Ministry of Economic Development
Manatū Ōhanga

FINANCIAL INTERMEDIARIES

Discussion Document

July 2006

ISBN 0478284799

First Published July 2006
Regulatory and Competition Policy Branch
Ministry of Economic Development
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New Zealand
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2. FOREWORD

In my time as Minister of Commerce, I have heard many comments about the importance of having trusted financial intermediaries in New Zealand. I'm pleased to continue these conversations with the publication of this discussion document.

I believe that a sound and efficient financial sector needs trusted financial intermediaries to match New Zealanders with appropriate products and to give advice on financial decision making.

The Government greatly values the assistance of stakeholders - in particular, the benefit of your working experience as, and with, financial intermediaries - in designing new legislation. I therefore strongly encourage you to make a submission, so that we might have the most practical and effective legislation for financial intermediaries in New Zealand.

Hon Lianne Dalziel
Minister of Commerce
July 2006

3. INFORMATION FOR SUBMITTERS

The Ministry of Economic Development has prepared this discussion document following consultation with other government officials and agencies. Written submissions on the issues raised in this document are invited from all interested parties.

How to Make a Submission

Please send your submissions to **Nicolette Buddle** at the contact details provided below.

Please note that the questions in the discussion document are only intended to provide a suggested focus of the issues. Some of the questions have elements that overlap with other questions. Submitters should also feel free to provide broader comments where desired if issues are not subject to specific questions. However, submitters should provide reasons for their answers or in support of their position. There is no need to address all the issues or questions, and submitters should feel free to provide submissions only on the issues of direct concern if so desired.

The closing date for submissions is: **1 September 2006**

After receiving submissions, the Ministry will evaluate them and seek further comments where necessary before developing recommendations for the Minister and then Cabinet to consider.

Copies of the Discussion Document

Hard copies of the discussion document are available on request from Nicolette Buddle at the contact details provided below. The document is also available electronically on the Ministry of Economic Development website (www.med.govt.nz).

Contact for Queries and Submissions

Please direct all submissions and any queries to:

Nicolette Buddle

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Regulatory and Competition Policy Branch

Posting and Release of Submissions

The Ministry may post all or parts of any written submission on its website at [www.med.govt.nz]. The Ministry will consider you to have consented to posting by making a submission, unless you clearly specify otherwise in your submission.

In any case, content of submissions provided to the Ministry are likely to be subject to public release under the Official Information Act 1982 following requests to the Ministry (including via e-mail). Please advise if you have any objection to the release of any information contained in a submission, and in particular, which part(s) you consider should be withheld, together with the reason(s) for withholding the information. The Ministry will take into account all such objections when responding to requests for copies and information on submissions to this document under the Official Information Act 1982.

Privacy

The Privacy Act 1993 establishes certain principles with respect to the collection, use, and disclosure of information about individuals by various agencies including the Ministry. It governs access by individuals to information about themselves held by agencies. Any personal information you supply to the Ministry in the course of making a submission will be used by the Ministry only in conjunction with the matters covered by this document. Please clearly indicate in your submission if you do not wish your name to be included in any summary of submissions that the Ministry may publish.

Disclaimer

The opinions and proposals contained in this document are those of the Ministry of Economic Development and do not reflect government policy.

Readers are advised to seek specific legal advice from a qualified professional person before undertaking any action in reliance on the contents of this publication. The contents of this discussion paper must not be construed as legal advice. The Ministry does not accept any responsibility or liability whatsoever whether in contract, tort (including negligence), equity or otherwise for any action taken as a result of reading, or reliance placed on the Ministry because of having read, any part, or all, of the information in this discussion paper or for any error, inadequacy, deficiency, flaw in or omission from the discussion paper.

Process

This discussion document reflects preliminary views only on the matters raised. The submission period runs to **1 September 2006**.

Following this, the process will run as follows:

- Officials will then analyse the submissions made and finalise proposals for the content and substance of the proposed legislation to submit to the Minister of Commerce in late 2006.
- A Cabinet paper will then be prepared and submitted to Cabinet by the Minister of Commerce, seeking final policy approvals for the proposed legislation and authority to provide drafting instructions to Parliamentary Counsel Office in late 2006.

- Once Cabinet policy approval is obtained, drafting instructions will be forwarded to Parliamentary Counsel Office. It is expected that drafting will take around 3-4 months to complete.
- In 2007, the draft Bill will then be presented to the Cabinet Legislation Committee and Cabinet for approval and for introduction in the House of Representatives.

Access to Current Statutes, Regulations and Bills

Current statutes and regulations may be accessed through the government's interim Public Access to Legislation website at www.legislation.govt.nz.

Acknowledgment

The Ministry would like to thank everyone who has assisted with consultation and drafting for this discussion document.

4. EXECUTIVE SUMMARY

Review of Financial Intermediaries

1. The Government is reviewing the regulation of financial intermediaries in New Zealand because the current voluntary or sector specific regulation of intermediaries is failing to ensure that intermediaries are accountable to consumers, that intermediaries have the experience and expertise to match consumers with products, and that consumers are able to make informed decisions about their intermediaries.

2. Cabinet has provided "in-principle" approval to the introduction of a co-regulatory framework under which "approved professional bodies" and the Securities Commission and the Minister will work together to regulate financial intermediaries. This co-regulatory framework will be set down in legislation.

3. This discussion document builds on the consultation carried out by the independent Taskforce on Financial Intermediaries and by Ministry of Economic Development officials and presents detailed options under the co-regulatory model for public comment.

4. In particular, the document seeks public comment on the content of the proposed legislation:

    - The application of the legislation
        - The definitions of "financial intermediary", "financial advice" and "financial product"
        - The different classes of financial intermediaries and how these different classifications will work in practice
    - Legislative conduct standards for financial intermediaries
    - Disclosure obligations on financial intermediaries
    - The co-regulatory model
        - the powers of the Securities Commission
        - the powers of the Minister
        - the powers and rules of the "approved professional bodies"
        - co-regulatory processes.

5. Submissions to the discussion document will contribute to preparation of a Cabinet paper in late 2006. This subsequent Cabinet paper will seek approval for the content of the financial intermediary legislation, proposed to be introduced in 2007.

5. OUTCOMES OF THE REVIEW OF FINANCIAL INTERMEDIARIES

Desired outcomes in the financial sector

6. The outcomes the government is seeking to achieve from the financial sector are a sound and efficient financial system, investment which encourages growth and innovation, an environment which facilitates wealth accumulation and confidence in the sector which encourages participation by consumers and market participants. To do this, the Government is working on an effective and consistent framework for the regulation of non-bank financial institutions, financial products and financial intermediaries.

7. This work encompasses a number of reviews including the Review of Financial Intermediaries (dealt with in this discussion paper) the Review of Products and Providers and the Review of Domestic Institutional Arrangements (led by Treasury).[1]

Role of financial intermediaries in the financial sector

8. Trusted financial intermediaries play a key role in addressing information asymmetry in the financial sector, as the market will only operate efficiently if investors can make informed choices about which products or providers best suit their needs and risk levels.

9. Retail investors often do not have sufficient expertise, time or information to make these choices unaided. Information on financial matters can be costly to gather and share, and once it is released, the value of the information dissipates.

10. Intermediaries can help investors understand and choose investments and give investors reasonable assurance that an investment is suitable for their needs. Intermediaries should have the expertise, time and information to break down the knowledge gap between the provider and the consumer to assist in the efficient allocation of resources by matching consumers with products that best meet their needs and risk appetite.

Why the Government intervenes

11. While there are currently many trusted financial intermediaries in New Zealand, the Government is carrying out this work because most intermediaries only have informal incentives placed on them to credibly vouch for the quality of information. These incentives arise because their business is based on giving accurate information and they will suffer reputational and therefore economic loss if they provide misleading information or allow a provider to falsify or exaggerate information.

12. Consumers have limited information and a limited ability to evaluate their financial intermediaries. In addition, consumers may not verify the information provided by financial intermediaries so there may only be incentives on some intermediaries to do the minimum necessary to keep their client satisfied. Low entry requirements may also allow intermediaries to operate off the reputations of other intermediaries. There

[1] These reviews are discussed at paragraph 323. Discussion documents will be released for public submissions.

may not be sufficient incentives for intermediaries to act ethically or to manage conflicts of interests appropriately. As well, most consumers do not have experience and expertise in investing in the financial sector.[2]

[2] Refer ANZ-Retirement Commission Financial Knowledge Survey, March 2006 Research Report (at page 9): "Investing is one of the more complex areas of personal finance where there is evidence of some confusion and gaps in knowledge."

6. OBJECTIVES OF THE REVIEW OF FINANCIAL INTERMEDIARIES

Objectives

13. In order to meet the desired outcomes and address the reasons why intervention is required, the objective of the Government's work on financial intermediaries is to ensure that:

    - that intermediaries are effective and efficient in addressing information asymmetries in the market, and

    - that the regime addresses the information asymmetries about the intermediaries themselves by providing the investor with confidence in the competency and integrity of their intermediary.

14. This means:

    - ensuring adequate disclosure of intermediaries' conflicts of interests, fees and competency so that investors/consumers can make informed decisions about whether to use an intermediary and whether to take their advice;

    - investors having intermediaries available that have the experience, expertise and integrity to effectively match an investor consumer with products that best meet their needs and risk profile;

    - intermediaries being held accountable for any advice given and that there are incentives for intermediaries to manage appropriately conflicts of interest;

    - the promotion of a sound and efficient financial sector in which the public have confidence in the professionalism and integrity of intermediaries;

    - regulation that is well targeted and does not impose unnecessary costs; and

    - encouraging innovative and competitive markets.

15. These objectives will be incorporated into legislation to ensure that all parties operating in the co-regulatory environment must carry out their roles in accordance with the objectives.

16. Ministry officials will work to coordinate New Zealand regulation with Australian and international practice, where this is appropriate.

Question:

Q1 Are there any other objectives for the review which should be included in legislation (which are not already covered by paragraphs 13 and 14?)

Assessment of current regulatory regime against objectives

17. The current regulatory regime is inconsistent across the different types of financial intermediaries and has limited overall coverage of financial intermediaries' activities. For example, investment advisers and brokers must comply with disclosure obligations under the *Investment Advisers (Disclosure) Act 1996* but these disclosure obligations do not apply to all intermediaries.[3] Sharebrokers need to apply for a licence from the District Court by demonstrating they are fit and proper persons before they can operate as a broker,[4] but this licensing does not apply to all brokers who handle client money and property and other intermediaries, so there is no easy way for the public to determine the competency of their advisers.

18. The regulatory regime as it currently stands does not create the right incentives on financial intermediaries, nor does it address all of the problems for consumers in identifying competent intermediaries and making informed decisions about whether or not to take advice.

19. In 2004, New Zealand's regulatory regime was assessed by the International Monetary Fund (IMF) Financial Sector Assessment Program which considered New Zealand's securities regulations against the "IOSCO Objectives and Principles of Securities Regulation" in relation to how we regulate financial intermediaries.[5] The resulting IMF report[6] recommended more comprehensive regulatory oversight of financial intermediaries in New Zealand, through either a licensing regime, or, as a less costly option, the imposition of standards, with monitoring by the regulator. This was on the basis that not all financial intermediaries in New Zealand are subject to comprehensive standards for internal organisation and operational conduct.

20. In addition, other current problems in the New Zealand intermediary industry include:

    - Lack of consistent domestic standards and lack of confidence across the industry. Submissions to the earlier Taskforce work noted this, and that change was required in this industry.[7] This was clear from responses to the Taskforce's final paper on options for change. Some 72% of respondents[8] agreed that change was required to this industry. The main reasons for change were to increase standards, to increase consumer and industry confidence and to increase consumer investment. Some 7% of respondents did not want change and 21% made comments, but did not express a view.

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[3] The *Investment Advisers (Disclosure) Act 1996* is proposed to amended by the Securities Legislation Bill
[4] *Sharebrokers Act 1908*
[5] IOSCO Objectives and Principles of Securities Regulation, Principle 23: "[Financial] intermediaries should be required to comply with standards for internal organization and operational conduct that aim to protect the interests of clients, ensure proper management of risk, and under which management of the intermediary accepts primary responsibility for these matters. "A "financial intermediary" is generally described as an individual or a business who markets financial products or provides financial advice (that is, advice about financial products or investments or savings decisions and choices) to members of the public. This description includes a large number of individuals and businesses (including financial institutions), insurance companies and agents operating in New Zealand's financial sector including mortgage brokers, investment advisers and bank and insurance company employees.
6 Available as a country specific publication on the IMF website at
http://www.imf.org/external/pubs/ft/scr/2004/cr04417.pdf
[7] Refer submissions to the Taskforce work at http://www.med.govt.nz/templates/ContentTopicSummary____7823.aspx
[8] These respondents represented views from consumers, industry representatives groups, individuals intermediaries across a range of financial intermediary sectors including mortgage brokers, insurance brokers, investment advisers, financial planners.

- It's hard to attract younger people into the industry without a focus on professionalism.[9]

- If there is a problem with an intermediary, there is no standard dispute resolution or disciplinary process. This applies not only to intermediaries but is common across the financial sector.[10]

- For those intermediaries wanting to operate trans-Tasman there is currently no mutual recognition regime under which they can operate. If a regime is developed which achieves equivalent outcomes (but not with necessarily identical regulation) to the Australian regime then options like mutual recognition could be explored which would enable intermediaries to operate in both countries at low cost.

21. The Review of Financial Intermediaries is intended to address these problems.

Financial Intermediaries Taskforce

22. In 2004, the Minister of Commerce (then the Hon Margaret Wilson) appointed an independent Task Force on the Regulation of Financial Intermediaries to consider and report on the regulation of financial intermediaries in New Zealand.

23. The Task Force's terms of reference required it to consider options for reform that would ensure quality financial information and advice is provided to the public and assist New Zealanders to make the most of their savings. The Task Force's final report "*Confidence, Change and Opportunity*" was publicly released in August 2005.

24. The Task Force recommended an industry and government co-regulatory model which would allow different sectors of the financial intermediary industry to develop their own standards, dispute resolution and disciplinary procedures by forming approved professional bodies (approved professional bodies), to which certain classes of financial intermediaries ("personal financial advisers") would have to belong. The Task Force proposed that approved professional bodies would be overseen by a public regulator. (The full list of the Taskforce recommendations is at Annex Two).

Why did the Task Force recommend a co-regulatory model?

25. The Task Force noted that there was strong support from industry stakeholders for enhanced self and/or co-regulation on the basis that the knowledge and practices of existing industry bodies could be leveraged to help address the current limitations of the existing self regulatory organisations.[11] Currently, industry relies on voluntary compliance with codes of ethics and disciplinary procedures, but it is difficult for industry bodies to effectively sanction poor behaviour (e.g. members can simply leave the industry body but still continue to practise) and existing industry bodies are not well set up to deal with all disciplinary matters. As well, a number of intermediaries do not belong to industry groups.

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[9] Feedback provided to Ministry officials from industry groups
[10] Refer to the 2005 National Consumer Survey on Awareness and Experience of Consumer Legislation available at http://www.consumeraffairs.govt.nz/policylawresearch/research/awareness/nrb/index.html
[11] Taskforce report "*Confidence, Change and Opportunity*" page 44

26. In addition, there was a high level of consensus across industry participants, consumer and regulatory bodies (including self regulatory bodies) that change was required and that it was unlikely to occur in the existing environment. The other options of enhanced self regulation or direct government regulation were not recommended.

27. Ministry officials note that part of the review of the regulatory frameworks is encouraging the use of different regulatory tools. The review of regulatory frameworks (announced in the 2006 Budget) will include consideration of the appropriate level of regulation or mix between self-regulation, co-regulation and state regulation.

Cabinet approval

28. In December 2005, Cabinet agreed (in principle) to the co-regulatory model, with Ministry officials to carry out the detailed design work.[12] In particular, Cabinet agreed in principle that the co-regulatory framework should have the following features:

    - that there would be industry-led approved professional bodies and a government regulator which would work together to regulate financial intermediaries;
    - the government regulator would be the Securities Commission;
    - financial intermediaries would be subject to enhanced disclosure obligations when providing financial advice with obligations dependent upon the class of financial intermediary;
    - legislation would set a number of conduct standards for financial intermediaries;
    - financial intermediaries would be subject to dispute resolution and disciplinary procedures.

29. Cabinet also directed the Ministry of Economic Development to undertake detailed design work with stakeholders on the Task Force recommendations and to report back with options, recommendations and final policy decisions regarding arrangements for financial intermediary regulation in mid/late 2006, with the intention of introducing legislation in 2007.

30. This discussion document seeks public comment on the application and content of the proposed legislation to contribute to the final policy decisions.

[12] Work in progress regulatory impact statement - http://www.med.govt.nz/upload/28130/ris-bccs-20051212.pdf

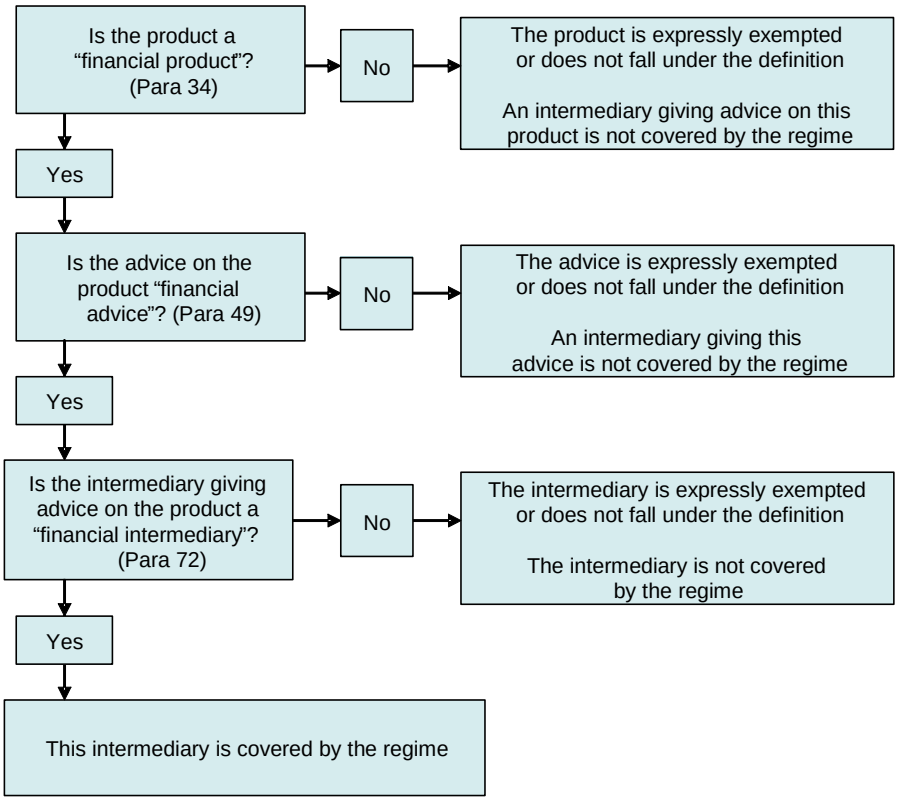
7. APPLICATION OF THE PROPOSED LEGISLATION

31. The first matters to consider under the application of the legislation are the descriptions of "financial intermediary", "financial advice" and "financial product" and the classification of the types of "financial intermediary".

Descriptions

32. The Taskforce referred to a "financial intermediary" as an individual or business who markets financial products[13] or provides financial advice[14] to members of the public.[15]

33. Ministry officials have used this description as a starting point. It is important to note that the description of "financial intermediary" will depend on the description of "financial advice" (see paragraph 49) which itself depends on and requires a description of "financial product" (see paragraph 34) as set out in the flow chart:



"Financial product"

34. The Taskforce described a "financial product" as "any product having an investment, debt, risk or credit component."

35. This description could include the following products:

- Credit products (including hire purchase contracts, credit cards, mortgages, reverse equity mortgages)

[13] See paragraph 34
[14] See paragraph 49
[15] Taskforce final report, page 4

- Debt/equities and any other securities
- Foreign exchange contracts
- Managed investment products
- Superannuation products
- Investment life insurance products
- Life insurance products
- General insurance products
- Futures and derivatives.

36. While the Ministry supports a broad description of "financial product" to allow future development of financial products, and to encourage greater certainty, Ministry officials recognise that there are reduced levels of risk for consumers for advice on some products.

37. For example, the Taskforce suggested that advice on some risk products, such as car insurance, travel insurance, home and contents insurance does not have sufficient implication for New Zealand consumers in light of the objectives of the review of intermediaries.[16] This was on the basis that consumers were generally aware about their options, and were familiar with the product.

38. Another example of an exempted financial product is a "call deposit" which is excluded from the definition of "security" in the Securities Legislation Bill.[17] As "investment advice" (in the Bill) is restricted to recommendations about acquiring or disposing of securities, the effect of the exclusion is that a person providing advice on a "call deposit" is not providing investment advice and is not subject to the investment adviser disclosure requirements under the Securities Legislation Bill.

39. The Ministry's discussion document on the Securities Legislation Bill Regulations sought submissions on exemptions to "investment advice". Ministry officials are reviewing responses to this discussion document in relation to investment adviser disclosure, and will incorporate submissions into the policy development work for financial intermediaries.

40. Ministry officials are still considering whether public familiarity with a product is sufficient to reduce obligations on intermediaries. General public familiarity with a product may not be sufficient to meet the objectives of the Government's work on financial intermediaries, which are to ensure:

    - that intermediaries are efficient in addressing information asymmetries in the market, and also

[16] Taskforce report page 33
[17] Sect 20 Securities Legislation Bill proposing to amend s2 Securities Markets Act 1988

- that the regime addresses the information asymmetries about the intermediaries themselves by providing the investor with confidence in the competency and integrity of their intermediary.

To meet these objectives, familiarity with a product would have to mean that members of the public know enough about that product to make informed decisions.

41. If public familiarity with a product is enough to reduce intermediary obligations, then Ministry officials consider that the public appears to be generally familiar with the short term general insurance products such as:

- vehicle insurance
- house and contents insurance
- travel insurance (there is some dispute as to whether or not this is short-term)
- personal / domestic property insurance products.

42. The Ministry is however concerned that even if these products are generally understood, this does not mean that a member of the public will know how much insurance they should or shouldn't have, or who offers the best products for their particular circumstances.

43. Ministry officials are keen to hear your views on these exceptions and whether there are certain products about which members of the public can be assumed to have sufficient knowledge so that intermediaries who advise on those products are exempt from some or all requirements of the legislation.

Investment property

44. The Taskforce suggested that advice about tangible property should not be included in the proposed legislation, on the basis that collecting rare books, stamps wine etc is usually a hobby and is subject to the Consumer Guarantees Act. However, the Taskforce did suggest that advice about investment property should be included as New Zealanders view real estate as a retirement savings vehicle and because such property is marketed as an investment opportunity for members of the public.[18] This would also impact on whether or not real estate agents fell under the definition of "financial intermediary" (see paragraph 67).

45. "Investment property" can include commercial premises such as business premises, car-parks, garages. It may be difficult in practice to determine when a financial intermediary is offering advice on property to a member of the public as an investment opportunity, especially as this will depend largely on the intention of the member of the public on how they use that property. There are some existing definitions of "investment property", for example, "investment property" is defined as under the New Zealand International Accounting Standards as:

[18] Taskforce report page 34

"property (land or a building -or part of a building - both) held (by the owner or by the lessee under a finance lease) to earn rentals or for capital appreciation or both rather than for:

- use in the production or supply of goods or services or for administrative purposes; or
- sale in the ordinary course of business."[19]

46. It is arguable that, given the levels of capital appreciation in residential housing in New Zealand, some residential home owners own their own property for capital appreciation reasons.

47. Ministry officials have also received comments that investment advice on some other forms of tangible property which are not collected as hobbies, for example, gold bullion, should also be included in regulation.

48. Ministry officials seek your views on whether "investment property" should be included as a 'financial product" and whether or not there should be other tangible property included in the definition of "financial product".

Questions:

Q2 Are the basic categories of financial product (at paragraph 35) appropriate?

Q3 If not, why not? Are they too broad or too narrow?

Q4 Should there be any exemptions for advice about certain products?

Q5 If so, which products? And why?

Q6 Is "public knowledge" about a type of financial product a good enough reason to reduce obligations on intermediaries?

Q7 Do you think that "investment property" should be included as a "financial product"? If so, how would you define "investment property"?

Q8 What would be the cost and benefit of including advice on any "investment property" in this regime?

Q9 Should other forms of tangible property (for example gold bullion) be considered as a "financial product"?

"Financial advice"

49. The proposed description of "financial intermediary" requires a description of "financial advice" to provide certainty to consumers and industry.

[19] New Zealand equivalent to International Accounting Standard 40 at IAS 40.5

50. As a starting point, the Taskforce referred to “financial advice” as “advice about financial products or investment or savings decisions and choices.”[20]

51. In relation to advice on financial products, by comparison, “investment advice” under the Investment Advisers (Disclosure) Act is currently defined as:

    a. A recommendation, opinion, or guidance given to a member of the public in relation to buying or selling (or not buying or selling) securities; and

    b. Without limiting paragraph (a)… includes any such recommendation, opinion, or guidance, that is communicated by letter, newspaper, periodical, broadcasting, sound recording, television, cinematographic film, video, or any form of electronic or other means of communication.

    but does not include

    c. Any such recommendation, opinion, or guidance given by a person whose principal occupation is that of a journalist and that is given in that person's capacity as a journalist; or

    d. Any such guidance about the procedure for buying or selling securities.

52. In this section, Ministry officials seek submissions on what should be considered financial advice, and also any required exceptions.

Proposed description

53. Ministry officials propose to describe “financial advice” by reference to financial products, so that financial advice is a recommendation, opinion, or guidance given to a member of the public in relation to buying or selling financial products.

54. Ministry officials seek your views on whether or not this description should extend further, to include financial advice which is not related to financial products. This information was defined by the Taskforce as advice that relates to “investment or savings decisions and choices”. This could include advice relating to financial structuring involving (e.g.) trust arrangements which may include, but not be restricted to, the financial products used by a particular client.

55. Your views are invited on whether advice that relates to investment or savings decisions and choices should be included as “financial advice”, and if so, the form of any words that easily and practically describe this type of advice, and the type of exemptions (if any) that may be required to ensure that there are no unnecessary costs.

Questions:

Q10 Is the proposed description of “financial advice” workable? If not, why not and how should it be changed?

Q11 Is there advice which does not relate to the buying and selling of

[20] Taskforce report, page 4

financial products? If so, how should it be described?

Q12 What would be the benefits and costs of treating such advice as "financial advice"?

Exceptions

56. There are exceptions to the definition of "investment advice" in the Investment Advisers (Disclosure) Act, so that recommendations, options and guidance from journalists are not treated as "investment advice".

57. Ministry officials are aware that, in addition to journalists, members of other professions may be "financial intermediaries" because they provide financial advice.

58. Comments are invited on whether or not there should be any express exception for any group which provides "financial advice" to members of the public. (This paper discusses journalists, accountants, lawyers, budget advisers and real estate agents).

Journalists

59. Advice provided by journalists is expressly exempted from the definition of "investment advice" in the Investment Advisers (Disclosure) Act. The Task Force noted this point, and also referred to the contribution that journalists provide to overall consumer financial literacy and also "press freedom" concerns. However, because of this contribution, there is greater risk that members of the public will rely on journalists' advice when making financial decisions, without being advised of any potential conflicts of interest that may exist or journalists making sure they have taken reasonable steps to ensure the accuracy of the information.

60. Ministry officials are keen to hear your views on whether advice provided by journalists, when acting as journalists, should be excluded from the definition of "financial advice" or whether some requirements should be placed on them and what these should be.

Lawyers and Accountants

61. Ministry officials are aware that a broad description of "financial advice" which includes financial advice which is not related to financial products (see paragraph 54) carries the risk that it will include advice provided by lawyers and accountants even though they are acting as lawyers or accountants in providing that advice, and not as financial advisers.

62. Lawyers and accountants giving professional advice on legal and accounting matters are already covered by separate existing regulations,[21] and Ministry officials are not convinced about the benefit of extending the definition of "financial advice" to include these professionals.

[21] Refer *Lawyers and Conveyancers Act 2006* and the *Institute Of Chartered Accountants Of New Zealand Act 1996*

Budget advisory services

63. Ministry officials have received comments that the proposed description of "financial advice" would include those people who currently provide budget advisory services as a community service to those members of the public who are in financial difficulties and require budgeting and debt restructuring information and advice.

64. It is possible that some of these intermediaries are not acting in the ordinary course of business or employment, by providing pro bono advice, and so would fall outside the description of "financial intermediary" (refer to paragraph 77).

65. For the avoidance of doubt however, we are considering exempting this class of intermediaries, i.e., those intermediaries that provide services on a not for profit basis or not in the course of business), on the basis that:

- such intermediaries do not act for reward or commission, and so there is a reduced risk of conflicts of interest between the intermediary and any product provider; and

- unless exempted, such intermediaries would be subject to the highest level of regulation as they take into account the personal circumstances of a member of the public, and the cost of compliance with the highest level of obligation may discourage intermediaries from providing these services to community or charity groups.

66. This is not to say that the Ministry expects lower standards from those advising such groups (one good reason for intermediaries to be subject to the conduct and competency standards) but invites submissions on this point.

Real estate agents

67. Ministry officials have received a number of comments on whether or not real estate agents would or should be covered by this regulation. As noted at paragraph 57, the definition of financial intermediary is not restricted by professions, instead, the definition includes those individuals or businesses within any profession that provide financial advice.

68. Real estate agents may provide financial advice if investment property is a financial product, as real estate agents provide recommendations, opinions or guidance on investment property.[22]

69. The Taskforce also noted that concerns had been raised about disclosure and selling practices in the investment property arena (for example, "hard selling" practices, excessive statements about returns with inadequate basis for the claims, and lack of disclosure of relevant factors that would enable a consumer to assess the risk and returns in relation to property investments).[23]

70. Real estate agents could fall under a range of financial intermediary roles:

[22] See paragraph 44
[23] Taskforce report at page 26

- Execution only intermediaries – if they carry out the client's (i.e. the vendor's) instructions to sell an investment property

- Product marketers – if a property developer markets investments for non-owner-occupiers in a new apartment development

- High level intermediaries - if they consider the circumstances of a member of the public, and advise accordingly against a range of investment opportunities.

71. Ministry officials have invited comment on whether or not "financial product" should include investment property. Here, comments are invited on whether or not real estate agents should be exempted.

Questions:

Q13 Ministry officials note that a number of professions including journalists, lawyers, accountants, budgeting advisers and real estate agents can provide financial advice. In your view, should any profession be exempted from the proposed legislation?

Q14 If so, can you please describe the group, and then provide reasons why, including consideration of the costs and benefits of such an exemption.

"Financial intermediary"

72. The Taskforce referred to a "financial intermediary" as an individual or business who markets financial products[24] or provides financial advice[25] to members of the public.[26]

73. There are a number of changes which Ministry officials propose:

- Removing the reference to "marketing products"

- Restricting the application to those people who provide financial advice in the course of their business or employment.

74. The Ministry is also considering adding express reference to describe those intermediaries who receive money/property from members of the public to buy and/or sell financial products.

75. We seek your views on these suggestions (each discussed below) as well as any other amendments.

Intermediaries who "market products"

76. The Ministry proposes removing the reference by the Task Force to those intermediaries who "market" products on the basis that advice given in relation to

[24] See paragraph 34
[25] See paragraph 49
[26] Taskforce report, page 4

marketing or selling a financial product will be included in the definition of "giving financial advice".

"In the course of business or employment"

77. Ministry officials consider that the role of a "financial intermediary" should, like the role of an "investment adviser" and "investment broker" in the Investment Advisers (Disclosure) Act, be restricted to those persons who provide financial advice or receive money or property in the course of their business or employment. This is on the basis that not all opinions on financial matters are required to be regulated - only those opinions of people who provide financial advice as part of their job, as these opinions are more likely to be relied upon, than opinions of people who do not provide financial advice as part of their employment or business.

Carrying out transactions

78. Ministry officials are aware that some intermediaries may carry out transactions in addition to providing advice. It is important that these intermediaries are included in the definition of "financial intermediary" as these intermediaries will have set responsibilities in relation to money handling.[27] The Ministry is considering including an express reference to those intermediaries who receive money and/or property from members of the public to buy and/or sell financial products under instruction. These intermediaries may give financial advice to members of the public, in a broad sense, in terms of how an investment is going, but their main focus is to act on the instructions of clients.

79. The Investment Advisers (Disclosure) Act currently refers separately to investment brokers and investment advisers.

80. To expressly include these intermediaries, Ministry officials are considering including those intermediaries who carry out transactions by receiving money and property, in relation to the buying and selling of financial products.

Proposed description

81. The proposed description of a financial intermediary would refer to a person[28] who, in the course of the person's business or employment gives financial advice to [or provides transaction services for] members of the public.

[27] See paragraph 150
[28] See paragraph 121 for a discussion on individuals and businesses

Questions

Q15 In your view, is the proposed description of "financial intermediary" appropriate?

Q16 Do all intermediaries provide advice? Or do some intermediaries only carry out a transaction at a client's request?

Classifications of intermediary

82. Intermediaries offer various levels of service. The Taskforce concluded that intermediaries could be divided into three groups, according to the level and type of service they provide:

    - *Information only/Execution only*[29] – an individual or business who provides only factual information about a product

    - *Product marketer* – an individual or business who markets financial products

    - *High level intermediary* – an individual or a business who advises a member of the public on the suitability or appropriateness of financial advice or financial product.

83. Cabinet recommended that obligations on financial intermediaries would be dependent upon the class of financial intermediary. This is on the basis that the cost of requiring an intermediary who offers a basic service to have as many obligations and the same level of skill and expertise as an intermediary who offers a more detailed service, would outweigh the benefit of increased regulation.

84. Ministry officials are also considering whether or not there should be a further category to include those intermediaries who receive money or property from members of the public for the purpose of buying or selling financial products, without providing advice.

85. This section seeks your views on the suggested classifications particularly:

    - whether these classes represent a realistic division in the types of New Zealand intermediaries; and

    - how these divisions may be interpreted by intermediaries and members of the public, and how this matters.

Financial intermediaries who give financial advice: Information only

86. Ministry officials propose that the first category of financial intermediary who gives financial advice is the “information only” intermediary.

87. The “information only” intermediary is a financial intermediary who provides or passes on factual information about a financial product to a member of the public.

88. For example:

    - a share broker who provides information on the current buy and sell price for a listed company share;

    - the employee who provides a consumer with a factual description of the various products that business has on offer;

[29] “Execution only” intermediaries are discussed separately at paragraph 116

- a call centre employee answering mortgage rate queries; or
- a bank teller giving information on rates.

89. Currently the Investment Advisers (Disclosure) Act exempts information only intermediaries from disclosure obligations. These intermediaries are defined as those who "only transmit investment advice relating to particular securities given by those issuing securities."[30] To date there has not seemed to be any problems with this definition.

90. Depending on the final definition of this group, it is assumed that there will be a low need to regulate this class of intermediaries on the basis that:

- Providing factual information does not require intermediaries to have high levels of competency, just to be able to transmit information accurately.
- Members of the public will be less likely to rely on or treat information received from information only intermediaries as detailed specialised advice as they are just passing on factual information.
- If they are passing on information given by the provider of the product than there should be some protections around the accuracy of this information under obligations placed on the provider itself.[31]
- Such intermediaries are generally employed by large organisations, and the employer will generally take responsibility for employee actions under the employer/employee relationship. There is a risk that an employee may do an act for which an employer may not be liable, but in that situation, there is always the indirect protection which "brand" or reputation can provide to require or motivate an employer to remedy a situation caused by an employee.

91. Hence, these intermediaries we do not believe should be required to be registered as financial intermediaries, or to be members of an approved professional body.

92. It is possible that information only intermediaries will need to seek and record some information from a member of the public. For example, if a member of the public telephones an insurance company call centre to find out a certain term or condition of their insurance policy, it is reasonable to expect the call centre employee to take generic information from the consumer, i.e. age, date of birth, policy number, for the purpose of identifying that consumer. The mere act of asking for such information is not sufficient to elevate a call centre employee into the role of a product marketer (who actively promotes a product, rather than simply providing information) or a high level intermediary (who advises on the suitability of product) as the call centre employee may require such information prior to passing on the requested information on the product.

93. Information only intermediaries may be subject to legislative standards including conduct and disclosure standards as well as discipline and dispute resolution and any other matters which submitters raise. These obligations are discussed at paragraph 126 and beyond.

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[30] Section 2 Investment Advisers (Disclosure) Act
[31] This will be addressed in the Review of Financial Products and Providers, refer paragraph 324

94. Ministry officials are interested in your views on this identified class of intermediary.

Questions:

Q17 Does the category of "information only" financial intermediary present a realistic division in the types of New Zealand intermediaries?

Q18 Is there any information only intermediary who is not an employee? If so, can you please provide an example of how such an intermediary operates, and how they contact / are in contact with members of the public?

Q19 Do you agree or disagree with the assumptions at paragraph 90 about information only intermediaries?

Financial intermediaries who give financial advice: Product marketer

95. The next Taskforce classification of a financial intermediary who provides advice, is an individual or business who "markets" financial products.

96. The Taskforce suggested that a product marketer could include:

- a property developer marketing investment for non-owner-occupiers in a new apartment development; or
- a superannuation provider promoting the benefits of a work-place superannuation scheme to employees at a work site, but who stop short of advising on the suitability or appropriateness of the product for the consumer.[32]

97. The Ministry suggests that this class of intermediaries would more usually include:

- a call centre employee selling insurance products for one product provider
- a bank customer service officer actively selling a bank or bank related product (such as insurance) to a bank customer

on the basis that a "product marketer" intermediary is a financial intermediary who:

- only advises on and sells a particular financial product or a particular financial product provider's products
- has expertise relating to a particular financial product or a particular financial product provider's products rather than a wide range of financial products and services (as opposed to high level intermediaries); and
- in most cases, is likely to be an employee.

[32] Taskforce report, page 29

Assumptions about product marketers

98. Depending on the final definition of this group, it is assumed that there will be more need to regulate this class of intermediaries, than "information only" intermediaries, on the basis that:

    - Providing information on a product for the main purpose of selling that product, as opposed to simply providing information about a product, increases the reliance that a consumer will put on the intermediary selling the right product, and, because of that reliance, increases the risk that a consumer may suffer loss.

    - This risk however can be managed - product marketers may be required to issue a disclaimer noting that they only sell for a particular financial product or a particular financial product provider's products (see paragraph 182).

    - Like information only intermediaries, product marketers are generally employed by large organisations, and the employer will have responsibilities for employee actions. It has been suggested that some product marketers may be employed by financial providers as contractors, which may reduce any potential liability for the financial provider.

99. The Taskforce suggested that product marketers would not have to be registered as financial intermediaries, belong to approved professional body or adhere to approved professional body rules. Consumers are expected to decide whether or not a recommended product is appropriate for them themselves.

100. It is probable that these intermediaries will seek and record some information from a member of the public. For example, if a member of the public asks a bank customer service officer for information about mortgage rates applicable to that person, it is reasonable to expect the officer to review the existing accounts of the customer, or to seek personal information from the consumer, i.e. age, date of birth, sex, income etc.

101. The mere act of asking for such information is not sufficient to elevate an officer into the role of a high level intermediary (who advises of suitability of product) as the officer may require that information to consider whether or not that product can be offered to that customer, or to advise the customer of the terms and conditions applicable to the purchase of that financial product. This is different from advising on whether the product is appropriate for that customer, as there is still the assumption that the client will decide the suitability of the product themselves.

Possible way to distinguish product marketers

102. Ministry officials appreciate that it may be difficult to work out when an intermediary is marketing or promoting a product, and when an intermediary is recommending a product based on the customer's personal circumstances (see paragraph 108 for information on "high level intermediaries").

103. One possible way to clearly distinguish between product marketers and high level intermediaries could be on the basis of range of products sold.

104. For example:

- a product marketer could be defined as an intermediary who provides advice on a particular financial product or a particular financial product provider's products. An additional protection may be that they are required to be an employee of the provider;

- alternately, a product marketer could be defined as an intermediary who provides advice on certain products, for example, short tail insurance. It is possible that advice on some insurance products may be exempted from their regulation. Another way to keep regulation at the appropriate cost level may be to place lower obligations on intermediaries who advise on such products, by referring to them all as "product marketers."

105. It has been suggested to Ministry officials that employees in call centres in New Zealand currently sell products like general insurance (i.e. car, home etc) based on a "needs assessment". Under this example, a product marketer could take personal information from a consumer by way of a needs analysis to sell a product, and then pass the consumer through to a high level financial intermediary for queries on more complex products.

106. Ministry officials do not intend that call centre employees who are actively promoting a product should fall under the highest level of regulation simply because they take personal information from a member of the public by carrying out a simple "needs" assessment. To avoid this, it could be that financial intermediaries who give financial advice about a certain product such as general insurance expressly fall under the definition of "product marketer" while intermediaries who give advice about more complex products are automatically high level intermediaries.

Obligations on product marketers

107. Product marketer intermediaries may be subject to legislative standards including conduct and disclosure standards as well as discipline and dispute resolution and any other matters which submitters raise. These obligations are discussed at paragraph 126 and beyond.

Questions

Q20 Does the category of "product marketer" financial intermediary represent a realistic division in the types of New Zealand intermediaries?

Q21 Is there a product marketer who is not an employee? If so, can you please provide an example of how such an intermediary operates, and how they contact / are in contact with members of the public?

Q22 Do you think that financial intermediaries who give advice about less complex products (such as (e.g.) car insurance, house and contents insurance) should be automatically subject to lower levels of regulation than intermediaries who give advice on and sell more complex products (such as (e.g.) life insurance)?

Q23 Do you agree or disagree with the assumptions about product marketer

intermediaries?

Financial intermediaries who give financial advice: High level

108. The Taskforce referred to the highest level of intermediary as a "personal financial adviser". Ministry officials consider that a range of intermediaries will fall under this category, including some intermediaries who do not classify themselves as "advisers". To avoid this, this discussion document will refer to a "high level intermediary" where the Taskforce referred to a "personal financial adviser".

109. A high level intermediary is an individual or a business who advises a member of the public on the suitability or appropriateness of financial advice or financial product to the individual circumstances of that member of the public. This is more than simply discussing a range of products which may all be fit for purpose; rather, this intermediary provides professional financial advice to consumers.

110. High level intermediaries take into account the needs of the client before providing advice. There are two aspects to this role:

- Quality – that a member of the public can rely on an intermediary having sufficient skill and experience to provide the advice or service; and

- Independence – that a member of the public can rely on an intermediary considering a range of options before making a recommendation – not just endorsing one particular financial product or a particular financial product provider's products.

Obligations on high level intermediaries

111. High level intermediaries are expected to provide the highest level of service, with the most reliance being placed on them by members of the public.

112. Depending on the final definition of this group, it is assumed that there will be the most need to regulate this class of intermediaries on the basis that:

- Members of the public are likely to treat and rely on recommendations received from high level intermediaries as detailed specialised advice as the advice is expected to apply to their personal circumstances, and hence, consumers will be at a increased risk of suffering loss if the advice is misleading, or not of good quality;

- Such intermediaries are less likely than information only or product marketer intermediaries to be employed by large organisations, which means that:

    - there is lower standardisation across employers; and

    - there is also less protection offered by employers being liable for actions of an employee, or by employers keen to protect their brand.

113. The Taskforce suggested that high level intermediaries would have to be registered on a public register as financial intermediaries, belong to approved professional body

and adhere to approved professional body rules. These obligations would be set down in statute.

114. Other obligations which could be set down in statute include obligations relating to

- conduct including:
  - i. belonging to an approved professional body
  - ii. meeting the initial entry level competency and conduct standards set by the approved professional body
  - iii. maintaining these competency and conduct standards
  - iv. reporting to the approved professional body on how they are maintaining their competency and conduct standards.
- money handling
- disclosure
- discipline
- dispute resolution
- any other matters which submitters raise (these obligations are discussed at paragraph 126 and beyond).

115. High level intermediaries will be subject to the highest level of obligation to address the greater risk posed to consumers by incompetent, unethical or unprofessional advice that is presented as being fit to the circumstances of the client. This does not mean, of course, that regulation will protect members of the public from investment risk, or that it is possible to have a zero risk environment. Consumers will still be responsible for their decisions – it's just that advisers who give inappropriate, unethical or negligent advice will find it harder to practise.

Questions

Q24 Does the category of "high level" financial intermediary represent a realistic division in the types of New Zealand intermediaries?

Q25 Do you agree or disagree with the assumptions made about high level intermediary intermediaries?

"Execution only" intermediaries

116. Ministry officials are considering whether to not there should also be a further category of financial intermediary which would include those intermediaries who do not provide advice, but who receive money or property from member of the public for the purpose of buying or selling financial products, in other words, those intermediaries who are providing transaction services.

117. The Taskforce referred to this class of intermediaries as “execution only” intermediaries. An example of an “execution only” intermediary is a broker arranging a share transfer for a client.

118. Ministry officials are considering placing separate obligations on these “execution only” intermediaries on the basis that:

- Intermediaries who carry out transactions behave differently to those who provide advice – for example, it would be appropriate for the execution only intermediary to be subject to money handling requirements, but maybe not the information only intermediary.

- Execution only intermediaries do not have to provide financial advice. The Ministry doesn’t want to provide a loop hole by making all financial intermediary legislation dependent upon the giving of financial advice.

- Execution only intermediaries are also likely to need to be subject to “fit and proper” requirements as regulated by the Financial Action Task Force (FATF) which are aimed at ensuring that brokers meet certain positive standards before they can deal with client money and property to help counter risks of money laundering and terrorist financing.

(Refer to paragraph 149 for discussion on obligations on “execution only” intermediaries).

119. The split between those intermediaries who provide “financial advice”, and those who execute transactions is not new - in the Investment Advisers (Disclosure) Act, investment advisers and investment brokers have separate obligations as the money handling disclosure requirements only apply to investment brokers.

120. There will be overlap in practice between the two types of roles, so, where an “execution only” intermediary does provides financial advice, then, depending on the type of advice given, that intermediary will also be subject to the obligations attaching to the information only, product marketer or high level intermediary, just as an investment broker has to comply with investment adviser obligation under the Investment Advisers (Disclosure) Act when that broker is acting as an investment adviser.

Questions

Q26 Do you think that there should be a separate category of financial intermediary to include “execution only” intermediaries (that is those intermediaries who provide transaction services without providing advice)?

Q27 Does the category of “execution only” financial intermediary represent a realistic division in the types of New Zealand intermediaries? If not where should these intermediaries fit?

Individual or a business

121. It is worth noting that there is no restriction on the legal form that a financial intermediary can take. It may be a natural person, a company, a partnership or

another form; some financial intermediaries may employ or have contractual relationships with other financial intermediaries - a large single entity employer such as a bank may fall under the definition of "financial intermediary" by providing financial advice to members of the public (e.g. through publishing public brochures with advice on financial products) just as its employees and contractors are also likely to be intermediaries because of the advice that they given to members of the public.

122. Obligations under the Investment Advisers (Disclosure) Act already apply equally to individuals and businesses who act as investment advisers.[33] Under the proposed co-regulatory model, there may have to be some differences in obligations on financial intermediaries, depending on whether or not an entity is a business or an individual. This is likely because financial intermediaries will have obligations in addition to disclosure, such as belonging to approved professional bodies,[34] meeting competency standards, conduct standards and being subject to increased disciplinary standards. It may be more difficult for a business to meet a "conduct" standard, or for a business to be made subject to criminal penalties than an intermediary who is a natural person.

123. Officials will consider how to describe the obligations to be placed on financial intermediaries and whether some obligations may be more easily met by natural person financial intermediaries, than by corporate form financial intermediaries.

124. It is possible that businesses themselves could be approved professional bodies, or that approved professional bodies could have a special "corporate" membership with different conduct requirements for businesses.[35] This could address the concerns noted here. It is not the intention that any regulatory arbitrage should result from the design of obligations, or that intermediaries form or disband businesses to avoid the effects of regulation.

125. Ministry officials seek your views on the number of possible high level intermediaries who will be businesses, and also the difficulties that some obligations may pose for certain types of intermediaries.

Question

Q28 Will businesses be high level intermediaries? If so, what processes do businesses use to advise a member of the public on the suitability or appropriateness of financial advice or financial product to the individual circumstances of that member of the public?

Q29 If so, are there any obligations which businesses will find it harder to comply with than individuals practising as high level financial intermediaries?

[33] Refer definition of "*investment adviser*" and "*person*" under s2 of the *Investment Advisers (Disclosure) Act 1996* which includes "*an individual, a corporation, an unincorporated body of persons and an association or combination of individual or corporate or unincorporated bodies.*"
[34] Refer paragraph 114
[35] Refer paragraph 300

8. LEGISLATIVE REQUIREMENTS

126. The proposed legislation on financial intermediaries is likely to place obligations on intermediaries of all classifications in relation to:

    - Conduct (including specific conduct requirements, adhering to approved professional body requirements, money handling); and

    - Disclosure.

127. Ministry officials note that many of these matters are addressed in existing or proposed legislation.

128. While the proposed financial intermediary legislation will apply to all financial intermediaries, it may be that some obligations that exist in other legislation may be sufficient for that particular type of intermediary, so as not to be required in the legislation here.

9. CONDUCT

129. The proposed legislation will set conduct standards for all intermediaries. Conduct standards are rules that an intermediary would have to follow when acting as an intermediary. These conduct standards will address matters such as minimum standards of behaviour and statutory duties of care.

130. Those intermediaries who belong to approved professional bodies will also be subject to conduct standards set by approved professional bodies. These approved professional body standards will not themselves be set in legislation, but high level intermediaries are likely to have a statutory obligation to comply with approved professional body rules.

131. Currently, under tort law, a financial intermediary can have a duty of care in giving of financial advice and may be liable if they breach that duty of care (for example, by negligent misstatement), and loss can be attributed to that breach.

132. There are also a number of different conduct requirements already in New Zealand legislation (e.g. those relating to misleading or deceptive advertising).

Deceptive, misleading or confusing

133. The proposed financial intermediary legislation is likely to require that:

- conduct relating to financial advice is not deceptive, misleading or confusing
- disclosure is not deceptive, misleading or confusing
- advertising is not deceptive, misleading or confusing.

134. These three obligations would apply to all intermediaries – information only, product marketer and high level, on the basis that misleading information at any level can put consumers at risk, and on the basis that the Fair Trading Act 1986 already applies to prevent misleading deceptive and confusing behaviour in those who provide goods and services in trade.[36]

135. This requirement is already present in some existing sector specific legislation, for example, in relation to dealings in securities, section 21 of the Securities Legislation Bill proposes to insert section 13(1) into the *Securities Markets Act 1988*:

> "A person must not engage in conduct, in relation to any dealings in securities, that is misleading or deceptive or likely to mislead or deceive."

136. This is described as a "general dealing misconduct provision" – it is a strict liability offence which only requires loss to be proven. The penalty which can be applied to a breach of this requirement is a compensatory penalty.[37]

137. Other penalties are described further in the Securities Legislation Bill in relation to specific behaviour relating to listed securities. For example, in relation to certain

[36] Fair Trading Act 1986 ss9-12
[37] Refer s21 Securities Legislation Bill which would insert a new s42U into the Securities Markets Act 1988.

insider trading and market manipulation behaviour, a person can be subject to imprisonment.[38]

138. The Ministry proposes that the financial intermediary regime would have the equivalent of a "general dealing misconduct" provision and a statutory duty of care.

139. In this section, the Ministry is keen to seek your views on whether or not proposed legislation should also contain more specific obligations on financial intermediary behaviour, and the type of penalties that failing to meet such behaviour obligations should attract.

Statutory duties in other jurisdictions

140. In Australia, there are a number of "good faith" statutory duties on those holding an Australian financial services licence (being licensed to provide financial advice) including the obligations:

- not to engage in conduct that is, in all the circumstances, unconscionable;[39]
- to accord the instructions of the client priority over other instructions or transactions;[40]
- to ensure advice is appropriate to the client and reasonable in all of the circumstances, having regard to the relevant personal circumstances in relation to giving the advice;[41] and
- warn clients if their advice based on incomplete or inaccurate information.[42]

141. In England, under the *Financial Services and Markets Act 2000*, the Financial Services Authority (FSA) has the power to issue (and has done so) statements of principle and a code of practice on the conduct expected of approved persons (that is, someone who FSA has approved to carry out a certain function).[43]

142. The Statement of Principle requires an approved person to:

- act with integrity in carrying out his controlled function;
- act with due skill, care and diligence in carrying out his controlled function;
- observe proper standards of market conduct in carrying out his controlled function; and

[38] Refer s26 of the Securities Legislation Bill, which proposes to insert a new section 43 into the Securities Markets Act dealing with criminal penalties and offences in relation to insider conduct and market manipulation.
[39] Corporations Act 2001 (Aust.) - s991A
[40] Corporations Act 2001 - s991B
[41] Corporations Act 2001 - s945A
[42] Corporations Act 2001 - s945B
[43] Financial Services and Markets Act 2000 (UK) - s64

- deal with the FSA and with other regulators in an open and cooperative way and disclose appropriately any information of which the FSA would reasonably expect notice.[44]

Options for New Zealand legislation

143. In light of the UK and Australian obligations, and the current tortious obligations that can apply to some financial advisers, the statutory duty of care in the proposed legislation could require high level financial intermediaries to:

    - Exercise reasonable care, diligence and skill[45] - that is, demonstrate the required skill to advise consumers. This could extend to a statutory duty to ensure that the advice is appropriate for that consumer;

    - Warn consumers if they cannot exercise reasonable care, diligence and skill (e.g. where they are acting on incomplete information);

    - Act in accordance with the Act;

    - Act with integrity; and

    - Act in the best interests of the client. [46]

144. The Ministry notes that some financial intermediaries already have duties which may conflict, for example, in some situations, insurance intermediaries are deemed to be acting as agent for an insurer in relation to premium received, and hence could not always act in the best interests of the client, where that clashed with the best interests of the insurer.[47]

Additional obligations on high level intermediaries

145. In addition to statutory duties of care, high level intermediaries could also have a statutory obligation to:

    - Belong to an approved professional body;

    - Adhere to approved professional body standards; and

    - Provide information to an approved professional body for the purposes of registration.

146. These requirements may be necessary to ensure that a breach of an approved professional body rule has some effect.

Professional indemnity insurance

[44] Refer to the FSA Handbook at www.fsa.gov.uk
[45] Compare s137 Companies Act 1993 for similar duties owed by directors
[46] Compare s131 Companies Act 1993 for similar duties owed by directors
[47] Refer to the *Insurance Intermediaries Act 1994*

147. There is the power under the Securities Legislation Bill for regulations to require investment advisers to have a minimum level of professional indemnity insurance, and prescribe that amount, or give an undertaking that the adviser has adequate professional indemnity insurance for the protection of the person to whom the adviser gives investment advice.[48]

148. Ministry officials already have considerable information on this matter through submissions received under the Securities Legislation Bill Regulations discussion document on whether such regulations were required. Ministry officials will not address this matter in this document.

Questions

Q30 In addition to a general strict liability provision requiring intermediaries not to engage in conduct that is misleading or deceptive or likely to mislead or deceive, would it be useful to have additional specific prohibitions on financial intermediary conduct?

Q31 Do you agree with the possible statutory duties listed at paragraph 143 above?

Q32 Should any of the additional duties apply to all intermediaries, or just high level intermediaries? Why?

Q33 What would be the costs and benefit of imposing such duties?

Q34 And, what type of penalties should attach for breach of the duties listed at paragraph 143 above? For example, should there be criminal penalties?

Obligations on execution only / transaction intermediaries

149. There are likely to be increased obligations on those financial intermediaries who handle money. This is to:

    a. Ensure that intermediaries are accountable to clients for how their money and property is handled; and

    b. Counter risks of money laundering and terrorist financing.

Money handling

150. The Taskforce suggested that there is an absence of transparency in many cases around the status of money held by an intermediary on behalf of a consumer (for example, whether those funds are held on trust for the consumer). The Task Force endorsed the requirement under the Securities Legislation Bill to disclose whether or not the money or property received by a broker is held on trust and proposed that, as

[48] New section 49C Securities Markets Act 1988, proposed to be amended by the Securities Legislation Bill

a general rule, client funds should be required to be held on trust in an account which is separate from the intermediary's.[49]

151. Currently under the Securities Legislation Bill, investment brokers have certain obligations to disclose to members of the public how they deal with investment money or investment property.[50] In addition, the NZX Participant Rules require market participants to hold client funds on trust at all times, and to protect those funds from the date of receipt.[51]

152. The proposed financial intermediary legislation could apply money handling requirements to all financial intermediaries who will hold money or property if these terms were defined by reference to the new "financial product" definition above, rather than simply to securities.

153. This could require any intermediary who receives money or property in relation to the buying, selling of financial products to meet trust account and reporting standards, which could include:

- Holding that money or property on trust for the client in a separate trust account with (e.g.) a registered bank;
- To describe that account as a trust account;
- Not using funds in the account as security for any entity other than the client;
- Accounting to the client for that money (including disclosing to the client that the money is held on trust);
- Keeping a record of the transactions on that account; and
- Not using that account for the intermediaries' own funds.

154. Ministry officials note that there may have to be separate reporting for trust accounting, as not all intermediaries who handle client money will be subject to monitoring by the approved professional body, as only those high level intermediaries are required to be approved professional body members.

"Fit and proper" person requirements

155. New Zealand has signed up to the Financial Action Task Force (FATF) 40 Recommendations on combating money laundering and the financing of terrorism. These recommendations apply to "financial providers" which includes those intermediaries who handle client monies.

156. Execution only intermediaries could be subject to positive regulation, which means that they could only handle or receive client money or property if they first meet certain further "fit and proper" requirements.

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[49] Taskforce report page 27

[50] S21 Securities Legislation Bill with a proposed s S41J for the *Securities Markets Act 1988*. Investment money is that money received from a member of the public in relation to acquiring or disposing of securities, while investment property is security certificates or other valuable property received from a member of the public in relation to acquiring or disposing of securities (S20 Securities Legislation Bill).

[51] NZX Participant Rules, 14.5

157. These are likely to contain requirements that an execution only intermediary has not breached relevant financial prohibitions, (for example, prohibitions against fraud, insider trading, etc) and that the intermediary has not been convicted of certain criminal offences, been made bankrupt or been banned from being a director or manager of a company, within a defined period of time.

Questions:

Q35 What types of intermediaries, in addition to investment brokers, would receive money and property from members of the public?

Q36 Should these intermediaries be subject to money handling legislative requirements?

Q37 Which types of intermediaries hold trust accounts now? Are there some sectors of financial intermediaries which use a trust account more than another sector?

Q38 Are the requirements listed at paragraph 153 appropriate for those who hold client money?

Q39 What would be the cost and benefit of applying these obligations to intermediaries who receive money and property from members of the public?

Q40 Who would be responsible for monitoring these trust accounts?

10. DISCLOSURE

158. Legislation will also place disclosure obligations on intermediaries. These disclosure obligations are likely to extend to all classes of intermediaries.

159. Disclosure is a useful tool to addressing information asymmetries in the market, but there are limits to disclosure's usefulness if it results in cumbersome documents that do not inspire consumers to actually read the information. Officials are aware of the number of submissions to the Taskforce and the subsequent discussion document on the Securities Legislation Bill Regulations which sought simpler and lower cost disclosure obligations.

160. This section discusses the type of disclosure obligations, and seeks input on how to balance the costs and benefits of providing such disclosure so that the regime addresses the information asymmetries about the intermediaries themselves.

Disclosure obligations on investment advisers and brokers

161. Under the Securities Legislation Bill, prior to giving advice, investment advisers will be required to disclose:

- information on their qualifications and experience;
- whether they are a member of a professional body;
- whether they have professional indemnity insurance;
- whether there are dispute resolution facilities available;
- any past criminal convictions;
- the nature and level of the fee, as well as any relevant remuneration (including the amount or rate, and the name of the person from whom remuneration will be received, whether the adviser is an associated person or has a relationship with anyone connected with the investment, or someone who may influence the provision/content of investment advice); and
- details of securities about which advice is given.[52]

162. Investment brokers are required to disclose criminal convictions, and procedures for dealing with money (in addition to investment adviser disclosure, when they are also "investment advisers").[53]

163. At the date of the release of this discussion document, Ministry officials are reviewing submissions on the form and method of these disclosure obligations, and whether there should be additional disclosure obligations on financial intermediaries. Work on these submissions will be incorporated into work on disclosure in relation to financial intermediaries. Further submissions are not required on the proposals under the Securities Legislation Bill regulations.

[52] Ss 41C – 41G Securities Legislation Bill
[53] Ss 41H – 41J Securities Legislation Bill

Taskforce recommendations

164. The Taskforce recommended that there should be enhanced disclosure obligations for financial intermediaries. This is on the basis that disclosure will assist a consumer is making an informed assessment on the suitability of an intermediary, and matters that may affect the appropriateness and quality of the advice. Effective disclosure can help investors to compare intermediaries. Most submitters agreed, concluding that disclosure should be consumer focussed, well timed, proportionate and monitored.[54]

165. The Taskforce recommendations are attached at Annex Two.

Disclosure obligations on information only intermediaries

166. The Taskforce suggested that information only intermediaries should disclose:

- The nature and level of fee that they receive for giving advice; and
- Remuneration options (if any).

167. These intermediaries have few disclosure obligations as there is a small risk that consumers will rely on these intermediaries heavily in making investment decisions and it is easier to manage the risks as most information only intermediaries are employed by businesses, which themselves are financial intermediaries.

168. However, it is noted that as these intermediaries are not members of approved professional bodies, all obligations must be placed on these intermediaries by way of statute.

169. Ministry officials wish to seek views on the suggested disclosure requirements, and whether there are any other disclosure obligations which may be appropriate for an information only intermediary to have to provide to members of the public, for example:

- Should an intermediary have to tell a member of the public about dispute resolution facilities? If not, is there another place from where that member of the public would get this information?
- Does a member of the public need to know about an information only intermediary's fees or bonus system?

170. Ministry officials are keen to hear your views on whether you agree that information only intermediaries should have to make these (or any) disclosures, and the costs and benefits of these disclosure obligations as attached to the different classes.

[54] Taskforce report, page 38

Questions:

Q41 Do you agree with the disclosure obligations for information only intermediaries listed at paragraph 166?

Q42 Do information only intermediaries receive commissions, bonuses, fees or remuneration which is in addition to salary or wages?

Q43 What information should a member of the public be required to be told about an information only intermediary?

Q44 What would be the cost of requiring information only intermediaries to disclose this information? Does the benefit to consumers of receiving this information outweigh the cost?

Disclosure obligations on execution only intermediaries

171. The Taskforce suggested that, in addition to meeting the disclosure obligations placed on "information only" intermediaries,[55] "execution only" intermediaries should also have disclosure obligations in relation to:

- dispute resolution;
- previous convictions, previous bankruptcies, certain prohibitions and Court findings; and
- fees, including fees on switching products.

172. In relation to disclosure on previous convictions etc, under the FATF requirements (discussed at paragraph 155), execution only intermediaries can only handle money if they do not have any such previous convictions. In other words, there could be a positive requirement that intermediaries have to be "fit and proper" before they can handle money – which means that there would be nothing to disclose, as consumers could rely on these requirements to ensure that the intermediary was acting appropriately.

173. Ministry officials also seek your views on whether fees on switching products would be included in the general information on remuneration that a broker would be required to provide.

174. Currently, investment brokers are required to disclose the following prior to receiving investment money[56] or investment property:[57]

- how payment or delivery of money or delivery of property should be made to the broker;

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55 At paragraph 166

56 Investment money is money received from or on account of a member of the public in relation to acquiring or disposing of securities – *Investment Advisers (Disclosure) Act 1996*, s2

57 Investment property is security certificates or other valuable property received from or on account of a member of the public in relation to acquiring or disposing of securities – *Investment Advisers (Disclosure) Act 1996*, s2

- whether or not the money or property received by the broker will be held on trust for the investor, and will be so held until it is disbursed or distributed in accordance with the investor's instructions;

- what records will be kept by the broker in relation to the money or property, whether the investor has access to those records, and the terms of that access;

- whether or not the receipt, holding, and disbursement of the money and the receipt, holding, and distribution of the property, by the broker will be audited by an auditor and, if so, the name of the auditor; and

- the extent, if any, to which the broker can use the money or property for the benefit of the broker or any other person (as well as any other information that must be disclosed under regulations to be made under the Securities Markets Act, to be amended by the Securities Legislation Bill).

175. Ministry officials consider that the current investment broker requirements could extend to all financial intermediaries who act as brokers in relation to financial products. This would mean that any intermediary who receives money or property in relation to the buying, selling of financial products would be subject to these disclosure obligations.

Questions:

Q45 Should "execution only" intermediaries have to make disclosure listed in paragraph 174? Particularly, should fees on switching products be included in the general information on remuneration that a broker would be required to disclosure?

Q46 If not, why not, and which obligations would you remove or add?

Q47 If you agree that execution only intermediaries should have to make these disclosures, what are the costs and benefits of these disclosure obligations?

Disclosure obligations on product marketer intermediaries

176. The Taskforce suggested that product marketer intermediaries should disclose:

- Whether dispute resolution facilities are available;

- In the previous five years before the service is provided:

    - relevant convictions;

    - whether the adviser has been adjudicated bankrupt;

    - prohibitions from managing a company or business;

    - any successful court action taken against the financial intermediary in the intermediary's professional or business capacity; and

- whether the intermediary has been expelled from or prohibited from being a member of a professional body.

- Where advice or marketing relates to switching products, disclosure of remuneration to the intermediary, the cost to the client (for example, exit fees, entry fees and implementation fees), and the benefits of the alternative as against the existing product.

- Details of the types of products about which the intermediary gives advice or markets and, if the intermediary only advises or markets in relation to products of a particular product generator or generators, a statement to that effect and the name of each of those product generators.

- Disclosure in dollar terms, on a periodic basis, of the difference between the aggregate gross returns on all investments organised though the financial intermediary, and the actual net return received by the consumer, with an explanation of the difference.

- To the extent practicable, total benefits to the intermediary of the consumer's business (including "soft dollar" benefits) where those benefits are not already disclosed as part of the actual gross and net gross return disclosure above.

- The role being undertaken by the intermediary, including a statement as to whose interests the intermediary is acting in and a description of those interests, and for product marketers, a "health warning" about the limitations in the information provided (for example, "I have not considered your personal circumstances, and accordingly, the product may not suit your needs").[58]

177. The Ministry is most interested in the costs and benefits that this disclosure will provide, as it is the intention that disclosure is consumer focussed, well timed, proportionate and monitored.

178. When thinking about this disclosure, it may help to consider what you would expect a product marketer to disclose (e.g.) should a call centre employee selling general insurance products disclose this information? Should a property developer marketing investment for non-owner-occupiers in a new apartment development disclose this information?[59]

179. The Ministry is receiving and reviewing feedback on these disclosure obligations in relation to the Securities Legislation Bill discussion document on investment adviser and investment broker disclosure, which asked submitters for their views on these disclosure obligations.

180. If you have not submitted on these disclosure requirements, please comment on the cost and benefits posed by these suggestions. If you have already submitted, please note that Ministry officials are reviewing your submissions.

[58] See paragraph 182
[59] See paragraphs 96 and 97

"Health warning"

181. To address the risk that some consumers may treat product marketers as providing a higher level of advice than anticipated, officials seek views on whether or not it is appropriate to have product marketers provide a health warning.

182. Health warnings may take the form of a statement to consumers noting that the product marketer is providing advice on a product from a particular provider, and that a consumer may wish to seek independent financial advice, or to consider options themselves.

183. Ministry officials are keen to hear your views on whether you agree that product marketer intermediaries should have to make this disclosure.

Questions:

[Earlier submissions on the Securities Legislation Bill Regulations discussion document are being reviewed by Ministry officials and do not have to be repeated here.]

Q48 Should product marketer intermediaries have to make the disclosure listed in paragraph 176? What are the costs and benefits to this?

Q49 Should product marketers provide a statement to consumers which explains that consumers are not receiving advice from a high level intermediary? If so, what information should be in such a statement? What are the costs and benefits of providing this statement?

Disclosure obligations on high level intermediaries

184. The Taskforce suggested that, in addition to those obligations placed on product marketer intermediaries,[60] high level intermediaries should disclose:

- Experience;
- Qualifications;
- Membership of professional bodies; and
- Nature and scope of any professional indemnity insurance.

185. Some of these requirements will be imposed on an investment advisers under the Securities Legislation Bill and are discussed in paragraph 161. Other requirements were recommended by the Task Force, these are contained in Annex Two.

186. These additional disclosure obligations reflect the higher quality advice that high level intermediary are expected to provide – consumers should be able to rely on intermediaries to be professional. It is assumed that intermediaries who have

[60] At paragraph 176

experience and qualifications will be better advisers than those who do not have appropriate experience and qualification.

187. Ministry officials are keen to hear your views on whether you agree that high level intermediaries should have to make these disclosures, and the cost and benefit of these disclosure obligations

Questions:

Q50 Should high level intermediaries have to make additional disclosure listed in paragraph 184?

Q51 If not, which why not, and which obligations would you remove?

Q52 If you agree that high level intermediaries should have to make these disclosures, what are the costs and benefits of these disclosure obligations?

Timing of disclosure

188. In most cases, officials have assumed that disclosure would be required to be made by intermediaries prior to providing the advice or the service.

189. The timing of disclosure was raised in the Securities Legislation Bill Regulations discussion document, where submitters noted that it may be difficult to provide complete remuneration information prior to the advice being given, and that it may be more appropriate for some disclosure to be made within 5 days of providing the advice or service. Earlier submissions on the Securities Legislation Bill Regulations discussion document will be considered by the Ministry. This is also being considered in relation to current work on the Supplementary Order paper under the Securities Legislation Bill.

Sector specific disclosure

190. We note that there may it appropriate to have be some additional or replacement specific disclosure obligations, which may be based on separate sectors of industry, or the type of the intermediary. For example, investment advisers and brokers have special obligations through the Investment Advisers (Disclosure) Act.

191. Ministry officials are considering consultation with targeted groups such as those financial planners who are not “investment advisers” and mortgage brokers to ensure that any required sector specific disclosure obligations / exclusions are considered.

192. As part of the Review of Financial Products and Providers, the Ministry is also considering the role and responsibility of insurance intermediaries towards product providers and the client and some more specific questions on insurance intermediary disclosure will be asked in the context of that review.

193. Ministry officials are interested in hearing your views on any specific disclosure obligations.

Questions:

Q53 Is there any sector which should have special disclosure obligations?

Q54 If so, which obligations, and to which sector? And what would be the costs and benefits of having different disclosure obligations?

11. THE CO-REGULATORY MODEL

194. Legislation will also set in statute the co-regulatory framework, by setting the objectives of the co-regulatory model, and by defining the roles of the approved professional bodies, the Securities Commission and the Minister.

195. Cabinet agreed to the co-regulatory framework because:

- approved professional bodies have the industry knowledge, experience, reputation and incentive to monitor sector effectively and to act as a frontline regulator; and
- the Securities Commission already has a key role in monitoring the market and will ensure appropriate checks and balances for approved professional bodies.

196. The suggested objective of the co-regulatory model is:

- a relationship which recognises that:
  - approved professional bodies have the industry knowledge and experience and reputational incentives to effectively design the rules that govern their sector and to act as the front-line supervisor; and
  - that the Securities Commission will monitor the market and approved professional bodies to ensure there is public accountability and the objectives of the legislation are being met.

197. This objective, as well as the objectives for the regulation of financial intermediaries,[61] will assist approved professional bodies, Securities Commission and the Minister to achieve clarity about their respective responsibilities and roles.

198. The co-regulatory model also requires approved professional bodies and the Securities Commission to have sufficient resources to carry out their functions and to have sufficient time to create good working relationships.

199. Legislation will create and set the roles and responsibilities for approved professional bodies, the Securities Commission and the Minister.

200. Clear role descriptions in legislation will help address possible tensions between the views of industry and the Minister and the Securities Commission, particularly the risks that:

- the Securities Commission is seen as "second guessing" approved professional body administrative decisions, or placing high standards on industry
- that public regulatory oversight may be limited to "rubber stamping" or
- that the structure implies a higher level of government assurance than is actually delivered.

[61] At paragraph 13

12. POWERS OF THE SECURITIES COMMISSION AND THE MINISTER

201. Legislation will set the powers of the Securities Commission and the Minister.

202. The Securities Commission has the role of market oversight regulator, required to balance the enhanced role of the industry-based approved professional bodies by monitoring industry activity, approving industry-developed rules, and stepping in where it considers that the industry has not effectively regulated itself. The Securities Commission needs powers to:

- monitor and enforce statutory obligations on financial intermediaries
- carry out its proposed role under co-regulatory model

203. The Minister will make final decisions on the basis of recommendations provided by the Securities Commission.

Monitoring and enforcing statutory obligations on financial intermediaries

204. Under the legislation, financial intermediaries are likely to have to meet statutory standards, and be subject to offences if they fail to comply with the statutory standards. In addition, high level intermediaries will be obliged to meet the approved professional body rules, which will be backed by statute.[62]

205. To monitor and enforce intermediary obligations, the Taskforce had originally suggested that there would be a separate disciplinary body.

206. Ministry officials suggest that to avoid additional costs and the need to set up another financial sector regulator, the role of the disciplinary body could be carried out by the approved professional body (perhaps an independent board of the approved professional body) for low level breaches of approved professional body rules and the Securities Commission for breaches of the statutory standards and high-level breaches of approved professional body rules.

207. This section deals with discipline for breaches of statutory standards. The role of the Securities Commission and the approved professional body in relation to non-statutory breaches is discussed at paragraph 279.

208. The table below sets down the circumstances for breach of statutory standards, and the suggested roles and responsibilities. To explain the table:

- It would be the responsibility of approved professional bodies to pass to the Securities Commission complaints from consumers and other intermediaries regarding any allegations of breaches of the statutory standards for members, and any breaches that the approved professional body itself becomes aware of;

[62] See paragraph 234

- The Securities Commission would rely on approved professional body reporting mechanisms to provide it with information regarding breaches of statutory standards by financial intermediaries;

- Any of the Commission's decisions could be judicially reviewed. The Commission would be able to apply to Court for all of the Court orders. Other appropriate people will also be able to apply to the Court for orders, this may include approved professional bodies, as well as other aggrieved parties;

- Not all approved professional body decisions could be appealed to the Securities Commission, on the basis that this could involve considerable cost and time. Instead, it is suggested that only those approved professional body decisions which reach a certain threshold (e.g.) resulting in an approved professional body instructing an intermediary to make certain disclosures, or correct certain behaviour, that could be appealed to the Securities Commission.

209. The Securities Commission could have the ability to make any, all or none of the following orders:

- Prohibition orders – which may prohibit or restrict intermediaries making or distributing statements or information;

- Correctives orders – which may require an intermediary to publish or distributing statements or information;

- Disclosure orders – which may require an intermediary to disclose certain information; and

- Temporary banning orders – which can restrict an intermediary from acting as an intermediary temporarily.

210. Courts could have the power to impose injunctions, corrective powers, disclosure orders. The Securities Legislation Bill has these remedies as well as the following remedies:

- Civil remedy order – under which an intermediary has to pay a set amount to an entitled person (being someone who had received advice or services from the intermediary);

- Imposing criminal penalties (if an intermediary fails to comply with statutory obligations or Securities Commission orders); and

- Permanent banning orders – which can prevent an adviser from acting as an adviser for up to ten years.[63]

Circumstance	Offence	Approved Professional Body responsibility	Securities Commission responsibility	Court
A person acts as a high level	Breach of statutory	If approved professional body	Investigating the matter when it is brought to the attention	Hearing applications from

[63] Refer s21 of the Securities Legislation Bill, proposing to insert a new section 43K into the *Securities Markets Act 1988*

Circumstance	Offence	Approved Professional Body responsibility	Securities Commission responsibility	Court
intermediary without belonging to an approved professional body	obligation for high level intermediaries to belong to an approved professional body	becomes aware, notifying Securities Commission.	of the Securities Commission. Considering whether or not to carry out disciplinary action. Carrying out disciplinary action, options inc: * Prohibition order * Temporary banning order * Corrective or Disclosure order * Applying to Court for an injunction, permanent banning order, or civil remedy.	the Securities Commission / approved professional body/other to: * grant injunctions * issue corrective or disclosure orders *grant civil remedy *issue criminal penalty *Permanent Banning Order Carrying out judicial review of the Securities Commission decisions.
An intermediary does not comply with a statutory disclosure obligation or other conduct obligations	Breach of statutory obligation.	If approved professional body becomes aware, notifying Securities Commission.	Investigating the matter when it is brought to the attention of the Securities Commission. Considering whether or not to carry out disciplinary action. Carrying out disciplinary action, options inc: * Prohibition or corrective orders * Disclosure order * Temporary banning order * Applying to Court for an injunction, permanent banning order, or civil remedy.	[See above]
A high level intermediary breaches an approved professional body rule.	Breach of approved professional body rules.	Investigating the matter when it is brought to the attention of the approved professional body.	No action, unless the conduct breaches the threshold limit set in the approved professional body rules If approached by the	[See above]

Circumstance	Offence	Approved Professional Body responsibility	Securities Commission responsibility	Court
	Breach of statutory obligation to comply with rules of an approved professional body	Considering whether or not this matter should be considered by the approved professional body or the Securities Commission, considering the threshold limit set in the approved professional body rules in relation to whether the breach is either sufficiently serious or sufficiently repetitive to put the reputation of the market at risk. Considering whether or not to carry out disciplinary action. Carrying out disciplinary action which could include: * Prohibition or corrective orders * Disclosure order	approved professional body, investigating the matter. Considering whether or not to carry out disciplinary action. Carrying out disciplinary action, options inc: * Prohibition or corrective orders * Disclosure order * Temporary banning order * Applying to Court for an injunction, permanent banning order, or civil remedy. If approached by the financial intermediary after the approved professional body has made a decision: * hearing the appeal, provided that the matter can be appealed to the Securities Commission.	

211. Ministry officials are keen to hear your views on the suggested sharing of responsibilities in relation to breaches of statutory standards.

Questions:

Q55 Do you agree with the table setting down responsibilities in relation to discipline of intermediary for breaching statutory standards?

Q56 Is there a better model for disciplining intermediaries? If so, please provide details.

Securities Commission's proposed role under co-regulatory model

212. The Securities Commission will require specific powers to carry out its role under the co-regulatory model.

213. It is proposed that the Securities Commission will be responsible for:

- considering and providing recommendations on whether approved professional bodies meet the entry requirements and functions required of approved professional bodies and whether the rules of the body are consistent with the objectives of the Act;

- providing recommendations to any changes to the rules of an approved professional body to the Minister about whether any amendments to the rules are consistent with the objectives of the Act;

- providing recommendations to approved professional bodies and the Minister and (possibly) directions to an approved professional body that an approved professional body may need to make changes to its rules or functions if the approved professional body fails to meet the objectives of the Act through its rules, the exercise of its rules, or performance of its functions; and

- recommending removal of an approved professional body if it fails to meet the objectives and functions of the Act, its breaches are serious and it has failed to make changes as a result of directions from the Commission.

(The exact process for applying to be an approved professional body is discussed at detail at paragraph 302 and beyond).

Powers of the Minister

214. The Minister will be responsible for:

- considering whether an approved professional body meets the entry standards, functions and objectives of the Act and approving or rejecting the approved professional body;

- approving changes to an approved professional body's rules;

- removing an approved professional body if its breaches are serious, if it fails to meet the requirements of the Act and the objectives of the Act, and it has failed to make changes as a result of directions from the Commission;

- considering the recommendations of the Securities Commission; and

- directing amendments to approved professional bodies.

215. The obligation to consider the recommendations of the Securities Commission will be in statute. Ministry officials are keen to hear your views on the Minister's powers.

216. Ministry officials have prepared the following table as a possible illustration of the different roles of the approved professional bodies and the Securities Commission under certain circumstances.

Circumstance	Offence	Approved Professional Body responsibility	Securities Commission responsibility	Ministerial responsibility
An approved professional body breaches its statutory obligations or administration of its rules	Breach of statutory obligations	Reporting any breach to the Securities Commission Working to remedy the breach	To act in accordance with the objectives of the Act. Working with the approved professional body to discuss the matter (Possibly) to issue directions to correct breach If breach is not remedied, is serious, and regime is not meeting statutory objectives, can recommend to the Minister that an approved professional body is removed.	Considering the recommendation of the Securities Commission Considering the objectives of the Act and the co-regulatory model, whether breach is serious and whether all other action has been undertaken by the Commission and failed. Deciding whether or not to de-register the approved professional body.
An approved professional body's rules are no longer appropriate for market conditions or are deficient in some way	Not meeting the objectives of the Act	To act in accordance with the objectives of the Act. Discuss the matter with the Securities Commission	To act in accordance with the objectives of the Act. Working with the approved professional body to discuss the issue identified with the rules and why the rules no longer meet the objectives of the Act. (Possibly) to issue directions for approved professional body to consider rules Passing a recommendation as to whether or not a approved professional body is de-registered	Considering the recommendation of the Securities Commission Considering the objectives of the Act and the co-regulatory model Deciding whether or not to de-register the approved professional body

Questions

Q57 Are there any powers which the Securities Commission will require which are not listed above?

Q58 Are there any powers which the Minister will require which are not listed above?

Q59 Is there a better model of responsibilities than the table which details the responsibilities of the Securities Commission and the Minister? If so, please provide details.

13. POWERS OF AN APPROVED PROFESSIONAL BODY

217. An approved professional body is the industry voice in the co-regulatory model. The approved professional body uses its expertise to come up with industry-set standards.

218. The approved professional body provides an initial point of contact for intermediaries – and will act as the frontline supervisor. The Securities Commission then has the responsibility to apply the objectives of the Act and the co-regulatory model to balance the industry perspective (this could include considering whether or not standards act as barriers to entry, or whether standards are too low, when compared to other approved professional bodies). Approved professional bodies and the Securities Commission will share responsibility for administering the regime and for achieving the objectives of the legislation.

219. An approved professional body represents a range of similar intermediaries. The similarity can be due to industry sector or practices (which may be independent of industry or similar across a range of industries). Approved professional bodies don't have to replace self regulatory organisations - it's just that membership of an approved professional body will be mandatory for all high level financial intermediaries.

220. This section details the functions and rules of approved professional bodies.

221. Ministry officials have provided this information in an attempt to raise all relevant issues for prospective approved professional bodies. Any suggested options are not intended to be prescriptive.

222. Legislation is a useful way to set the entry requirements and the functions of an approved professional body. For the Minister to approve an approved professional body, the approved professional body would have to:

- Meet entry requirements;
- Have rules that describe the approved professional body's functions, and describe how the approved professional body will carry out its functions; and
- Comply with its own rules.

Entry requirements

223. It is likely that an approved professional body will have to meet "fit and proper" requirements in order to accord with the FATF requirements on financial providers. This would require an entity to have a sufficiently rigorous corporate governance structure which could include:

- Access to trained staff;
- Audits to verify its processes;
- A governing board which has suitable experience, qualifications and systems to manage internal conflicts;

- Issuing an annual report to the Securities Commission;
- Explaining its role to consumers;
- Having and maintaining relationships with existing approved professional bodies in relation to sharing information; and
- Recognising cross sector competencies and practise standards from other approved professional bodies.

224. Ministry officials are considering whether there should be:

- a set corporate form for approved professional bodies; or
- some restrictions on some behaviour (e.g.), making a large profit at the expense of financial intermediaries - to address this, it is possible that approved professional bodies may be required to be "non-profit".

225. It will be up to each approved professional body to show the Securities Commission that they can act as a regulator for their area.

226. There has been some comment on "dealer" groups in relation to the Australian introduction of the *Financial Services Reform Act 2001(Aust)*. A dealer group is a group of advisers who have chosen to group together to share business practices. Approved professional bodies are not dealer groups, as approved professional bodies will act as co-regulators to set, comment on and report on industry practice.

Lobbying

227. The Taskforce suggested that approved professional bodies should not lobby.

228. Ministry officials think it important that approved professional bodies can still comment on matters such as law reform without fear that this may be caught within any restriction on "lobbying".

229. Subsequent feedback from stakeholders also suggested that approved professional bodies did still want to comment on matters affecting members.

230. Ministry officials consider that a restriction on lobbying is likely to be difficult to enforce, but that it would be useful to require approved professional bodies to consider how they act on their members' behalf.

Questions

Q60 Are there any minimum corporate governance requirements which should be placed on approved professional bodies?

Q61 Is there any function which an approved professional body should not be able to carry out because it would interfere with an approved professional body's responsibilities?

Approved Professional Body to set functions

[Ministry officials have provided this information in an attempt to raise all relevant issues. Any suggested options are not intended to be prescriptive].

231. Legislation is likely to require an approved professional body to have rules, and to have its rules approved by the Minister. These rules will detail how that approved professional body can carry out its functions.

232. These functions may include:

- Registration – keeping a list of financial intermediaries to know who its members are and to monitor them.
- Competency – setting initial and ongoing standards for financial intermediaries for practice in that industry.
- Conduct – setting accepted practice standards which are in addition to those standards set in statute.
- Reporting and monitoring financial intermediary members - notifying the Securities Commission when an approved professional body becomes aware of breaches against statutory standards and meeting the reporting obligations to the Securities Commission (perhaps through an annual report).
- Discipline – having the ability to discipline members who breach approved professional body standards, and assisting the Securities Commission deal with breaches of statutory standards.
- Disputes – having the ability to deal with consumer complaints.

233. There is likely to be a requirement to make the approved professional body rules publicly available.

234. The approved professional body rules will have legislative backing in their application as it will be an offence for a member of an approved professional body to breach the approved professional body rules, for a high level intermediary to practise without being a member of an approved professional body, or for an approved professional body to not comply with its own rules. It is also likely to be an offence to hold yourself out as an approved professional body unless you are an approved professional body.[64]

235. It is envisaged that approved professional body rules could include rules on:

- Its corporate structure including information on:
  - Corporate (or other) form;
  - Details of entities involved in the structure (e.g.) details on board members and directors;

[64] Consider s36A *Securities Markets Act 1988* in relation to registered exchanges

- Infrastructure;
- Governance;
- Funding;
- Accounting to members; and

- The approved professional body functions (see paragraph 232) and how the approved professional body will carry out these functions (discussed below).

236. To carry out these functions and to set its rules, it is envisaged that the approved professional body would require the legislative power to collect information from financial intermediaries and be required to adhere to its own rules

237. It is likely that the legislation would grant approved professional bodies exemption from liability for the exercise of its legislative functions, except in the case of bad faith, or negligence.[65]

Functions of Approved Professional Bodies – Register / List

238. The first function for an approved professional body is to know who its members are.

239. Ministry officials have assumed that the rules of the approved professional body will:

- Define its proposed membership; and
- Detail how the approved professional body plans to keep this information up to date and accurate.

240. The approved professional body could be required to keep a list to pass onto a public body responsible for collecting this information.

241. There are a number of purposes for keeping this information:

- For the benefit of the approved professional body - in identifying and monitoring its members.
- For the benefit of the Securities Commission – in identifying and monitoring the approved professional body to which financial intermediaries belong.
- For the benefit of the consumer - in knowing if an intermediary is a member of an organisation, and to know which dispute resolution methods are appropriate.

242. The information to be collected by each approved professional body from each high level intermediary, and provided to the public body, would be:

- name of high level intermediary;
- trading name;

[65] Refer to the protection from liability available to registered exchanges at s47 of the Securities Markets Act 1994

- address (this could include physical as well as any internet address advertising services);

- approved professional body to which they belong;

- name of the area in which they are competent to provide advice. This means that there may have to be a set recognised category of competencies (see paragraph 245 below); and

- information on the place to go for dispute resolution.

243. Once the approved professional body has passed this list onto the public body, the approved professional body would also be free to have this list on their own website to promote their own members. The approved professional body would have the responsibility of making sure that both lists were up to date through regular communication with the public body.

244. This register / list run by the public body would also have a list of approved professional bodies to which high level financial intermediaries would have to belong.

Labelling

245. In light of the number of intermediaries practising across a range of areas, it may assist consumers and intermediaries if approved professional bodies could agree on a set list of categories of competencies. This would assist intermediaries in helping them decide which approved professional body to join, and would help consumers know the set area of expertise of their intermediary.

246. This would not be intended to affect existing separate brands of qualifications (e.g. CFP, CFA) rather it could be a useful way to introduce a common way of describing an area of practice. On this basis, the Ministry is keen to test reaction to the following categories:

- General insurance

- Life insurance

- Health insurance

- Mortgage broking

- Financial planning

247. Ministry officials are keen to hear views on whether it would help to classify competencies by general subject area or whether this should be left to the approved professional body to accurately define in its rules.

Questions

[Ministry officials ask these questions in an attempt to raise all relevant issues. Any suggested options are not intended to be prescriptive].

Q62 Do you agree with the information to be provided by high level intermediaries at paragraph 242?

Q63 Is there any additional information which approved professional bodies should be required to collect from high level intermediaries, and which consumers would expect?

Q64 Is there any information which should not be on a public register?

Q65 What will be the cost of providing this information to the approved professional body, and the cost of the approved professional body providing this information to the public body?

Q66 Is labelling of competencies required?

Q67 If so, should it be up to an approved professional body to develop common descriptions of competencies? Or should this be part of the oversight the role of the Securities Commission or the government? What would be best taking into consideration costs and benefits of each option?

Functions of Approved Professional Bodies – Competency setting

248. One of the most important roles of the approved professional body will be to set competency standards that prospective high level intermediary members must meet.

249. "Competency" refers to the initial required level of skill for an intermediary to practice in a particular sector, as well as the continuing level of skill that intermediaries are required to maintain.

250. It will be up to industry to identify what these initial and ongoing skills are. It would not be appropriate for government or the government regulator to set competency standards, as this is an area where approved professional bodies have the experience and expertise.

251. The industry will provide the frontline experience and expertise of what is required to practice in that area, and the Securities Commission and Minister will have the oversight to compare competency settings between approved professional bodies in light of the objectives of the Act and the co-regulatory model. The Minister and Commission will need to ensure that competency standards are suitable, but that they do not impose unnecessary barriers to entry.

252. It is anticipated that industry would develop competency standards or use existing standards to ensure that the objectives of the regime are met.

253. Competency standards will not be listed in legislation – rather the legislation will place the obligations on high level financial intermediaries to comply with approved professional body rules, which will set the competency standards.

254. It would be open for an approved professional body to have different competency standards for different parts of the industry – for example, an approved professional body could require those who have just graduated to show some kind of tertiary level specialisation. Those who have experience in the industry for some time may have to show a lesser qualification, or perhaps a practical test to be run by the approved professional body.

255. The approved professional body will have to maintain records of the initial and ongoing competency hurdles attained by the intermediary.

256. Ministry officials have received a number of comments on "grandparenting", the process under which intermediaries who have spent time in an industry are allowed to practise without having to meet new standards.

257. While there is likely to be a transition period to allow intermediaries to meet new standards, the Taskforce suggested that there should not be grand parenting on the basis grand parenting was to remain then this would create double standards that rewarded length of time in the industry. However, there is a risk that without grand parenting people may leave the industry.

258. If an approved professional body considers it to be appropriate, an approved professional body could acknowledge and recognise the value of an intermediary's experience as one part of a measure of competency by setting a way to measure experience to quality of services - (e.g.) conducting site visits/inspections to ensure that length of time does equate to good service. Again, this competency measure would be up to approved professional bodies to set (in a frontline role) and to discuss with the Securities Commission (as the oversight regulator).

259. Another competency setting measure that recognises experience could be through apprenticeships – it would be open for an approved professional body to recognise time spent by a potential financial intermediary working with a fully competent financial intermediary as a measure of competency, and to discuss this with the Securities Commission when formulating the approved professional body rules.

Questions

Q68 Do you agree with the proposed "competency setting" function of approved professional bodies? Why / why not?

Functions of Approved Professional Bodies – Conduct standards

260. In addition to competency setting, an approved professional body could also set codes of conduct for high level intermediary members. These codes of conduct are in addition to the statutory standards discussed at paragraph 129.

261. The approved professional body codes would not be in legislation, but financial intermediaries would have a statutory obligation to comply with the approved professional body rules.[66] This leaves the approved professional bodies with more room to amend their codes of conduct under the process described at paragraph 305.

262. Ministry officials note that the approved professional body could, if it wishes, include the following matters in their codes of conduct:

- business practice – for example, how an adviser conducts his/her business – how they maintain records of advice, client files, professional indemnity insurance;
- advice giving procedures (e.g. needs analyses / risk assessments);
- ethical standards;
- how an intermediary would address conflicts of interests between an intermediary's obligations to the client and any product provider / other entity;
- procedures for intermediaries to comply with statutory disclosure obligations;
- intermediaries to adopt risk management practises; and
- processes for dealing with client funds or acting as client nominee.

263. An approved professional body may choose to address risk management by requiring professional indemnity insurance of all its members. This would then ensure that, provided that an entity was not in breach of its insurance, there would be some means of protecting consumers and the intermediary.

Questions

Q69 Do you agree with the proposed "conduct setting" function of approved professional bodies? Why / why not?

Functions of Approved Professional Bodies – Monitoring and reporting

264. An approved professional body may have responsibility for monitoring financial intermediary members to see if they are meeting approved professional body standards, and to report this to the Securities Commission, as well as reporting on the status and operations of the approved professional body itself.

265. The level of monitoring and reporting could be set by approved professional bodies as part of their rules and then approved by the Minister on the recommendation of the Securities Commission. Alternatively, there could be some consistent monitoring and reporting requirements specified in legislation.

[66] Refer paragraph 145

Monitoring

266. There are a range of options that approved professional bodies could consider as part of their monitoring processes for financial intermediary members, each with different costs attached. Monitoring processes could either be set by approved professional bodies or contained in regulation.

267. The Ministry is keen to ensure that financial intermediaries adhere to standards, so that industry and consumers can benefit from advisers who meet set standards of behaviour, but not to the extent that monitoring compliance results in excessive fees for consumers or excessive administrative resources or time restraints on intermediaries.

268. Monitoring options could include:

- Low cost options (e.g.) requiring financial intermediaries to attest that they have complied with a set of standards. This option relies on financial intermediaries understanding their obligations and behaving honestly and gives intermediaries responsibility for their actions. This could be complemented by relying on complaints from consumers and industry.

- A potential higher-cost option is regular physical site inspections run by approved professional bodies. This option could provide greater assurance to consumers, approved professional bodies and the Securities Commission that financial intermediaries are complying with their set obligations.

- Other monitoring options could include consumer and industry surveys including shadow shopping/mystery shopper tests[67] and random site visits. The cost of this monitoring can vary, as can the benefit, depending on the range of questions asked and the sample size, and the frequency and the extent of random inspections. This could be undertaken by either approved professional bodies or potentially the Securities Commission.

269. Imposing significant monitoring obligations on approved professional bodies could be costly for them, particularly in their start-up phase when they will not have a financial base from member fees. The costs of imposing monitoring requirements will need to be weighted against the benefits of that monitoring.

270. The Ministry is considering ways to deal with these costs. One option is to take a phased approach to the implementation of monitoring requirements, starting with lower-cost approaches with the potential to strengthen those requirements at a later point. Another option is for the Securities Commission to undertake some of the initial monitoring, for example, the shadow shopping.

Questions

Q70 Do you agree with the proposed "monitoring" function of approved professional bodies? Why / why not?

Q71 What do you consider the costs of the suggested monitoring approaches

[67] Compare "Shadow Shopping survey on superannuation advice – an ASIC report "(April 2006) at www.asic.gov.au

would be? Could these costs be mitigated through a phased implementation or through greater initial monitoring by the Securities Commission?

Reporting

271. An approved professional body may have responsibility to report to the Securities Commission on:

- levels of compliance by financial intermediaries; and/or
- on the operation of the approved professional body itself.

272. This reporting is suggested to be necessary to ensure that there is a close relationship between the approved professional body in its frontline role, and the Securities Commission in its oversight role. This reporting could occur at regular intervals (e.g. – 6 monthly or annually) as well as ad hoc reporting if matters arise, and could be specified in regulation to ensure consistency across approved professional bodies.

Regular reporting

273. Regular reporting could take the form of an annual report which could include details on:

- membership numbers;
- number of disciplinary matters considered;
- number of disputes reported;
- approved professional body corporate governance details;
- financial accounts for the approved professional body;
- any other details about how an approved professional body is complying with its statutory obligations and functions; and
- any other details raised by submitters.

274. This report could be delivered to the Securities Commission and made public, unless there was any commercially sensitive information.

Ad hoc reporting

275. Ad hoc reporting would mostly relate to an approved professional body reporting information on breaches of statutory standards or its rules, but could also include information relating to sudden trends.

276. This ad hoc reporting would be subject to less formal procedures. The approved professional body and the Securities Commission could consider whether or not such information could be treated as confidential if required.

277. The Commission would have the ability to carry out inspections and request further information from the approved professional under certain circumstances.

Questions

Q72 Do you agree with the proposed "reporting" function of approved professional bodies? Why / why not?

Q73 Is there any other way to ensure that the Securities Commission could be kept updated on approved professional body and financial intermediary behaviour?

Functions of Approved Professional Bodies – Discipline

278. The Taskforce suggested that the co-regulatory model could include a separate disciplinary body. Ministry officials suggest that to avoid additional costs, the role of the disciplinary body could be carried out for low level breaches by the approved professional body (perhaps an independent board of the approved professional body) and, for high level breaches, by the Securities Commission.

279. The role of the approved professional body in relation to statutory breaches has been discussed earlier in the paper. This section deals with financial intermediaries breaching non statutory standards.

Discipline for breach of non statutory standards

280. Approved professional bodies may have the ability to discipline those approved professional body members who do not comply with the internal approved professional body rules, without recourse to the Securities Commission.

281. This is on the basis that:

- the approved professional body would be best placed to judge the seriousness of the breach of the specific approved professional body rule; and
- not all matters would require the Securities Commission to exercise their powers.

282. The approved professional body could be free to set a threshold in relation to disciplinary matters, so that, under this threshold, the approved professional body will consider all matters, and over this threshold, the Securities Commission will consider all matters.

283. This threshold could refer to:

- the offence that the financial intermediary is accused of:

- e.g. an intermediary failure to meet a reporting deadline could be dealt with by the approved professional body, but a failure to comply with a competency standard could be more serious, and hence dealt with by the Securities Commission;

- the number of times an intermediary breaches the non statutory standard;

  - e.g. if an intermediary has breached an approved professional body rule three times, then the repetition is sufficient to put at risk the reputation of the market, and it is appropriate for the Securities Commission to consider the matter.

284. The Securities Commission would have a chance to comment on the approved professional body threshold through the initial rule approval process (see paragraph 302).

285. Any approved professional body process for hearing disciplinary matters is likely to require an independent, or unbiased process and an ability to punish inappropriate intermediary behaviour.

286. Approved professional bodies could report results of disciplinary processes to the Securities Commission, and allow appeal functions to the Securities Commission. Appeals from, and reviews of Securities Commission decisions would be to a Court.

Questions

Q74 Do you agree with the proposed "disciplinary" function of approved professional bodies? Why / why not?

Functions of Approved Professional Bodies – Dispute Resolution

287. The Taskforce suggested that there should be a separate dispute resolution body.

288. As dispute resolution procedures could be applicable across other sectors of the financial system, Ministry officials are preparing a discussion paper on dispute resolution which will be released for public feedback as part of the Review of Financial Products and Providers. A number of options will be presented, including the option of an industry-based dispute resolution body or bodies. These options will consider the ideas of having:

  - one dispute resolution body for the financial sector which is paid for by industry or

  - different ombudsman with various levels of sharing of facilities from such things as call centres, to staff. This option would require either an existing body taking on intermediaries or the industry forming an ombudsman scheme itself.

289. The Taskforce also suggested that an approved professional body would have the responsibility of dealing with initial dispute resolution (in some cases, perhaps after

initial internal dispute resolution through a business). This is on the basis that an approved professional body is best placed to know the common issues that arise and how best to deal with them.

290. For an approved professional body to exercise initial dispute resolution, it is assumed that an approved professional body would have to show that it was able to provide an independent and unbiased way to deal with disputes. This may require:

- An independent body set up to hear complaints, perhaps a consumer representative, or at least some measure of independence.
- A ways to record the hearing and the finding.
- Processes that are not too confronting for consumers.

291. Officials understand that an approved professional body undertaking a function like this could be costly, as the number of complaints heard by each approved professional body may not be sufficient to warrant the cost.

292. Under any option, approved professional bodies would also have to agree to work with other approved professional bodies, the Securities Commission and other dispute resolution mechanisms to share information on disputes resolution.

Questions

Q75 Do you think approved professional bodies need to have a "dispute resolution" function? Why / why not?

Cross sector competencies

293. Approved professional bodies will have to maintain a close working relationship with the Securities Commission and other approved professional bodies, on the basis that there may be some shared membership across approved professional bodies by high level intermediaries because some high level financial intermediaries are likely to practise across a range of industries.

294. Ministry officials are keen to avoid a situation where high level financial intermediaries have to belong to a number of approved professional bodies and to meet different standards just to continue practising.

295. To address this, Ministry officials have suggested a few options:

- a high level intermediary could join the approved professional body which represents their principal area of practice. This approved professional body would then set the competency and conduct standards for that area of practice. To practise in another area, the intermediary would have to undertake the competency/conduct requirements set by an approved professional body in that other area. However, the intermediary would not have to join two approved professional bodies, or report to more than one approved professional body, as the principle approved professional body would undertake all administrative roles in relation to the intermediary.

- approved professional bodies could allow “associate” memberships, so that high level intermediaries who already belong to an approved professional body could have an associate membership with a second approved professional body and only meet those rules which relate to competency and conduct, with lower fees.

296. These options are open for approved professional bodies to consider, in light of the obligation on high level intermediaries to belong to at least one approved professional body.

Questions

Q76 What is your preferred option on how to deal with cross sector practice? What would be the costs and benefits of your preferred option?

14. BUSINESSES AS APPROVED PROFESSIONAL BODIES

297. There has been a lot of comment on whether single employer entities (e.g. banks or insurance companies) can be approved professional bodies. The reason for this is that a number of businesses have noted that they have set processes which mirror the proposed functions of approved professional bodies, they wish to avoid duplication, and, they have invested significant resources in setting up these processes.

298. There are a number of good reasons why businesses may wish to be considered as approved professional bodies:

- businesses have current systems to monitor the quality of advice given by people within that business, or connected to that business;
- businesses are strongly motivated to protect brand, and are aware that employees will be the public face of that brand;
- they have the money and incentive to contribute to internal and external dispute resolution processes;
- there is a reduced risk of conflict between existing business practices and standards set by any approved professional body;
- businesses won't have to share confidential information with approved professional bodies;
- there may be a large number of intermediaries within one business;
- there may be gaps where industry bodies do not wish to form an approved professional body where a business may be able to provide coverage;
- businesses can target competencies that directly relate to their products and systems; and
- employers are already liable for the actions of their employees in any event - this may make it easier for the employer to direct its members.

299. Conversely,

- membership of a business-based approved professional body may not be easily retained if an intermediary leaves his/her employment;
- this may result in a large number of approved professional bodies, which would take more resources of the Securities Commission;
- membership of a business-based approved professional body could discourage financial intermediaries from joining industry-based approved professional bodies due to the additional cost, and this may mean that industry based approved professional bodies cannot achieve the required numbers to operate efficiently;

- there is a risk that product providers who are approved professional bodies could require financial non–employee intermediaries to belong to their approved professional body if they wanted to sell that provider's products. It is unlikely that the Minister would approve rules that are perceived to impose unnecessary barriers to entry or which endorse anti-competitive behaviour;

- Ministry officials are unsure whether the processes set up by businesses are aimed at high level intermediaries, or whether they deal mostly with procedures for product marketers. Product marketers are not required to belong to approved professional bodies. Businesses are free to set their own standards on their product market employees; and

- it is difficult to see how an employer could act as a regulator of "intermediaries" (through being an approved professional body) in situations where the employer is also legally liable for the actions of the intermediaries, through vicarious liability.

Alternate options

300. There are alternate options to include businesses within the co-regulatory model, for example:

- large single employer firms with high internal standards could take responsibility for their employees as some sort of "corporate member" of an approved professional body; or

- there could be different classes of approved professional bodies.

301. These options build on previous discussion at paragraph 121. Ministry officials are keen to hear views on whether or not approved professional bodies can be business based, or industry based, and whether there are different issues arising for employers as approved professional bodies.

Questions

Q77 Should there be any restriction on the type of entity which can seek to apply to be an approved professional body?

Q78 Do you agree with the reasons listed at paragraphs 298 and/or 299? If not, which ones? And why not?

Q79 What are the costs and benefits of allowing single employer entities to be approved professional bodies? Does the cost outweigh the benefit, or the benefit outweigh the cost?

15. PROCESS FOR BEING AN APPROVED PROFESSIONAL BODY

Initial approval process for approved professional body

302. There will be a set process that will apply to entities applying to be an approved professional body. Ministry officials have provided outlines of one possible process. Your submissions are sought on this, and all alternate processes.

One possible approval process

- Potential approved professional bodies will decide on the approved professional body structure and draft rules (described at paragraph 235).

- Before the applicant approved professional body structure and rules are finalised, there will be a process of consultation between the applicant approved professional body and the Securities Commission on the content of the rules. This consultation process will be triggered by the applicant approved professional body contacting the Securities Commission to express its interest in being considered as an approved professional body.

- When the applicant approved professional body is satisfied that the consultation period is over, the applicant approved professional body will then provide its final report and application to the Minister outlining its structure and rules. The content, and the timing of the delivery of this final report is determined by the applicant approved professional body – it is for the applicant approved professional body to decide when it wants to present its rules to the Minister for formal consideration.

- The Minister will refer the rules to the Securities Commission to seek its opinion.

- The Securities Commission then assesses the applicant approved professional body's structure and rules against the objectives of the Act, and the objectives of the co-regulatory model.

- Once the Securities Commission has completed its assessment and made its recommendations, the Securities Commission has the responsibility to pass its recommendations to the Minister.

- The Minister then must consider applicant approved professional body's structure and rules in light of the recommendation of the Securities Commission, the objectives of the Act and the objectives of the co-regulatory model and decide whether or not to approve the applicant as an approved professional body.

- Once the Minister has decided whether or not to approve the applicant approved professional body, the Minister has the responsibility to pass this information to the Securities Commission and the approved professional body in writing, and perhaps also to issue a notice in the *Gazette*.

- The Ministry would then enter the approved professional body into a register run by a public body. The approved professional body rules would then be publicly available through that same register (note that the conduct rules of the NZX are publicly available[68]).

- If the Minister does not approve the applicant approved professional body's application, then the applicant approved professional body can start the process at the consultation level with the Securities Commission to amend its structure / rules.

303. Ministry officials have provided this outline to raise a number of process issues which will have to be spelled out in legislation. For example, to provide certainty to the market, Ministry officials consider that it may be appropriate to set time limits on the assessment and recommendation process. This discussion document seeks your views on appropriate time limits.

304. Your submissions are sought on this, and alternate processes.

Questions

Q80 Do you agree or disagree with the proposed process for initial approval of an applicant approved professional body? Why

Q81 Are there other approval methods which may work better? Why?

Q82 Do you agree that there should be time limits on the initial approval process?

Q83 If so, what would be an appropriate time for the Securities Commission to consider rules of an applicant approved professional body in light of Securities Commission resources or detail of the applicant approved professional body rules?

Q84 And, what would be an appropriate time for the Minister to consider rules of an applicant approved professional body in light of the Minister's resources or detail of the applicant approved professional body rules?

Change of rules process

305. Approved professional bodies may wish to amend their rules after they have been approved by the Minister. It is possible that not all rule changes would require fresh approval from the Minister.

306. As above, Ministry officials have provided the outline of one possible process. Your submissions are sought on this, and alternate processes.

[68] Section 36Q Securities Markets Act 1988

- An approved professional body provides details of the rules that it wishes to change to the Minister.

- The Minister will refer the rules to the Securities Commission to seek its opinion.

- From the date of receipt, the Securities Commission has a set time period in which to pass to the Minister its recommendation on whether the proposed change is minor or technical in nature and does not require Ministerial approval, or whether the proposed change is sufficiently serious to require Ministerial approval.

- The Securities Commission must pass its recommendation to the approved professional body at the same time.

- The Minister then considers whether or not the proposed change requires Ministerial approval in light of the Securities Commission recommendation and the objectives of the Act and the co-regulatory model. To provide certainty to the market, the Ministry considers that it is appropriate to set time limits on this consideration process. The timing will start from the date that the Minister receives the Securities Commission recommendation.

- If the proposed change does require Ministerial approval, then the Minister considers the content and substance to the proposed change, and decides whether or not to approve the change within a set time period.

- If the proposed change does not require Ministerial approval, then the Minister must advise the approved professional body / Securities Commission within a set time period, so that either the approved professional body can amend the rules itself or the Securities Commission can approve the rule amendment.[69]

Prompts to change rules

307. It has been suggested to Ministry officials that it may be useful for the Securities Commission to direct approved professional bodies to change their rules. In the International Monetary Fund report on New Zealand, it was suggested that, in relation to registered stock exchanges, that:

> "Securities legislation should be amended to authorize: (1) the Securities Commission to direct on public interest grounds, or recommend to the Minister that the Minister direct, a recognized securities exchange to amend some or all of its conduct rules; and (2) authorize the Minister to make such a direction on the Securities Commission's advice and on public interest grounds."[70]

308. Such a recommendation should be based on a concern by the Securities Commission that the approved professional body's rules are not meeting the objectives of the Act. The Ministry seeks your views on whether this is appropriate.

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[69] Consider Securities Markets Act, s36L where the time period noted is 40 days between receiving the request for change, and the date when the Minister must publish the note in the Gazette.

[70] Refer "New Zealand: Financial Sector Assessment Program—Detailed Assessments of Observance of Standards and Codes—International Organization of Securities Commission (IOSCO)—Objectives and Principles of Securities Regulation", page 12, at http://www.imf.org/external/pubs/ft/scr/2004/cr04417.pdf

Questions

[Ministry officials ask these questions in an attempt to raise all relevant issues. Any suggested options are not intended to be prescriptive].

Q85 Do you agree or disagree with the proposed process for changing rules of an approved professional body? Why?

Q86 Are there other methods which may work better? Why?

Q87 Do you agree that there should be time limits on the rule change process?

Q88 Should the Securities Commission be able to initiate the process to change the approved professional body rules? Could the Securities Commission approve rule changes if technical or minor?

Issuing directions

309. It could be useful for the Securities Commission to issue directions to approved professional bodies to require them to comply with their rules, or with the Act. This would only apply in the situation where the Securities Commission is satisfied that the approved professional body is not meeting the objectives of Act.

Question

Q89 Do you agree that the Securities Commission could issue directions to an approved professional body to require it to comply with the approved professional body rules?

De-registering approved professional bodies

310. If an approved professional body does not comply with directions, then the Minister could de-register an approved professional body by revoking the "approved" status of the approved professional body.

311. One possible process for this could require the Minister to be satisfied that:

- the approved professional body has breached its obligations; that the approved professional body has failed to comply with directions, with legislation and with the objectives of the co-regulatory model;
- the Securities Commission has already issued directions to the approved professional body and that these have been ignored;
- the Securities Commission has already raised the matter of compliance with the approved professional body in writing;

- the Commission has allowed sufficient time for the approved professional body to remedy the situation;

- the Minister has obtained the recommendation of the Securities Commission on any proposed de-registration;

- the Minister has advised the approved professional body of the proposed de-registration

all prior to actually de-registering the approved professional body.

312. The Minister's decision would be open to judicial review.

313. There would also need to be some way to deal with the transition period between registration and de-registration of an approved professional body to ensure that the day to day practice of financial intermediaries is not affected. This would involve consideration of "default" options, discussed at paragraph 317.

Questions

Q90 Do you agree or disagree with the proposed process for deregistering an approved professional body? Why?

Q91 Are there other methods which may work better? Why?

16. EDUCATION

314. The Taskforce suggested that there should be an educational component for the general public which should be carried out by a public body. Stakeholders have since suggested that to Ministry officials that this would be an onerous component of an approved professional body's duties.

315. Ministry officials are keen to seek your views on:

- Whether public education should be within the role of approved professional bodies?

- Whether approved professional bodies should be responsible for a reduced role, that is, educating the public in relation to the role of an / their approved professional body?

316. Another option is that approved professional bodies could contribute advice / resources to a central body which has responsibility for educating the public on matters including financial intermediaries, and the wider financial sector, or that the government instead contribute to this work.

Questions

Q92 Should public education be within the role of approved professional bodies? Why? What are the costs and benefits which apply to your response?

17. RISKS UNDER THE CO-REGULATORY MODEL

Default position required…

317. There is a risk that there will be no approved professional body for a particular part of the industry, or that an existing approved professional body fails to carry out the functions listed above or is de-registered.

318. There are also industry capture risks - that industry regulatory bodies (especially in those sectors where there is already a strong industry representative) act as "closed shops" deterring innovation and competition, preventing entry into the industry by creating excessive barriers or not taking into account the interests of all relevant stakeholders (for example consumers) when carrying out their regulatory functions.

319. The co-regulatory model requires a default option to meet these risks. The Ministry is considering a range of options including:

- A regime run by the Securities Commission under which financial intermediaries would not have to join an approved professional body, but could register directly with the Securities Commission, agree to abide by model codes of conduct, competency (to be set in consultation with industry experts) discipline and dispute and reporting.

- Government officials working and negotiating with existing approved professional bodies to broaden the industry coverage to allow financial intermediaries to be covered by another approved professional body. This could involve government assistance. Again, industry feedback would be required.

Questions

Q93 Do you agree or disagree with the proposed default options at paragraph 319? Why?

Q94 Are there other methods which may work better? Why?

18. COSTS

320. The Ministry is aware that there will be costs involved in the set-up and ongoing maintenance of approved professional bodies.

321. To encourage participation in the co-regulatory model, the government is considering the type of assistance (including financial assistance) that could be provided for the set-up of approved professional bodies. Any assistance would relate only to the set-up, rather than ongoing maintenance.

322. Ministry officials intend to raise this matter for Cabinet consideration.

Questions

Q95 What type of assistance would you require if setting up an approved professional body? Could you describe this assistance, and/ or place a value on it?

19. LINKS TO OTHER REVIEWS

323. The work on the regulation of financial intermediaries is being considered against the context of other existing projects: the Review of Financial Products and Providers, Domestic Institutional Arrangements and the Financial Action Task Force 40 Recommendations on Anti-Terrorism and Money Laundering. The Ministry's Financial Sector team is either leading or participating in these projects, so is well placed to efficiently make the necessary links and share information.

Review of Financial Products and Providers (RFPP)

324. The RFPP considers the regulation of insurance (health, life and general), superannuation, collective investment schemes (unit trusts, participatory securities, group managed investment schemes, contributory mortgages) non-bank financial institutions (friendly societies, credit unions, building societies, finance companies, industrial and provident societies), futures and derivatives and offerings of securities.

325. There are close links between the work on financial intermediaries and the RFPP as both deal with financial sector market conduct, and because financial intermediaries (which also includes financial institutions) provide advice on financial products, including advice from product providers.

326. The financial intermediary work is proceeding separately to that of the RFPP on the basis that the research and consultation undertaken by the Task Force, and the resulting Task Force recommendations for a co-regulatory model, mean that the work on financial intermediaries is more advanced than the work on each of the areas of the RFPP.

327. Ministry officials are working closely to ensure consistency across these reviews – for example, work on insurance intermediaries is feeding into the work on insurance products and insurance product providers.

328. Discussion documents for the RFPP will be released in July/August 2006 and policy decisions to be made in late 2006 with the intention of legislation being introduced in 2007/2008.

Domestic Institutional Arrangements

329. The work on Domestic Institutional Arrangements (which institutes the Securities Commission as the regulator of market conduct) is progressing consistently with this paper.

Financial Action Task Force Recommendations

330. The Ministry of Justice is leading a government review to ensure that New Zealand is more compliant with the Financial Action Task Force's 40 Recommendations to deter money laundering, and its 9 Special Recommendations to counter the financing of terrorism. To comply with the recommendations, we are intending to place the required fit and proper requirements on people handling investment money. The Ministry is also working closely with the Ministry of Justice on this work to ensure that these requirements are aligned as much as possible with the work on financial intermediaries work to minimise compliance costs.

331. In relation to the Secret Commissions Act 1910 (which seeks to prohibit secret rewards and inducements in agency, principal and third party relationships), Ministry of Justice officials are considering the form of any review of the Act, including whether there should be a separate Secret Commissions Act or not (the offences, for example, could be provided for in the Crimes Act 1961).

332. Cabinet has already approved an increase in the penalties associated with the offences in this Act.

Trans-Tasman Implications

333. The Memorandum of Understanding on Business Law coordination between Australia and New Zealand (MOU) and the Trans-Tasman Mutual Recognition Arrangement (TTMRA) are both relevant to this work.

Memorandum of Understanding of Business Law

334. The MOU (signed in 2000) between the two governments is based on the presumption that we should coordinate our business laws with Australia unless there is a good reason for the law to be different.

335. The Government is aware of concerns about the Australian experience in regulating financial intermediaries and considers that the differences between the two financial intermediary sectors (where most New Zealand financial intermediaries are individuals or small and medium sized businesses, compared with the large dealer groups resulting from Australian legislation) and the costs involved mean that there is good reason for the proposed co-regulatory model to be different.

Trans-Tasman Mutual Recognition Arrangement (TTMRA)

336. The TTMRA, which came into effect in 1998, is an arrangement between New Zealand and Australia, whose strategic objective is to remove regulatory barriers to trans-Tasman trade in goods and the movement of registered professionals either through mutual recognition of our respective regulatory regimes or through harmonisation. It is implemented by way of overarching legislation which provides that mutual recognition in relation to the sale of goods and registration of occupations will apply between all participating jurisdictions, unless specifically excluded.

337. Ministry officials have paid careful consideration to the Australian regime to ensure that equivalent objectives and outcomes to the Australian regime are obtained so that there is the potential to utilise (at least for some intermediaries) the TTMRA. This does not mean that we will be adopting Australian regime, rather this would enable intermediaries to operate in both jurisdictions, remove impediments to cross border activity and move us further towards a single economic market.

20. ANNEX ONE – QUESTIONS

Q1 **Are there any other objectives which should be included in legislation (which are not already covered by paragraphs 13 and 14?)**

Q2 **Are the basic categories of financial product (at paragraph 35) appropriate?**

Q3 **If not, why not? Are they too broad or too narrow?**

Q4 **Should there be any exemptions for advice about certain products?**

Q5 **If so, which products? And why?**

Q6 **Is "public knowledge" about a type of financial product a good enough reason to reduce obligations on intermediaries?**

Q7 **Do you think that "investment property" should be included as a "financial product"? If so, how would you define "investment property"?**

Q8 **What would be the cost and benefit of including advice on any "investment property" in this regime?**

Q9 **Should other forms of tangible property (for example gold bullion) be considered as a "financial product"?**

Q10 **Is the proposed description of "financial advice" workable? If not, why not and how should it be changed?**

Q11 **Is there advice which does not relate to the buying and selling of financial products? If so, how should it be described?**

Q12 **What would be the benefits and costs of treating such advice as "financial advice"?**

Q13 **Ministry officials note that a number of professions including journalists, lawyers, accountants, budgeting advisers and real estate agents can provide financial advice. In your view, should any profession be exempted from the proposed legislation?**

Q14 **If so, can you please describe the group, and then provide reasons why, including consideration of the costs and benefits of such an exemption.**

Q15 **In your view, is the proposed description of "financial intermediary" appropriate?**

Q16 **Do all intermediaries provide advice? Or do some intermediaries only carry out a transaction at a client's request?**

Q17 **Does the category of "information only" financial intermediary present a realistic division in the types of New Zealand intermediaries?**

Q18 **Is there any information only intermediary who is not an employee? If so, can you please provide an example of how such an intermediary operates, and how they contact / are in contact with members of the public?**

Q19 **Do you agree or disagree with the assumptions at paragraph 90 about information only intermediaries?**

Q20 **Does the category of "product marketer" financial intermediary represent a realistic division in the types of New Zealand intermediaries?**

Q21 **Is there a product marketer who is not an employee? If so, can you please provide an example of how such an intermediary operates, and how they contact / are in contact with members of the public?**

Q22 **Do you think that financial intermediaries who give advice about less complex products (such as (e.g.) car insurance, house and contents insurance) should be automatically subject to lower levels of regulation than intermediaries who give advice on and sell more complex products (such as (e.g.) life insurance)?**

Q23 **Do you agree or disagree with the assumptions at paragraph 98 about product marketer intermediaries?**

Q24 **Does the category of "high level" financial intermediary represent a realistic division in the types of New Zealand intermediaries?**

Q25 **Do you agree or disagree with the assumptions at paragraph 113 about high level intermediary intermediaries?**

Q26 **Do you think that there should be a separate category of financial intermediary to include "execution only" intermediaries (that is those intermediaries who provide transaction services without providing advice)?**

Q27 **Does the category of "execution only" financial intermediary represent a realistic division in the types of New Zealand intermediaries? If not where should these intermediaries fit?**

Q28 **Will businesses be high level intermediaries? If so, what processes do businesses use to advise a member of the public on the suitability or appropriateness of financial advice or financial product to the individual circumstances of that member of the public?**

Q29 **If so, are there any obligations which businesses will find it harder to comply with than individuals practising as high level financial intermediaries?**

Q30 **In addition to a general strict liability provision requiring intermediaries not to engage in conduct that is misleading or deceptive or likely to mislead or deceive, would it be useful to have additional specific prohibitions on financial intermediary conduct?**

Q31 **Do you agree with the possible statutory duties listed at paragraph 143 above?**

Q32 **Should any of the additional duties apply to all intermediaries, or just high level intermediaries? Why?**

Q33 **What would be the costs and benefit of imposing such duties?**

Q34 **And, what type of penalties should attach for breach of the duties listed at paragraph 143 above? For example, should there be criminal penalties?**

Q35 **What types of intermediaries, in addition to investment brokers, would receive money and property from members of the public?**

Q36 **Should these intermediaries be subject to money handling legislative requirements?**

Q37 **Which types of intermediaries hold trust accounts now? Are there some sectors of financial intermediaries which use a trust account more than another sector?**

Q38 **Are the requirements listed at paragraph 153 appropriate for those who hold client money?**

Q39 **What would be the cost and benefit of applying these obligations to intermediaries who receive money and property from members of the public?**

Q40 **Who would be responsible for monitoring these trust accounts?**

Q41 **Do you agree with the disclosure obligations for information only intermediaries listed at paragraph 166?**

Q42 **Do information only intermediaries receive commissions, bonuses, fees or remuneration which is in addition to salary or wages?**

Q43 **What information should a member of the public be required to be told about an information only intermediary?**

Q44 **What would be the cost of requiring information only intermediaries to disclose this information? Does the benefit to consumers of receiving this information outweigh the cost?**

Q45 **Should "execution only" intermediaries have to make disclosure listed in paragraph 174? Particularly, should fees on switching products be included in the general information on remuneration that a broker would be required to disclosure?**

Q46 **If not, why not, and which obligations would you remove or add?**

Q47 **If you agree that execution only intermediaries should have to make these disclosures, what are the costs and benefits of these disclosure obligations?**

Q48 **Should product marketer intermediaries have to make the disclosure listed in paragraph 176? What are the costs and benefits to this?**

Q49 **Should product marketers provide a statement to consumers which explains that consumers are not receiving advice from a high level intermediary? If so, what information should be in such a statement? What are the costs and benefits of providing this statement?**

Q50 **Should high level intermediaries have to make additional disclosure listed in paragraph 184?**

Q51 **If not, which why not, and which obligations would you remove?**

Q52 **If you agree that high level intermediaries should have to make these disclosures, what are the costs and benefits of these disclosure obligations?**

Q53 **Is there any sector which should have special disclosure obligations?**

Q54 **If so, which obligations, and to which sector? And what would be the costs and benefits of having different disclosure obligations?**

Q55 **Do you agree with the table setting down responsibilities in relation to discipline of intermediary for breaching statutory standards?**

Q56 **Is there a better model for disciplining intermediaries? If so, please provide details.**

Q57 **Are there any powers which the Securities Commission will require which are not listed above?**

Q58 **Are there any powers which the Minister will require which are not listed above?**

Q59 **Is there a better model of responsibilities than the table which details the responsibilities of the Securities Commission and the Minister? If so, please provide details.**

Q60 **Are there any minimum corporate governance requirements which should be placed on approved professional bodies?**

Q61 **Is there any function which an approved professional body should not be able to carry out because it would interfere with an approved professional body's responsibilities?**

Q62 **Do you agree with the information to be provided by high level intermediaries at paragraph 242?**

Q63 **Is there any additional information which approved professional bodies should be required to collect from high level intermediaries, and which consumers would expect?**

Q64 **Is there any information which should not be on a public register?**

Q65 **What will be the cost of providing this information to the approved professional body, and the cost of approved professional body providing this information to the public body?**

Q66 **Is labelling of competencies required?**

Q67 **If so, should it be up to an approved professional body to develop common descriptions of competencies? Or should this be part of the oversight the role of the Securities Commission or the government? What would be best taking into consideration costs and benefits of each option?**

Q68 **Do you agree with the proposed "competency setting" function of approved professional bodies? Why / why not?**

Q69 **Do you agree with the proposed "conduct setting" function of approved professional bodies? Why / why not?**

Q70 **Do you agree with the proposed "monitoring" function of approved professional bodies? Why / why not?**

Q71 **What do you consider the costs of the suggested monitoring approaches would be? Could these costs be mitigated through a phased implementation or through greater initial monitoring by the Securities Commission?**

Q72 **Do you agree with the proposed "reporting" function of approved professional bodies? Why / why not?**

Q73 **Is there any other way to ensure that the Securities Commission could be kept updated on approved professional body and financial intermediary behaviour?**

Q74 **Do you agree with the proposed "disciplinary" function of approved professional bodies? Why / why not?**

Q75 **Do you think approved professional bodies need to have a "dispute resolution" function? Why / why not?**

Q76 **What is your preferred option on how to deal with cross sector practice? What would be the costs and benefits of your preferred option?**

Q77 **Should there be any restriction on the type of entity which can seek to apply to be an approved professional body?**

Q78 **Do you agree with the reasons listed at paragraphs 298 and/or 299? If not, which ones? And why not?**

Q79 **What are the costs and benefits of allowing single employer entities to be approved professional bodies? Does the cost outweigh the benefit, or the benefit outweigh the cost?**

Q80 **Do you agree or disagree with the proposed process for initial approval of an applicant approved professional body? Why?**

Q81 **Are there other approval methods which may work better? Why?**

Q82 **Do you agree that there should be time limits on the initial approval process?**

Q83 **If so, what would be an appropriate time for the Securities Commission to consider rules of an applicant approved professional body in light of Securities Commission resources or detail of the applicant approved professional body rules?**

Q84 **And, what would be an appropriate time for the Minister to consider rules of an applicant approved professional body in light of the Minister's resources or detail of the applicant approved professional body rules?**

Q85 **Do you agree or disagree with the proposed process for changing rules of an approved professional body? Why?**

Q86 **Are there other methods which may work better? Why?**

Q87 **Do you agree that there should be time limits on the rule change process?**

Q88 **Should the Securities Commission be able to initiate the process to change the approved professional body rules? Could the Securities Commission approve rule changes if technical or minor?**

Q89 **Do you agree that the Securities Commission could issue directions to an approved professional body to require it to comply with the approved professional body rules?**

Q90 **Do you agree or disagree with the proposed process for deregistering an approved professional body? Why?**

Q91 **Are there other methods which may work better? Why?**

Q92 **Should public education be within the role of approved professional bodies? Why? What are the costs and benefits which apply to your response?**

Q93 **Do you agree or disagree with the proposed default options at paragraph 319? Why?**

Q94 **Are there other methods which may work better? Why?**

Q95 **What type of assistance would you require if setting up an approved professional body? Could you describe this assistance, and/ or place a value on it?**

21. ANNEX TWO - TASKFORCE RECOMMENDATIONS

Regulatory framework

1 The Task Force recommends that there should be a co-regulatory framework for the regulation of financial intermediaries.

Different obligations depending on function

2 The Task Force recommends that different obligations attach to an intermediary depending on the role the intermediary is undertaking, that is whether they are acting as a:

- *Personal financial adviser* - those who provide broad financial planning advice or advice on financial products, and implicitly or explicitly advise the consumer on the suitability or appropriateness for the consumer's personal circumstances;
- *Product marketer* - those who promote financial products, and provide more than factual information but do not advise on the suitability or appropriateness of the product for the consumer's personal circumstances;
- *Information only intermediary* - those who undertake a factual information function; and
- *Execution only intermediary* - those who execute client instructions, where that execution function is linked to a personal financial advice or product marketer role.

3 The Task Force recommends that there should be limited obligations for intermediaries who undertake an information or execution only role.

Obligations on business and individual

4 The Task Force recommends that the obligations recommended in this report (which differ depending on the intermediary's function) be placed on:

- Each person who provides financial advice or who advises on, or markets a financial product to a member of the public ("individual obligations"); and
- Each person who carries on a business that includes the providing of financial advice, or who advises on, or markets, a financial product to a member of the public ("business obligations").

Disclosure

5 The Task Force's recommendations in relation to disclosure are set out in the table of disclosure recommendations. These incorporate:

- Extension of the investment adviser disclosure regime in the Securities Legislation Bill to (with particular disclosure varying depending on the intermediary's function):
  - advice or marketing on any financial product within the scope of the recommendations, including risk, investment property and credit;
  - financial intermediaries providing financial advice without advising on financial products (including financial planners); and
  - information and execution only intermediaries.
- Additional disclosures by product marketers and personal financial advisers.

Form of disclosure

6 The Task Force recommends that any disclosure should be clear, concise and effective and enable comparisons across intermediaries.

7 The Task Force recommends that disclosure documents be standardised where possible, place important information prominently, provide dollar amounts rather than percentages and be clearly distinguishable from marketing material.

8 The Task Force recommends that disclosure reflect the medium of operating (for example, oral short form disclosure, despite the evidential difficulties, with a possible subsequent written confirmation, would be sufficient for telephone transactions for risk products and basic bank products).

9 The Task Force recommends that disclosure be consumer focused, and analysed from the perspective of benefit to the consumer.

10 The Task Force recommends that before determining the final content and form of disclosure there should be research into consumer views, in particular, what consumers would consider useful information and what form of disclosure would be most effective in conveying that information.

Standards

11 The Task Force recommends that core minimum standards should be set out in industry specific legislation.

12 The Task Force recommends that the following statutory standard (in addition to any other statutory or common law standards) should apply to all intermediaries:

- Not to engage in conduct that is misleading or deceptive or is likely to mislead or deceive including as to the nature, characteristics or suitability for purpose of the information, advice or financial product (all intermediaries).

13 The Task Force recommends that the following statutory standards (in addition to any other statutory or common law standards) should apply to all individuals or businesses undertaking a personal financial adviser role:

- To exercise reasonable skill, care and diligence having regard to the function being undertaken;
- To be remunerated on a basis agreed with the consumer in writing;
- To be subject to effective standards addressing conflicts as set out in this report;
- For individuals only, to have appropriate qualifications and/or experience for the functions undertaken (on an initial and ongoing basis); and
- For businesses only, to have in place adequate processes and policies to enable employees and the business to comply with the statutory standards and APB rules.

14 The Task Force recommends that businesses be liable for breach of standards by an employee. The Task Force also recommends that financial intermediary businesses would be liable in the Dispute Resolution Body and in Court proceedings for any compensation awarded to a consumer in relation to any employee's breach of that employee's obligations (i.e. the employee would not ordinarily have liability for such compensation unless the employee would be liable under existing statutory and common law). Employees would still be liable for financial penalties awarded by the Disciplinary Body as a disciplinary sanction.

15 The Task Force recommends that the legislation provide for consumers to bring actions for relief (including seeking compensation) in relation to statutory breaches.

Dispute resolution

16 The Task Force recommends that there be a single Disputes Resolution Body established by statute that has jurisdiction over all financial intermediaries.

17 The Task Force recommends that the Disputes Resolution Body be able to consider complaints about breach of a statutory standard or, in relation to personal financial adviser standards, an APB rule relating to that standard.

18 The Task Force recommends that:

- The Disputes Resolution Body should be, and be seen to be, independent of the industry. This could be achieved, in part, by the governing body of the Disputes Resolution Body being composed of persons who have experience of the perspectives of consumers and industry (who could be appointed or approved by the Minister);
- The rules governing the jurisdiction and procedures of the Disputes Resolution Body being subject to Ministerial approval/veto;
- To reduce the incidence of parties to the dispute process taking an overly formal approach: (i) evidence adduced in the dispute proceedings which is relevant to the dispute would not be admissible in any other forum (including the

Disciplinary Body and/or the statutory regulator); (ii) the decision of the Disputes Resolution Body though would be made available, on written request, to the disciplinary body and/or the statutory regulator; (iii) the jurisdiction of the Disputes Resolution Body would be limited to claims below a specified amount (for example $200,000); any claims above that would be a matter for the Courts;

- The Disputes Resolution Body, in conjunction with the APBs, be responsible for promoting to consumers the presence and role of the disputes resolution body; and
- The Disputes Resolution Body, in conjunction with the APBs, agree a process for considering the complaint at the first instance at the APB or member level to see if satisfactory resolution can be achieved without the need to commence a disputes resolution process.

The Task Force recommends that the Disputes Resolution Body be able to award compensation to consumers up to a certain level and that failure by any individual or business who undertakes a personal financial adviser role to pay compensation would be grounds for removal from an APB.

Disciplinary Body

19 The Task Force recommends that all financial intermediaries, and all persons carrying on business as a financial intermediary be subject to the jurisdiction of a single Disciplinary Body established by statute.

20 The Task Force recommends that sanctions available to the Disciplinary Body include:

- Temporary and permanent banning orders;
- Orders for supervision or management of practice;
- Orders for correction of information;
- Orders for reimbursement of fees to consumers; and
- Fines.

21 The Task Force recommends that there be an appeal from decisions of the Disciplinary Body to the District Court.

22 The Task Force recommends that there be:

- A threshold for bringing proceedings, for example, that there has been a significant breach of the obligations; and
- Effective safe harbours to excuse behaviour that is reasonable in the circumstances, although technically a breach of the legislation, for example, that "the breach is immaterial or, in all the circumstances, ought reasonably to be excused".

Authorisation framework for personal financial advisers

Approved Professional Bodies

23 The Task Force recommends that every individual and business who undertakes a personal financial adviser role must belong to an approved professional body (APB).

24 The Task Force recommends that an APB have the following roles:

- To consider and if thought appropriate make rules for those statutory standards that relate to its members and such other rules as the APB thinks appropriate, having regard to the statutory objectives (see discussion above) including establishing what are appropriate qualifications and/or experience (see discussion of standards in *"Reform recommendations"*) for advising in particular segments of the market, whether ongoing competency requirements need to be satisfied and if so, what they might be;
- To monitor compliance by members;
- To resolve low level disciplinary and consumer dispute matters;
- To fund a Disputes Resolution Body and Disciplinary Body;
- To report material breaches of standards to the Disciplinary Body and bring disciplinary proceedings against members when there has been a material breach;
- Either collectively with other APBs or individually, to promote to consumers their rights and the role of the APB; and
- To consider, and if thought appropriate, make rules relating to the financial

capacity of businesses to provide for consumer redress for established breaches of standards and rules.

25 The Task Force recommends that the APB rules be subject to a Ministerial approval/veto process.

26 The Task Force recommends that the Government discuss with existing industry bodies their likely approach to rationalisation if the Task Force's recommendations are adopted.

Registration

27 The Task Force recommends that:

- There be a register of all individuals or businesses undertaking a personal financial adviser role;
- No individual or business will be permitted to undertake such a role unless they are on the register;
- No individual intermediary should be able to register unless they satisfy the qualification requirements (defined to also include experience requirements) of their APB;
- An intermediary can be removed from the register for a serious breach of standards;
- The title "Registered", in relation to roles undertaken by financial intermediaries, would be reserved in legislation to those intermediaries who are on the register;
- The register be administered centrally (for example, by a Government department or agency) and be available to the public (including being available on the internet);
- That the register contain the following details about each registered individual financial intermediary (and similar details about business carrying on a personal financial advisory role):
  - their name;
  - a contact address (which could be the business address);
  - their qualifications;
  - any disciplinary sanctions imposed on them;
  - their employer; and
  - the industry body or bodies that they belong to; and
- That there be a statutory obligation on each intermediary seeking registration to supply these details and to notify of changes to them for as long as they are on the register.

Statutory regulator

28 The Task Force recommends that a statutory regulator have a market overview role including:

- Providing advice to the Minister on the approval/disapproval of APBs;
- Providing advice to the Minister on the approval/disapproval of APB rules;
- Providing advice to the Minister on the rules of the disciplinary and disputes resolution body;
- The power to impose temporary orders (for example stop order or temporary banning orders) in relation to businesses and individuals where there is a prima facie case of breach of standards, with the ability to refer the matter to the Disciplinary Body for full consideration; and
- To have stop, banning and rectification powers in relation to the new intermediary statutory disclosure requirements recommended by the Task Force (similar to the powers provided to the Securities Commission under the Securities Legislation Bill).

Minister

29 The Task Force recommends that the Minister have the power to approve or disapprove APBs and their rules, and the rules governing the composition and procedures of the Disputes Resolution Body.

30 The Task Force recommends that legislation identify core principles that should inform the exercise of discretionary powers under the regime.

31 The Task Force recommends that these core principles include:

- An intermediary industry that warrants public confidence;

- An intermediary industry that places a high priority on transparency of key information for consumers and enables accessible and effective enforcement of obligations;
- The encouragement of a dynamic, innovative and competitive intermediary industry that provides cost efficient and effective services to consumers;
- Restrictions and obligations imposed on industry participants are in proportion to the expected benefits for consumers and the industry; and
- The maintenance of a proper relationship between the costs of compliance with the regulatory regime and the benefits resulting from it.

Funding

32 The Task Force recommends that funding of the regime be a mixture of state and industry contribution, and that further consideration be given to the details of the funding mechanisms.

Scope

33 The Task Force recommends that the general approach be that the proposed framework should be broad in coverage but not "one size fits all" in its application. Accordingly the Task Force recommends that obligations and standards vary depending on the role a financial intermediary undertakes; and that some occupations and products be excluded from the reform proposals. The Task Force specifically recommends that:

- With the exception of journalists and authors, particular occupational groups should not be excluded from its recommendations;
- That the regulatory regime capture intermediaries who are providing financial advice or marketing to members of the public;
- That some risk products (for example, travel insurance, car insurance, house and contents insurance) be excluded from the regulatory framework; and
- That "not for profit" organisations which provide financial advice services (such as budget advice, debt management and/or debt restructuring), be included but that issues around regulation of the voluntary sector, including mitigating compliance costs, be addressed at a more detailed design phase.

Implementation and transition arrangements

34 The Task Force's preference would be for a specified notice period for introduction of the regulatory framework, rather than a "grand parenting" arrangement.

35 The Task Force recommends that a regulatory impact analysis be undertaken after further development work on the recommendations, as many of the specific costs will reflect the detailed design of the proposed regime.

Prudential regulation

36 The Task Force recommends that wraps (custodian based administration and portfolio management services) and master trusts be considered as part of the Government non-bank financial product and provider review.

Handling of client funds

37 The Task Force proposes that, as a general rule, client funds be required to be held on trust in an account which is separate from the intermediary's business funds.

Secret Commissions Act 1910

38 The Task Force recommends that the Secret Commissions Act be generally reviewed and not relied on in considering implementation of the Task Force's recommendations.

22. ANNEX THREE - DISCLOSURE REQUIREMENTS

Recommended disclosure requirements	Information only function	Execution only function	Product marketer function	[High Level] adviser function
Experience				Yes
Qualifications				Yes
Membership of professional bodies				Yes
Nature and scope of any professional indemnity insurance				Yes
Whether dispute resolution facilities are available to consumers		Yes	Yes	Yes
In the previous five years before the service is provided:				
• **relevant convictions**		Yes	Yes	Yes
• **whether the adviser has been adjudicated bankrupt**		Yes	Yes	Yes
• **prohibitions from managing a company or business**		Yes	Yes	Yes
• **any successful court action taken against the financial intermediary in the intermediary's professional or business capacity**		Yes	Yes	Yes
• **whether the intermediary has been expelled from or prohibited from being a member of a professional body**		Yes	Yes	Yes
The nature and level of the fee the intermediary will charge (if any)	Yes	Yes	Yes	Yes
Other interests and relationships reasonably likely to influence the intermediary in performing their function, such as relevant remuneration received from someone other than the consumer, and the amount or rate of remuneration			Yes	Yes
Details of the types of products about which the intermediary gives advice or markets and, if the intermediary only advises or markets in relation to products of a particular product generator or generators, a statement to that effect and the name of each of those product generators			Yes	Yes
Disclosure in dollar terms, on a periodic basis, of the difference between the aggregate gross returns on all investments organised though the financial intermediary, and the actual net			Yes	Yes

Recommended disclosure requirements	Information only function	Execution only function	Product marketer function	[High Level] adviser function
return received by the consumer, with an explanation of the difference				
To the extent practicable, total benefits to the intermediary of the consumer's business (including "soft dollar" benefits) where those benefits are not already disclosed as part of the actual gross and net gross return disclosure above			Yes	Yes
The role being undertaken by the intermediary, including a statement as to whose interests the intermediary is acting in and a description of those interests, and for product marketers, a "health warning" about the limitations in the information provided (for example, "I have not considered your personal circumstances, and accordingly, the product may not suit your needs")			Yes	Yes
Remuneration options, if any (that is, hourly rate, fee only, commission rebate) and whether any components of the remuneration are variable	Yes	Yes	Yes	Yes
Where advice or marketing relates to switching products, disclosure of remuneration to the intermediary, the cost to the client (for example, exit fees, entry fees and implementation fees), and the benefits of the alternative as against the existing product		Yes	Yes	Yes