS FOR SUBMITTERS

Questions in the discussion document are intended to provide a focus for discussion of the issues. Broader comments on the issues will also be welcomed.

Question One

a. Do you agree that the provision in the legislation that disclosure can be provided as soon as practicable after the service is performed allows sufficient flexibility to ensure disclosure is provided appropriately?

b. If not, please detail the instances where problems could occur and any potential solutions.

Question Two

a. Do you agree that some general content required to be disclosed by all financial advisers will aid consumers' understanding?

b. Do you agree that contact details, the status of the adviser, a guiding statement for the consumer dispute resolution arrangements and contact details for the Securities Commission should be contained in all financial adviser disclosure statements?

c. Should anything else be included?

d. Do you agree that no content should be permitted unless required by the regulations?

Question Three

a. Do you agree that financial advisers should be required to include a guiding statement in their disclosure document?

b. Do you believe that the wording of this statement should be mandated?

Questions Four

a. Do you agree that contact details for the Securities Commission be required to be included in all financial advisers disclosure document?

b. Do you agree that details on the role of the Securities Commission should be included in the disclosure statement?

Question Five

a. Do you agree that additional content for the disclosure documents should be prescribed in order to help disclosure to achieve its purpose?

b. Do you agree that mandated headings should form the basis of the disclosure document for authorised financial advisers?

c. Do you agree that the headings should be in the form of questions?

d. Do you agree that the order of the headings in the document should be mandated?

Question Six

a. Do you agree that authorised financial advisers should be required to disclose that they have been authorised by the Securities Commission in the mandated form discussed?

b. Do you agree that the class of authorisation should be disclosed (if applicable)?

c. Do you agree that the statement of being authorised is sufficient disclosure as to the status of the adviser?

Question Seven

a. Do you agree that authorised financial advisers be required to disclose what products and/or services they can offer?

b. Do you agree that any limitations as to the products and/or services the adviser can offer should be included?

c. Do you agree that the products and/or services the adviser can offer should be disclosed through the adviser indicating from a prescribed list the services they can offer? If you agree with this approach to service disclosure which categories of services should be included?

Question Eight

a. Which option for disclosure of fees, remuneration and other interests and relationships do you prefer?

b. If you do not agree with any of the options how do you believe fees and other remuneration should be disclosed?

c. Should any prescribed wording be included in the remuneration section to aid consumers' understanding of the differences in the types of remuneration an adviser receives and how this may influence the adviser's advice?

d. Do you agree that advisers that do not receive commission payments from issuers should be able to state in their disclosure document that they are "independent" or "unaligned" and that these terms should be restricted to advisers that meet this condition?

Question Nine

a. Do you agree that disclosure of any material interests, relationships and associations the adviser or associates may have should be required?

b. Do you consider that any prescribed wording should be included in the material interests, relationships and associations section to aid the consumer's understanding of other potential influences on the adviser and his/her advice?

Question Ten

a. Do you agree that an authorised financial adviser should only be required to disclose adverse disciplinary actions imposed on the adviser by the Code Committee?

b. Do you agree that proceedings within the previous 5 years is the appropriate time period?

Question Eleven

a. Do you agree that the items discussed do not need to be disclosed by an authorised financial adviser in their disclosure statement?

b. If not, which matters do you believe need to be disclosed?

c. Should these matters be included in additional information specified for the form?

Question Twelve

a. Do you agree that disclosure of criminal convictions and adverse findings by a Court or the Commission should not be required under the regulations but should be left to the discretion of the Securities Commission to require as a condition of authorisation?

Question Thirteen

a. Do you agree that indemnity insurance should not be required to be disclosed?

b. What are your reasons for agreeing or disagreeing that indemnity insurance should not be required to be disclosed?

Question Fourteen

a. Are there any classes of authorised financial adviser, financial adviser service, or client for which different disclosure requirements should be considered? If so please detail the circumstances and how you believe the disclosure requirements should differ.

Question Fifteen

a. How should individuals (who are not part of a QFE) who provide advice in regards to category 2 products, who are registered by not authorised, be required to disclose their status under the Financial Advisers Act 2008?

Question Sixteen

a. Do you think that, on balance, there would be a benefit to allowing advisers who provide service in relation to category 2 products to opt to provide disclosure at the level of authorised financial advisers?

b. If you have a view on optional disclosure, please describe the reasons for that view.

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a. Do you have any comments on the proposed disclosure requirements for QFEs?

Question Eighteen

a. Do you agree that the means of communication for QFE disclosure need not be prescribed in the regulations?

PART TWO: INTRODUCTION

PURPOSE OF THIS DISCUSSION DOCUMENT

The purpose of this discussion document is to consider the detail of the regulations under the Financial Advisers Act 2008 that need to be made to specify the content and form of disclosure for financial advisers.

OVERVIEW OF THIS DISCUSSION DOCUMENT

The disclosure regulations under the Financial Advisers Act 2008 will prescribe the content and form of disclosure required for each of the three categories of persons with disclosure obligations defined in the Act : authorised financial advisers, financial advisers in relation to category 2 financial products, and qualifying financial entities ('QFE' or 'QFEs').

This document discusses the general approach to the form and content of disclosure requirements for financial advisers. It then goes on to discuss the detail of requirements for authorised financial advisers and financial advisers in relation to category 2 financial products. The paper then briefly discusses QFE requirements.

The Ministry is seeking feedback on the proposed disclosure obligations for each of these categories. At this time, the Ministry is proposing that regulations be made for these three categories only. However, the Ministry also seeks feedback as to whether there is a need to consider regulations in regards to joint disclosure (section 31).

This discussion paper discusses certain mandated wording and form for disclosure documents. However, any particular language used is simply to aid the discussion of content requirements and is not necessarily a proposal for the final wording that will be required. The Ministry intends to engage a communications adviser to assist in ensuring that the relevant information is conveyed effectively to consumers.

This document was prepared with the input of an industry working group on financial adviser disclosure requirements. The Ministry would like to thank the group for their contributions to this work.

BACKGROUND

Financial Advisers Act 2008

The purpose of the Financial Advisers Act 2008 is to promote the sound and efficient delivery of financial advice, and to encourage public confidence in the professionalism and integrity of financial advisers, by:

a. requiring disclosure by financial advisers- so ensuring that investors and consumers can make informed decisions about whether to use a financial adviser and whether to follow a financial adviser's advice;

b. requiring competency of financial advisers- so ensuring that there are available to investors and consumers financial advisers who have the experience, expertise and integrity to match effectively a person to a financial product that best meets that person's need and risk profile; and

c. ensuring that financial advisers are held accountable for any financial advice that they give and that there are incentives for financial advisers to manage conflicts of interest appropriately.

The Act specifies who may perform a financial adviser service and the financial products and services on which they may advise.

The Act establishes different tiers of disclosure and conduct obligations according to the complexity and risk posed by the advice given. Those who wish to provide advice on securities, futures contracts, or an interest in land, or who provide a financial planning service, will be required to be authorised by the Securities Commission[1] and will also need to register as a financial service provider[2].

Those who wish to provide advice on a call debt security, a bank term deposit, an insurance product (excluding a life insurance product issued after 31 December 2008) or a consumer credit contract will be required to be registered but not authorised.

The Act also provides for an entity licensing model, under which advisers who operate as part of a qualifying financial entity may provide certain financial adviser services without being registered or authorised in their personal capacity. In this case, the entity takes on the responsibility of ensuring that the individual advisers within its organisation comply with the requirements of the Act. To become a qualifying financial entity, the entity must obtain approval from the Securities Commission.

[1] Except where the individual adviser is an employee of a qualifying financial entity and the advisory service they are providing is in regard to a product issued by the qualifying financial entity (section 17(2) of the FAA).

[2] The register is established and maintained under the Financial Service Providers (Registration and Dispute Resolution) Act 2008. Financial advisers are one type of financial service provider covered by this Act.

The Act will replace the existing obligations for investment advisers, brokers and sharebrokers. At present, investment advisers and brokers are regulated by Part 4 of the Securities Markets Act 1988 and Securities Markets (Investment Advisers and Brokers) Regulations 2007. This existing legislation will be repealed and revoked respectively once the Act comes into force. In addition the Sharebrokers Act 1908 will be repealed and use of the name 'sharebroker' will be restricted to authorised financial advisers who are members of a registered exchange. Once the current legislation is repealed, the Financial Advisers Act will govern both these areas.

Financial Sector Reform

Last year three pieces of legislation were passed to improve the regulation of financial institutions, financial products and financial providers:

i The Financial Service Providers (Registration and Dispute Resolution) Act 2008;

ii The Financial Advisers Act 2008; and

iii The Reserve Bank Amendment Act 2008.

Full implementation of these Acts is scheduled to be completed by December 2010.

The main requirements arising from this new legislation are:

i Registration of all financial service providers to provide a means of identifying and monitoring financial service providers;

ii Prudential regulation by the Reserve Bank of non-bank deposit takers;

iii Regulation by the Securities Commission of financial advisers to encourage professionalism and public confidence in the sector; and

iv Providing for comprehensive consumer dispute resolution and redress mechanisms.

New and existing regulation of the financial sector seeks to achieve the following outcomes:

i A sound and efficient financial sector;

ii Investment that encourages growth and innovation;

iii An environment that facilitates wealth accumulation; and

iv Confidence in the sector to encourage participation by consumers and market participants.

The need for sound regulation of the finance sector has been heightened by both the recent collapse of numerous New Zealand finance companies and the current global financial crisis.

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

The mechanisms to implement the Financial Advisers Act 2008 and the Financial Service Providers (Registration and Dispute Resolution) Act 2008 are currently being developed, with the aim of full implementation of both regimes by December 2010. The implementation process contains numerous components, with several government agencies participating. Although both Acts are scheduled to come into force in December 2010, our intention is to have the various components of the regime in place well ahead of this date so that industry has sufficient time to adapt and become compliant. The main projects are as follows:

1. Companies Office – Building the register for financial service providers.

2. Minister of Consumer Affairs - developing the dispute resolution framework. The Ministry of Consumer Affairs is currently seeking feedback on the dispute resolution framework.[3]

3. Code Committee - drafting the Code of Professional Conduct for authorised financial advisers. The Committee will be made up of both industry and consumer representatives and will be appointed by the Commissioner for Financial Advisers. The appointment process is currently underway[4].

4. Securities Commission - preparing the processes for the approval and supervision of financial advisers. Feedback is currently being sought on this area.

5. Minister of Commerce - developing the disclosure regulations. The Ministry of Economic Development is leading this process. These regulations are the topic of this discussion document.

PART THREE: DISCLOSURE REGULATIONS

1. PURPOSE OF FINANCIAL ADVISER DISCLOSURE

Under the Financials Advisers Act 2008, a financial adviser must make disclosure to their client before (or, if not practicable before, as soon as practicable after) performing a financial adviser service.

The purpose of disclosure by financial advisers, as described in the Act, is to ensure that investors and consumers can make informed decisions about whether to use a particular financial adviser and whether to follow that financial adviser's advice. To achieve this purpose the proposed guidelines discussed in this document aim to result in disclosure statements that:

i provide sufficient information for decision making;

ii engage the client's interest; and

iii are concise, comparable and easy to understand (plain language).

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[3] See consultation papers: *Draft Guidelines to Assist Schemes Applying to Become an Approved Dispute Resolution Scheme under the Financial Service Providers (Registration and Dispute Resolution) Act 2008; &Proposed Reserve Dispute Resolution Scheme under the Financial Service Providers (Registration and Dispute Resolution) Act 2008. These papers can be found at http://www.consumeraffairs.govt.nz/.*

[4] See www.seccom.govt.nz for more information on the Code Committee and other financial adviser information.

Disclosure can also help to underpin the accountability of advisers by ensuring that investors and consumers know how to make a complaint or seek redress.

The disclosure required of a financial adviser under the Financial Advisers Act is separated into four categories:

i "disclosure by authorised financial adviser" (section 23);

ii "disclosure by financial adviser in relation to a category 2 product" (section 25);

iii "disclosure by qualifying financial entity" (section 26); and

iv "disclosure by 2 or more financial advisers in joint disclosure statement" (section 31).

Disclosure is used to help address information asymmetries between the adviser and the client. There are limits however to disclosure's usefulness if it is in the form of a cumbersome document that is too difficult for the consumer to read or understand.

The disclosure statement will be one of the documents that a client receives when they begin their interaction with a financial adviser. The document needs to provide timely, relevant information to the consumer so that they can make a decision about whether or not to pursue the interaction with the adviser and whether or not they should follow any advice once it has been received. It should also help the consumer to compare advisers and the services they are offering.

The most relevant comparison to the disclosure requirements under the Act is the current investment advisers and brokers regime, established under Part 4 of the Securities Markets Act 1988. This regime consists solely of a requirement that the investment adviser provides disclosure.

In contrast, under the Financial Advisers Act disclosure is just one of the regulatory requirements for financial advisers. Financial advisers will also have minimum conduct and registration requirements. As such, all financial advisers must be of a set minimum standard to be allowed to operate.

This means that disclosure can be focussed on the information that is not standardised across advisers. This will allow for more effective communication of information that is relevant to consumers' decision making processes.

A key challenge is to develop a method of disclosure that will yield information that is useful to consumers. This points to the need for disclosure statements that are short, standardised and comparable across financial advisers.

2. GENERAL DISCLOSURE REQUIREMENTS

A. Delivery of disclosure

As noted, disclosure is required to be made before a financial adviser service is performed, if practicable. The Act allows for disclosure to be made after performing the service only if it is not practicable to make disclosure before the service is performed.

Concern has previously been expressed over the requirement to make disclosure before financial advice is given. The Ministry recognises that making disclosure before financial advice is given can be a challenge in certain circumstances. In particular, when advice is given over the telephone and a quick decision is necessary, it can be difficult to comply with this obligation while still providing an effective service to the customer.

While the Act allows for the disclosure to be given after the service is performed where not practicable before, the Ministry is aware that there is still some concern about the delivery of disclosure prior to advice being given over the telephone.

The Ministry is of the view that the legislation provides sufficient flexibility to allow advisers to make a judgement on whether it is practicable to provide disclosure before performing the service. In addition, we note the Securities Commission's exemption power in relation to disclosure obligations under the Act – if there are alternative compliance procedures that might be more appropriate in certain circumstances then an exemption may be appropriate.

We would like to seek industry views on this matter. If you consider there are situations in which delivering disclosure remains difficult, even with the threshold of being 'practicable', please detail these specific instances and how you consider that they could be remedied.

Question One

a. Do you agree that the provision in the legislation that disclosure can be provided as soon as practicable after the service is performed allows sufficient flexibility to ensure disclosure is provided appropriately?

b. If not, please detail the instances where problems could occur and any potential solutions.

B. Form of disclosure

The services an adviser may provide differ depending on the type of financial adviser, and each type has its own set of obligations. A financial adviser can offer different services depending on whether the financial adviser is: authorised; provides advice in relation to category 2 products only; or provides services as part of a qualifying financial entity (QFE) (i.e. without being individually registered or authorised).

For a financial adviser's disclosure statement to effectively perform its purpose, it needs to be easily compared with the disclosure statements of both, advisers of the same type and those of other types of adviser.

C. Content of disclosure

In order to allow for financial advisers to be easily compared with other advisers both within and across the types of financial adviser, we propose that only content required by regulations be included in the disclosure statement. We propose that no other content should be permitted.

On this basis, the Ministry seeks comment on the following general content required to be disclosed by all three categories of adviser:

i contact details – location of business premises, name, phone number, email address, fax, etc;

ii guiding statement;

iii status of the adviser – to communicate the type of adviser and potentially the services they can provide;

iv complaint and dispute resolution arrangements – contact details for both internal and external services; and

v contact details of the Securities Commission.

The guiding statement and the contact details are discussed in the "Content of disclosure: Additional Information" section that follows. The details of the status of the adviser vary according to the type of adviser. As such, how status of the adviser is disclosed is discussed further in sections 3 and 4, below.

Question Two

a. Do you agree that some general content required to be disclosed by all financial advisers will aid consumers' understanding?

b. Do you agree that contact details, the status of the adviser, a guiding statement for the consumer dispute resolution arrangements and contact details for the Securities Commission should be contained in all financial adviser disclosure statements?

c. Should anything else be included?

d. Do you agree that no content should be permitted unless required by the regulations?

D. Content of disclosure: Additional Information

Guiding statement

To maximise comparability and accessibility, we propose requiring that certain prescribed content be included in the disclosure statements in addition to contact details, adviser status and details of the dispute resolution scheme.

We propose that the additional content for the disclosure documents be prescribed in order to aid consumers' understanding of the purpose of the disclosure document. We propose that financial advisers provide a guiding statement for the consumer about the document itself at the beginning of the disclosure statement. The statement would briefly describe the purpose of the document is in relation to the decision making process of the consumer and the information contained in the document.

The Ministry's preferred option is for a guiding statement to have mandated wording. For example, for the disclosure document of an authorised financial adviser, the statement could be worded as follows:

> *"This document provides you with information to help guide you when using a financial adviser. This document provides information about the following questions:*
>
> *i Who I am and how I can be contacted?*
>
> *ii What are the financial products and services I can offer?*
>
> *iii How are the services I offer paid for?*
>
> *iv What other interests or relationships I have?*
>
> *v If necessary, how can you make a complaint about me or my services?"*

Those who provide advice in relation to category 2 products and QFEs are not required to disclose remuneration and other interests or relationships. As such, questions (iii) & (iv) could be removed for these advisers.

Alternatively no prescribed wording could be mandated for this section.

Question Three

a. Do you agree that financial advisers should be required to include a guiding statement in their disclosure document?

b. Do you believe that the wording of this statement should be mandated?

Securities Commission

The Securities Commission is the entity responsible for the supervision of financial advisers under the Act. Complaints about financial advisers can be made to the Securities Commission. The Commission is also responsible for promoting the understanding of the financial advisers regime (and other securities law).

The Commission will be a vital contact point for those who receive the services of financial advisers. As such, we propose that all financial advisers include the contact details for the Securities Commission in the disclosure statement. In this way, the Securities Commission could provide any important additional information to the consumer, such as a link to the Code of Professional Conduct[5] (which authorised financial advisers are required to adhere to). A short statement detailing when a person should consider contacting the Securities Commission could also be included.

Questions Four

a. Do you agree that contact details for the Securities Commission be required to be included in all financial advisers disclosure document?

b. Do you agree that details on the role of the Securities Commission should be included in the disclosure statement?

E. Form of disclosure: Headings

The Ministry proposes to mandate the headings required in the disclosure document, the wording and prominence of each heading and the order in which they appear in the document. We propose that headings be written in the form of questions so as to prompt the reader to consider the important issues which could influence their decisions.

The alternative to this is to allow free flow of text in order for the adviser to decide how to convey the information.

This discussion document does not propose the exact wording of the headings or other content requirements at this time. The Ministry proposes to engage a communications expert to assist it to ensure this information is conveyed effectively to consumers.

Question Five

a. Do you agree that additional content for the disclosure documents should be prescribed in order to help disclosure to achieve its purpose?

b. Do you agree that mandated headings should form the basis of the disclosure document for authorised financial advisers?

c. Do you agree that the headings should be in the form of questions?

d. Do you agree that the order of the headings in the document should be mandated?

[5] The Code of Professional Conduct will provide minimum standards of competence, knowledge and skills, ethical behaviour and client care which authorised financial adviser must demonstrate. The Code will be developed by a Committee consistency of industry and consumer representatives, and will be approved by the Commissioner for Financial Advisers and the Minister of Commerce.

3. DISCLOSURE BY AUTHORISED FINANCIAL ADVISERS

The Financial Advisers Act 2008 requires that in order to provide financial advice or make an investment transaction in relation to securities, futures contracts, or an interest in land, or to provide a financial planning service, an individual is required to be authorised by the Securities Commission, as well as being a registered financial service provider under the Financial Service Providers (Registration and Dispute Resolution) Act 2008.

The authorisation framework under the Financial Advisers Act means that authorised financial advisers will be required to meet certain standards before being able to offer financial advice. Authorised financial advisers will have to satisfy the Securities Commission that they:

a. are registered or eligible to be registered[6], meaning that the adviser will be required to confirm they:

   i are a member of a dispute resolution scheme (or their employer is a member);

   ii do not have convictions for crimes of dishonesty;

   iii are not bankrupt; and

   iv are not the subject of a management ban under New Zealand companies, securities or consumer law.

b. are of good character;

c. meet the level of competence, knowledge and skills specified in the Code of Professional Conduct; and

d. are not debarred from applying for authorisation.

As authorised financial advisers will have passed these checks, the disclosure statement can focus on the key information that differentiates advisers and is relevant to the consumer in making an investment decision.

Under section 23 of the Financial Advisers Act, authorised financial advisers must disclose the information prescribed by regulations. Regulations may prescribe disclosure in relation to any or all of the following matters:

a. professional or business experience relevant to performance of a financial adviser service;

b. criminal convictions;

c. disciplinary proceedings;

d. adverse findings by a court or the Commission;

e. bankruptcy or other insolvency proceedings;

f. fees;

g. material interests, relationships, or associations;

h. remuneration;

i. financial products in relation to which a financial adviser service is performed;

[6] Under the Financial Service Providers (Registration and Dispute Resolution) Act 2008.

j. procedures for handling a clients money or other property;

k. indemnity insurance;

l. dispute resolution arrangements;

m. location of business premises; and

n. matters required to be disclosed by the financial adviser's terms and conditions of authorisation.

This list of matters that could be prescribed is based on the current investment advisers and brokers' regime, under Part 4 of the Securities Markets Act 1988. As noted above, that regime consists solely of disclosure obligations and does not include minimum standards that an individual is required to meet in order to operate as an adviser or broker.

The Ministry considers that in the context of the new financial advisers regime, disclosure by an authorised financial adviser on all matters discussed above is not as relevant to a client as it is under the current investment advisers and brokers' regime. As such, the Ministry does not currently propose prescribing information on all of the matters listed in the Act.

In addition to the general content discussed, we propose that authorised financial advisers be required to disclose:

a. what services they can provide and any limits on those services;

b. how they are paid for their services, including fees and any other remuneration for both the individual and their organisation;

c. material interests, relationships, or associations (excluding remuneration) that could reasonably considered influence the advice given; and

d. adverse disciplinary action taken against them by the Code Committee.

A. Status of adviser

The Financial Advisers Act creates three types of financial adviser, with different obligations according to their status. Disclosing that the adviser is authorised by the Securities Commission and the class of authorisation that the adviser has received will help clients to distinguish between different categories of adviser and ascertain which services the adviser can offer.

The adviser's statement that they are authorised informs the consumer that an adviser has passed certain standards and is competent to give advice in a specified area. Consideration was given to whether additional information needs to be provided about what it means to be an "authorised" financial adviser. However, this approach is not preferred at present as the authorisation process seems to provide sufficient assurance to consumers regarding the standard and regulatory treatment of the adviser. As a further avenue for consumers, we have proposed (see section 2 – General Disclosure) that all financial advisers will be required to include the contact details of the Securities Commission in their disclosure statement.

The Ministry proposes that authorised financial advisers disclose that they have been authorised by the Securities Commission of New Zealand and the class of authorisation they have received (if applicable). We propose to mandate the text of this disclosure and the form below is being considered:

> *I, [insert name] am an authorised financial adviser. I am authorised in the class of [insert class here]*

Question Six

a. Do you agree that authorised financial advisers should be required to disclose that they have been authorised by the Securities Commission in the mandated form discussed?

b. Do you agree that the class of authorisation should be disclosed (if applicable)?

c. Do you agree that the statement of being authorised is sufficient disclosure as to the status of the adviser?

B. Services – "What services can I offer?"

The range of services that can be offered can vary from adviser to adviser depending, for example, on whether any conditions have been imposed by the Securities Commission due to their level of competence, or whether they are simply employed to provide advice on one issuer's products. When an individual engages an adviser the individual needs to be aware of what services this particular adviser offers (in comparison to another adviser) and any limitations on the services the adviser may be offering. For example, does this adviser only sell one issuer's products or is this adviser only authorised to provide advice in regards to a certain type of product.

We propose to require disclosure of the services and/or products that an authorised financial adviser can offer. We propose to mandate the form of disclosure for services, where a list of general services and/or products is provided and the adviser must indicate which services they offer by picking from the prescribed list. The product and service categories could be aligned with classes of authorisation contained in the Code of Professional Conduct also, if the Code Committee[7] chooses to follow this route.

For example the prescribed categories of services could include financial planning services, life insurance services, mortgage services, general insurance services, debt security services, and equity security services.

Once the adviser has indicated what products and/or services they can offer, they will then be required to indicate any limitations to the products and/or services that they offer. For example, limitations could occur due to their:

a. authorisation status; or

b. employment conditions; or

c. agency agreement.

[7] For more information on the process for development of the Code of Professional Conduct for authorised financial advisers and the role of the Code Committee, please see www.seccom.govt.nz.

Alternatively, advisers could be required to disclose the types of services and/or products which the adviser can offer in a general plain language statement, along with any limitations that could restrict the service the adviser is offering.

Question Seven

a. Do you agree that authorised financial advisers be required to disclose what products and/or services they can offer?

b. Do you agree that any limitations as to the products and/or services the adviser can offer should be included?

c. Do you agree that the products and/or services the adviser can offer should be disclosed through the adviser indicating from a prescribed list the services they can offer? If you agree with this approach to service disclosure which categories of services should be included?

C. Remuneration and other incentives

The most important part of the disclosure statement for the client states how an adviser is paid, how much the customer is paying and any other incentives the adviser may have that could influence the advice they give. Other than the services that the adviser can provide, these are the key factors that differentiate advisers. The disclosure statement is the key regulatory tool for creating transparency as to potential conflicts which can result from the way the adviser is remunerated.

When an adviser charges an upfront fee for all their services, the incentives they face are very clear to the client. However, when an adviser receives varying commissions or sales targets or has other relationships with certain institutions or persons, the incentives on the adviser could be seen to influence the advice they provide.

Although the Act does not prevent an adviser from having certain interests, relationships or associations (in addition to their relationship with their client) the range of influences on the adviser must be clearly disclosed to the client to allow the client to make an informed decision about engaging a particular adviser and whether to follow the advice received.

How potential conflicts of interest and remuneration should be disclosed has been the subject of debate. Is it better to require that an adviser fill in a simple statement about the types of incentives they face, without requiring quantitative data on commissions and other incentives? Or alternatively, is it a better approach to provide the client with detailed quantitative information?

Remuneration – "How are my services paid for?"

We propose three options for the disclosure of fees and other remuneration. These are:

Option 1

Require disclosure of the maximum commission and/or fee that the adviser and the adviser's associated organisation could receive as a single figure. The regulations would provide methodology for calculating the single figure.

This would be a large change from current form of disclosure of fees and remuneration in the Securities Markets Act. Requiring disclosure in this form may present some challenges to industry initially and could make certain fee structures untenable. Nevertheless, this approach could vastly improve the transparency in advisers' disclosure of remuneration and could assist consumers to compare services.

Option 2

Require fees and direct remuneration to be disclosed in one section in which the adviser would be required to state the possible ways in which they are remunerated but not the amount.

This option could contain the requirement to include some prescribed wording in relation to the incentives created by commissions and other potential conflicts of interest and what these can mean for an adviser's remuneration. The adviser would, however, be required to state whether or not fees and direct remuneration vary from product to product. These general statements would be supplemented by an undertaking to provide more detailed information in relation to specific products on request or in relation to a particular product before the customer commits to that product.

Option 3

Require authorised financial advisers to indicate the services they can provide from a prescribed list and indicate the maximum fee or commission associated with each type of product offered as discussed in section B - Services.

Disclosure of any fees that could be charged (and the amount of any potential fee) that are not directly related to a specific service or product would be required under a separate heading.

This would make clear what services offered to the client are linked to commission or other indirect remuneration which is not charged directly to the consumer and which are independent of the product(s) recommended.

This approach involves separating the various fees charged to the client and separating them collectively from remuneration the adviser may receive from recommending specific products. This system is designed to help the client's awareness of the fact that there are fees they are charged directly and also that there are indirect incentives operating on the adviser that could influence the advice provided.

Question Eight

a. Which option for disclosure of fees, remuneration and other interests and relationships do you prefer?

b. If you do not agree with any of the options, how do you believe fees and other remuneration should be disclosed?

c. Should any prescribed wording be included in the remuneration section to aid consumers' understanding of the differences in the types of remuneration an adviser receives and how this may influence the adviser's advice?

In addition to these options, consideration could be given to a mandated statement declaring whether the adviser is "independent" or "unaligned". An adviser would be considered to be independent or unaligned if they did not receive any commission payments from issuers for "selling" a particular issuer's products.

Question Eight continued

d. Do you agree that advisers that do not receive commission payments from issuers should be able to state in their disclosure document that they are "independent" or "unaligned" and that these terms should be restricted to advisers that meet this condition?

Other interests or associations – "Other information you should know about me?"

We propose that any other interests or associations the adviser or associates may have that could reasonably be considered to influence the advice given by the adviser be required to be disclosed. This would follow the remuneration section in the disclosure statement.

This section would be designed to cover matters currently included in the 'Other interests or associations' section in section 41E of the Securities Markets Act (with the exclusion of remuneration) and would require the nature and extent of the relationships to be disclosed. This would also cover the disclosure of interests of any other related parties that could be considered to influence the advice being provided by the financial adviser.

We are currently considering an appropriate title for this section and are looking at the option of prescribed wording that should be included with the disclosure in this section, designed to explain clearly why this information is important to the consumer. One heading being considered is "Other information you should know about me".

Question Nine

a. Do you agree that disclosure of any material interests, relationships and associations the adviser or associates may have should be required?

b. Do you consider that any prescribed wording should be included in the material interests, relationships and associations section to aid the consumer's understanding of other potential influences on the adviser and his/her advice?

D. Disciplinary proceedings

Once the Act is implemented, discipline of authorised financial advisers who breach the Code of Professional Conduct will be handled by the Disciplinary Committee, formed under the Act. The Committee will be chaired by the Commissioner for Financial Advisers and will include three other members (refer section 105 of the Act). If the Committee is satisfied that an authorised financial adviser has breached the Code of Professional Conduct the Committee may take any of the following actions:

a. recommend that the Commission cancels A's authorisation;

b. recommend that the Commission:

   (i) cancels A's authorisation; and

(ii) debars A for a specified period from applying to be re-authorised:

c. recommend that the Commission suspends A's authorisation for a period of no more than 12 months or until A meets specified conditions relating to the authorisation (but, in any case, not for a period of more than 12 months);

d. censure A;

e. order that A may, for a period not exceeding 3 years, perform a financial adviser service only subject to any conditions as to employment, supervision, or otherwise that the disciplinary committee may specify in the order;

f. order that A undertake training specified in the order;

g. order that A must pay a fine not exceeding $10,000; and

h. take no action.

On this basis we propose that an authorised financial adviser disclose if the Disciplinary Committee has taken any of the actions in (a) to (g) above, within the previous 5 years of the financial adviser service being performed.

Question Ten

a. Do you agree that an authorised financial adviser should only be required to disclose adverse disciplinary actions imposed on the adviser by the Code Committee?

b. Do you agree that proceedings within the previous 5 years is the appropriate time period?

E. Content not directly required

For authorised financial advisers, the Ministry does not propose to prescribe disclosure relating to the following matters:

i professional or business experience and any membership of professional bodies;

ii adverse findings by a Court or the Commission (other than how to make a complaint);

iii criminal convictions; or

iv procedures for handling money.

We believe that these matters are largely addressed through the information required by the Securities Commission and the Registrar of Financial Service Providers for the authorisation and registration processes, respectively, and that they do not need to be disclosed directly to consumers.

The procedures for handling clients' money are not addressed through the authorisation or registration process. However, the procedures are mandated in the legislation itself, so should be consistent across all authorised financial advisers.

However, disclosure of adverse findings by a Court or the Securities Commission and criminal convictions may need to be disclosed in some specific circumstances. Disclosure of these matters on an 'as required' basis is discussed further in Part D below.

Question Eleven

a. D you agree that these items do not need to be disclosed by an authorised financial adviser in their disclosure statement?

b. If not, which matters do you believe need to be disclosed?

c. Should these matters be included in additional information specified for the form?

Disclosure as required

Adverse findings by a Court or the Securities Commission and Criminal Convictions

The Ministry does not propose to include a requirement in the disclosure regulations that authorised financial advisers must disclose criminal convictions or adverse findings by a Court or the Securities Commission in their disclosure statement. This is proposed on the basis that those operating as a financial adviser will have to undergo certain criminal checks[8] as part of the registration process, with those that do not meet the registration requirements being unable to operate as financial advisers. In addition to this the individual then needs to satisfy the Securities Commission that they are of good character.

In order to ensure that if an instance arises where an adviser is able to be registered and authorised despite criminal convictions or an adverse finding by a Court or the Commission, the Commission can require disclosure of the matter by including it as a matter that must be disclosed by the financial adviser's terms and conditions of authorisation.

Question Twelve

a. Do you agree that disclosure of criminal convictions and adverse findings by a Court or the Commission should not be required under the regulations but should be left to the discretion of the Securities Commission to require as a condition of authorisation?

Indemnity insurance

The Ministry does not propose to require authorised financial advisers to disclose whether the adviser holds indemnity insurance.

Question Thirteen

a. Do you agree that indemnity insurance should not be required to be disclosed?

b. What are your reasons for agreeing or disagreeing that indemnity insurance should not be required to be disclosed?

[8] See section 14 of the Financial Service Providers (registration and Dispute Resolution) Act 2008.

Other considerations

The proposals in this paper are considered for all authorised financial advisers. However regulations may prescribe different disclosure for different classes of authorised financial adviser, financial adviser service, or client. The Securities Commission also has the ability to make exemptions in relation to disclosure obligations under the Act; if there are alternative compliance procedures that might be more appropriate in certain circumstances then an exemption may be appropriate.

The Ministry would like to seek feedback as to whether there is a need to consider different disclosure requirements for a certain class of authorised financial adviser, financial adviser service, or client.

Question Fourteen

a. Are there any classes of authorised financial adviser, financial adviser service, or client for which different disclosure requirements should be considered? If so, please detail the circumstances and how you believe the disclosure requirements should differ.

4. DISCLOSURE BY FINANCIAL ADVISERS PERFORMING A FINANCIAL ADVISER SERVICE IN RELATION TO A CATEGORY 2 PRODUCT

To provide advice or an investment transaction in relation to a call debt security, a bank term deposit, an insurance product (excluding a life insurance policy issued after 31 December 2008) or a consumer credit contract (as defined in section 11 of the Credit Contracts and Consumer Finance Act 2003), an individual is required to be registered but need not be authorised.

Under the Act the disclosure requirements for those who only provide advisory services in relation to category 2 products are less than those imposed on authorised financial advisers, as the advice relating to these category 2 products is less complex and authorised financial advisers are held to a higher standard of conduct. The regulations can prescribe the form of the category 2 disclosure and the following content of the disclosure document (see section 25 of the Financial Advisers Act):

a. the status of the financial adviser, for example, whether the financial adviser is authorised or not;

b. dispute resolution arrangements;

c. location of business premises; and

d. telephone, email and fax details.

A. Status of the adviser

Advisers in relation to category 2 products (who are not part of a QFE) must be registered but do not need to be authorised by the Securities Commission. There are a number of options for how this information as to the status of the adviser could be conveyed to the consumer. For example, advisers could be noted as either: registered; registered but not authorised; or able to provide advice on X products as follows:

a. I [insert name] am a financial adviser and can provide you with advice on [insert products] products only;

b. I am a registered, but not authorised, financial adviser. This means that I can provide you with advice on [insert products] products;

c. I am a registered financial adviser and can provide you with advice on [insert products] products only.

d. I am not an authorised financial adviser. I can provide you with advice on [insert products].

The Ministry is seeking feedback on the most appropriate form of disclosure for advisers of category 2 products (who are not part of a QFE) to disclose their status within the new financial advisers regimes. To clarify the difference between these and other financial advisers, the adviser could be required to disclose what they can (and do) provide advice in relation to.

Question Fifteen

a. How should individuals (who are not part of a QFE) who provide advice in regards to category 2 products, who are registered by not authorised, be required to disclose their status under the Financial Advisers Act 2008?

B. Optional further disclosure

The Ministry is considering allowing those advisers that provide advice in relation to category 2 products (i.e. those advisers who are registered but not authorised) to opt to provide disclosure on all the matters prescribed for disclosure by an authorised financial adviser (as opposed to prohibiting additional material as a matter of form). This would encourage transparency as to potential conflicts of interests. Consumers may also consider this disclosure to be a step towards increased professionalism in the sector.

There are some concerns about those who provide advice in relation to category 2 products providing optional further disclosure. Optional disclosure could increase confusion over the standard of the adviser the client is dealing with; a client could believe that the adviser has met the required competency standards when this is not the case. It may also decrease the incentive for an adviser to become authorised.

We seek your views on optional further disclosure for advisers in relation to category 2 products.

Question Sixteen

a. Do you think that, on balance, there would be a benefit to allowing advisers who provide service in relation to category 2 products to opt to provide disclosure at the level of authorised financial advisers?

b. If you have a view on optional disclosure, please describe the reasons for that view.

5. DISCLOSURE BY QUALIFYING FINANCIAL ENTITY (QFE)

Under the Financial Advisers Act, when an employee or agent of a QFE performs a financial adviser service (for which they are not required to be individually authorised), the QFE must make disclosure before (or, if not before, as soon as practicable after) a financial adviser service is performed for a client.

A QFE must have the capacity to ensure that its employees and agents comply with their financial adviser obligations under the Act. The Securities Commission needs to be satisfied that the QFE has this capacity.

The Securities Commission can subject QFEs to additional disclosure requirements through the terms and conditions imposed when QFE status is granted. These requirements are not the subject of the regulations or this discussion document. The Securities Commission is presently seeking feedback on QFE regulation in its staff paper titled 'Regulating and Supervising Financial Advisers'. The Securities Commission notes that any disclosure requirements imposed through terms and conditions of QFE status are expected to be consistent with the approach taken in the regulations for disclosure by individual financial adviser. This can be found at www.seccom.govt.nz.

A. Disclosure under regulations

We propose that a QFE should be required to disclose the following (as specified in section 23 of the Financial Advisers Act):

1. the QFE's dispute resolution arrangements;
2. matters required to be disclosed by the QFE's terms and conditions[9]; and
3. whether the QFE provides any other licensed service.

Question Seventeen

a. Do you have any comments on the proposed disclosure requirements for QFEs?

B. Delivery of QFE disclosure

The employee or agent working for the QFE has no personal disclosure obligation under the Act. However, as noted above, the QFE must disclose the required information to the person for whom the financial adviser service is performed before (or, if not practicable before, as soon as practicable after) the service is performed.

The means of communicating disclosure can be prescribed as part of the regulations. However, we are not proposing to prescribe how disclosure by a QFE needs to be communicated, so as to allow flexibility for entities to determine the most appropriate way to discharge the disclosure obligation.

Under this model, the QFE will need to consider how this obligation is discharged, as no particular method is prescribed.

[9] The regulations will not cover the detail of what could be required in the terms and conditions of QFE status. Specifying terms and conditions of QFE status is done by the Securities Commission in their approval of entities for QFE status.

The Ministry is seeking views on whether the means of communication for disclosure by a QFE need to be further prescribed.

Question Eighteen

Do you agree that the means of communication for QFE disclosure need not be prescribed in the regulations?