

The Chair
CABINET ECONOMIC GROWTH AND INFRASTRUCTURE COMMITTEE

FINANCIAL ADVISERS REGULATION: VOLUNTARY AUTHORISATION

PROPOSAL

- 1 I propose that regulations be promulgated to allow a person to seek authorisation to provide financial adviser services in relation to category 2 products (“**Voluntary Authorisation**”).

EXECUTIVE SUMMARY

- 2 The Financial Advisers Act 2008 (the “**FAA**”) does not enable the Securities Commission (the “**Commission**”) to authorise a person solely to provide financial advice on category 2 products.¹ This is a particular concern for insurance advisers and mortgage brokers, many of whom have already invested time and money in meeting the proposed competence requirements for authorised financial advisers.
- 3 The FAA allows regulations to be developed that will permit the Commission to authorise a person to provide financial advice on category 2 products. This paper recommends the drafting of such regulations on the basis that this would further the objectives of the legislation by providing incentives for advisers advising on category 2 products to aspire to a higher standard of regulatory coverage.
- 4 I note that the proposal may create a risk to the Authorised Financial Adviser (“**AFA**”) brand, if consumers expect that all AFAs should be competent to provide advice on investment matters. I do not consider that this is a significant risk as the AFA brand is fundamentally about quality assurance. The proposals do not impact on the quality of the services that AFAs provide. A further concern that has been raised is that the proposal could create a de facto standard for all advisers providing advice on category 2 products. I do not consider that this is a significant risk as the proposal does not directly compel any adviser to seek authorisation.

¹ Category 2 products include a range of simple securities (such as call debt securities), general insurance products and consumer credit contracts.

BACKGROUND

- 5 The FAA regulates the provision of financial adviser services. Specifically it restricts the provision of various types of financial adviser services to individuals and entities that have been approved by the Commission to provide such services. In the first iteration of the FAA, these services included the provision of:
- Financial advice on category 1 products;²
 - Financial planning services;³ and
 - Investment transaction services relating to category 1 products.
- 6 Under the FAA, as it then was, only AFAs and specific representatives of a qualifying financial entity (“QFE”) would be permitted to provide these financial adviser services.
- 7 During the passage of the Financial Service Providers (Pre-Implementation Adjustments) Bill (the “**Bill**”) this year many submitters raised concern about the definition of a financial planning service. Specifically, a concern was raised that the definition undermined the distinction between services on category 1 and category 2 products. As a result, a number of advisers who provided financial advice on category 2 products would have to be authorised. Submitters indicated that there was insufficient justification to warrant such a requirement.
- 8 In its consideration of the Bill, the Commerce Select Committee decided that the definition of financial planning service should be amended to focus on services that are provided in relation to investments (as opposed to services that are provided solely in relation to risk or credit products). Accordingly, the term “Financial Planning Service” was replaced with the term “Investment Planning Service” and consequently advisers providing services that did not involve investment matters, no longer required authorisation.
- 9 While the amendment made very clear that those who only provided services in relation to category 2 products did not have to be authorised, it raised a further policy question about whether the regulatory framework should allow a person to voluntarily seek authorisation to provide financial adviser services in relation to category 2 products. This issue was raised by a number of insurance advisers and mortgage brokers who, under the definition of “Financial Planning Service,” had already begun to take steps towards authorisation and were concerned that they were effectively prohibited from becoming authorised under the amended definition.

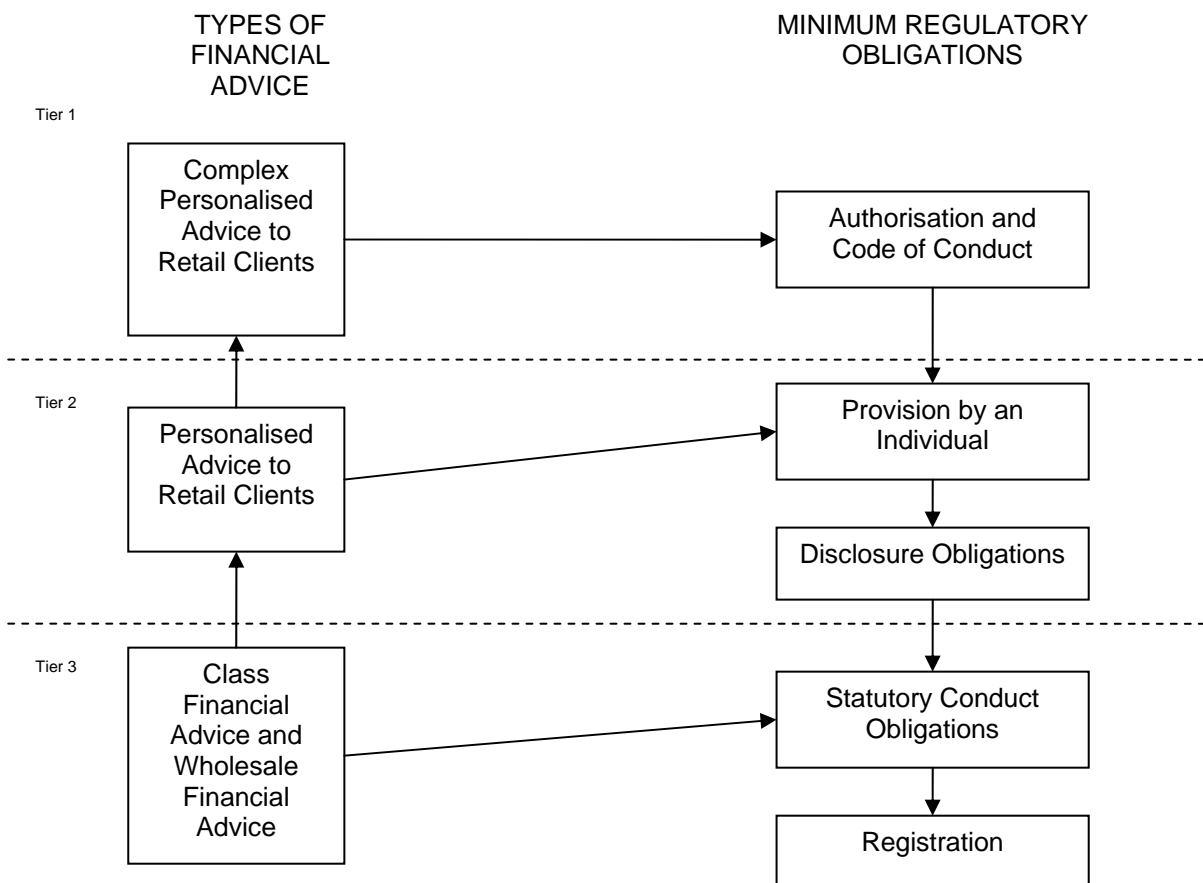
² In its’ first iteration, the FAA defined Category 1 products to include securities, land, derivatives and any other financial product specified in regulations.

³ The FAA defined a financial planning service as a service that analysed a client’s financial position, identified their financial goals and developed financial options for realising those goals.

- 10 In response to these concerns, I proposed an amendment to the Act during the Committee of the Whole Stage of the House to enable regulations to be developed to address the matter. This paper considers whether such regulations should be promulgated to allow people who are not required to be authorised to voluntarily seek such authorisation.

General Regulatory Framework

- 11 The FAA imposes a range of obligations on those people wishing to provide financial advisory services, including financial advice. These obligations have been tailored to different forms of financial advice and range from registration obligations through to specific conduct and disclosure obligations and professional conduct obligations. The FAA restricts the provision of certain forms of financial advice unless the minimum regulatory requirements are satisfied. The diagram below sets out the graduated regulatory requirements for different types of financial advice.



Note: Advisers are prohibited from providing the higher tiers of advice unless all the minimum regulatory requirements for that tier and the lower tiers have been met.

Authorisation

- 12 A specific feature of the regulatory framework that is relevant to any consideration of voluntary authorisation is the application of the authorisation requirements. The FAA provides that a person is eligible to be authorised if the Commission is satisfied that the applicant:
- a Is registered under the FSP Act;
 - b is of good character;
 - c meets the level of competency, knowledge and skills specified in the code for an authorised financial adviser; and
 - d is not de-barred from applying for authorisation.
- 13 If the applicant is eligible, the Commission is required to authorise the applicant for one or all of the specified types of financial adviser services. It is useful to note that the FAA does not in itself specify any competency, knowledge or skills requirements that advisers need to meet in order to become authorised. Rather, determinations of those matters have been delegated to the Code Committee.

The Code of Conduct

- 14 The Code Committee have recently recommended a final code (the “**Code**”) to the Commissioner of Financial Advisers (the “**Commissioner**”). The Commissioner has approved the Code and has recently forwarded on to me for my approval. This Code includes the minimum standards of competency that are required for authorisation. Specifically, Code Standard 16 states that “[t]o be an Authorised Financial Adviser, a financial adviser must attain the Unit Standard Sets within the National Certificate in Financial Services (Financial Advice)(Level 5) that are relevant to the financial adviser services provided by the AFA.”
- 15 The commentary in the Code specifies that an AFA who has passed Unit Standard sets A, B, C, and D can provide any form of financial adviser service.⁴ The Code also specifies that an AFA may provide financial adviser services without having obtained Unit Standard Set D if the adviser has attained Unit Standard Set E and does not provide services relating to a category 1 product. The table below sets out the subjects addressed in each of the unit standards.

⁴ Subject to any restrictions in the terms of their authorisation granted by the Commission and compliance with the ongoing competency requirements.

Unit Standard Set A	Knowledge of the industry, financial markets, the advice process and products
Unit Standard Set B	Knowledge of the Code and consumer protection laws
Unit Standard Set C	Professional practice advice process and complying with legislation
Unit Standard Set D	Investment unit standards
Unit Standard Set E	Insurance unit standards or residential property lending unit standards

- 16 It is also useful to note that Code Standard 14 obliges all AFAs to have the necessary competence, knowledge and skills to provide any financial adviser service. The AFA will need to be able to demonstrate that he or she had a reasonable basis for believing that he or she had the necessary competence, knowledge and skills to provide a specific financial adviser service. As such, even if an AFA has attained all of the standards above, he or she will need to be satisfied that he or she is competent to provide a particular financial advisory service before actually providing that service to a client.

OBJECTIVES

- 17 The statutory purpose of the FAA is to promote the sound and efficient delivery of financial adviser and broking services, and to encourage public confidence in the professionalism and integrity of financial advisers and brokers. It further states that the Act imposes competency requirements on certain financial advisers who deal with retail clients to ensure that there are available to such clients, advisers who have the experience, expertise and integrity to match effectively a client to a product that best meets that person's need and risk profile.
- 18 To properly address the question about whether people providing financial adviser services on non-investment matters (being advice on category 2 products) ought to be able to voluntarily seek authorisation, it is necessary to assess the purposes of authorisation. At the most fundamental level, authorisation enables the Commission to assess the quality of the adviser to determine whether they meet the minimum criteria to provide advice on matters that carry high risks for consumers and the wider economy. While the nature of the advice provided by the adviser (such as whether it relates to complex or simple products) is relevant to whether or not an adviser is *required* to seek authorisation, in my view, the purpose of authorisation is primarily to provide a minimum quality assessment of a given adviser.

COMMENT

- 19 I propose that regulations be promulgated to allow a person to seek Voluntary Authorisation. This would mean that an AFA who was authorised to provide financial adviser services in relation to category 2 products would be subject to the same regulatory obligations as any other AFA. As such, the primary distinction would be that, under the Code, an AFA authorised to provide financial adviser services in relation to category 2 products would be able to do unit standard set E (insurance unit standards or residential property lending unit standards) in place of unit standard set D (investment unit standards). He or she would also be restricted from providing advisory services in respect of category 1 products.
- 20 In my view, this would further the objectives of the legislation by providing incentives for advisers advising on category 2 products to aspire to a higher standard of regulatory coverage. Advisers providing advice on category 2 products would be able to distinguish themselves as higher quality advisers by opting into the AFA regulatory framework. As a result, such advisers would have to make more comprehensive disclosure, comply with the professional code of conduct and be subject to greater regulatory oversight by the Commission.
- 21 This in turn, this would encourage greater confidence in the use of advisers and would ensure the greater availability of high quality advisers over time.

Risks of allowing Voluntary Authorisation

- 22 I have identified some risks of proceeding with this proposal, which predominantly relate either to the dilution of the AFA brand or the creation of a de facto standard for advisers providing advice on category 2 products.

The AFA Brand

- 23 If the proposals are accepted, there is a risk that consumers may not understand that there will be a category of AFAs who will be unable to provide advice on investment matters. This could create general confusion about the appropriate adviser to use for specific advisory needs. Specifically, this proposal could blur the distinctions between advisers who work predominantly on investment matters and those that work with insurance and credit.
- 24 I am not convinced that this risk is significant. As I noted earlier in this paper, the purpose of authorisation was to provide quality assurance. The AFA brand, should first and foremost, be a brand of the standard to which the adviser is held. Accordingly, where an AFA is held to the same standard, irrespective of the type of product, enabling category 2 advisers to voluntarily become authorised should not dilute the AFA brand.

- 25 To the extent that the AFA brand is associated with investment products or complexity of the advisory service, I note that my proposal may result in some dilution of that brand. Aligning the AFA brand with category 1 products or complex investment services could have benefits for consumers. The search costs⁵ for consumers are likely to reduce if all AFAs were able to deal with complex matters or investment products. A single identifiable standard is also likely to have increased impacts on consumer confidence in using financial advisers.
- 26 I note, however, that the development of such a brand is unlikely, given the specialist nature of the advisory market. Advisers advising on certain category 1 products are, in many instances, unlikely to provide advice on other category 1 products. For example, advisers marketing KiwiSaver are unlikely to provide advice on direct equity or derivatives and futures contracts. Further, the competencies, knowledge and skills needed to provide financial advice varies according to the specific issue being addressed. For example, the competencies needed to provide advice on buying specific listed shares are likely to be significantly different to those needed to trade in derivative products. The Code requires an AFA to be competent to provide any financial advice. The consequence of this requirement is that many AFAs would not be able to provide advice on certain category 1 products. Given the limited expected benefit of associating the AFA brand with investment products or the complexity of the advisory service, I do not consider that the possible dilution of that brand by allowing Voluntary Authorisation is a significant risk.

The De Facto Standard

- 27 In 2008, Cabinet decided that advisers providing advice on insurance or credit matters should be able to continue providing advice without becoming authorised. The basis for this decision was that the magnitude of the risks posed by such products did not justify the costs of requiring people providing advice on such products to be authorised.
- 28 There is a risk that the proposal may compel a number of category 2 advisers to become authorised to maintain their existing business. If the proposal to introduce Voluntary Authorisation is adopted, it is likely that a significant number of mortgage brokers and insurance advisers will seek authorisation. As greater numbers of insurance advisers and mortgage brokers become authorised, it is likely that there will be increased competitive pressures on the remaining parts of the sector to seek authorisation. This in turn will have the effect of creating a minimum standard for the industry.

⁵ These costs would be the costs associated with finding advisers who were competent and able to provide appropriate advice on a range of category 1 products.

- 29 I am of the view, however, that this consequence is consistent with encouraging consumer access to competent advisers and the objective of ensuring that the costs imposed on the industry are commensurate with the risks associated with the advisory services provided. As noted, authorisation provides both the Government and consumers with assurance about the standard of the adviser. While the risks associated with advice on insurance and credit products did not warrant the costs of *requiring* authorisation, enabling people to become authorised voluntarily will enable category 2 advisers to spread the costs of authorisation over a greater amount of time. Such advisers will be able to continue providing advisory services in that time and will be better able to absorb such costs.

Risks of prohibiting Voluntary Authorisation

- 30 I note that, under the FAA in its earlier iteration, a number of mortgage brokers and insurance advisers chose to commence educational steps towards authorisation. This was supported by the Commission, which had taken the view that the FAA, in its earlier iteration enabled them to authorise a person to provide financial advisory services solely related to category 2 products. Mortgage brokers and insurance advisers are concerned that many of them who have signed up to undertake non-refundable training programmes with the objective of becoming authorised, may now no longer be able to do so. Many such advisers are likely to decide to stop their educational courses because of the change of the emphasis in the Act. In my view, it would be a perverse outcome if these advisers chose to aspire to lower standards as a result of the development of the FAA.

Recommendation

- 31 For the reasons set out above, I recommend that regulations be promulgated to allow a person to seek authorisation to provide financial adviser services in relation to category 2 products.

CONSULTATION

- 32 The Treasury, the Ministry of Consumer Affairs and the Securities Commission have been consulted on the contents of this paper. The Companies Office and the Department of Prime Minister and Cabinet have been informed.
- 33 Targeted consultation has also been undertaken with members of the financial adviser industry and the Code Committee for Financial Advisers. All advisers consulted were supportive of the approach proposed in this paper.

FISCAL IMPLICATIONS

- 34 There are no fiscal implications arising from the proposals in this paper.

HUMAN RIGHTS

- 35 There are no human rights implications arising from the proposals in this paper.

LEGISLATIVE IMPLICATIONS

- 36 The proposals in this paper will require the promulgation of regulations under the FAA.

REGULATORY IMPACT ANALYSIS

- 37 The Regulatory Impact Analysis requirements apply to the proposal and a Regulatory Impact Statement has been prepared and attached to the Cabinet paper.
- 38 The Deputy Secretary, Economic Strategy Branch, Ministry of Economic Development and the Regulatory Impact Analysis Review Panel have reviewed the Regulatory Impact Statement (RIS) prepared by the Ministry of Economic Development and associated supporting material, and considers that the information and analysis summarised in the RIS is sufficiently comprehensive and robust, and effectively communicated to enable Ministers to fairly compare the available policy options and take informed decisions on the proposals in this paper.
- 39 I have considered the analysis and advice of my officials, as summarised in the attached Regulatory Impact Statement and I am satisfied that, aside from the risks, uncertainties and caveats already noted in this Cabinet paper, the regulatory proposals recommended in this paper:
- Are required in the public interest
 - Will deliver the highest net benefits of the practical options available, and
 - Are consistent with our commitments in the Government Statement on Regulation

PUBLICITY

- 40 The Ministry of Economic Development will post a copy of this paper on its website. Subject to Cabinet approval, I will issue a press statement confirming Cabinet's decision in relation to the proposed regulations.

RECOMMENDATIONS

41 It is recommended that the Committee:

- 1 **Note** that section 154(h) of the Financial Advisers Act 2008 enables regulations to be made by Order in Council that specify further cases in which authorisation may be granted by the Securities Commission.
- 2 **Note** that enabling the Securities Commission to authorise an adviser for the purposes of providing advice on category 2 products will further the objectives of the legislation by providing incentives for such advisers to aspire to a higher standard of regulatory coverage.
- 3 **Note** that the risks of allowing category 2 advisers to voluntarily seek authorisation are minimal.
- 4 **Agree** that regulations be promulgated to allow a person to seek authorisation to provide financial adviser services in relation to category 2 products.
- 5 **Invite** the Minister of Commerce to issue drafting instructions to Parliamentary Counsel Office to give effect to the regulations, as outlined in the paragraphs above.
- 6 **Agree** that this paper be published on the Ministry of Economic Development website.

Hon Simon Power
Minister of Commerce

Date signed: _____

Regulatory Impact Statement

FINANCIAL ADVISER REGULATIONS: VOLUNTARY AUTHORISATION

AGENCY DISCLOSURE STATEMENT

This Regulatory Impact Statement has been prepared by the Ministry of Economic Development.

It provides an analysis of options to address concerns arising from the fact that the Securities Commission is prevented from authorising financial advisers to provide financial adviser services on category 2 products.

The proposals in this paper assess whether insurance and mortgage brokers should have the opportunity to become authorised under the Financial Advisers Act. Given that the legislation is still in the process of being implemented, there is little empirical data to draw on to demonstrate the consequences of enabling such people to become authorised.

None of the policy options are likely to have effects that the government has said will require a particularly strong case before regulation is considered – namely it does not impose direct additional costs on businesses, impair private property rights, market competition, or the incentives on businesses to innovate and invest, or override fundamental common law principles (as referenced in Chapter 3 of the Legislation Advisory Committee Guidelines).

Bronwyn Turley, Manager, Corporate Law and Governance

7 September 2010

STATUS QUO AND PROBLEM DEFINITION

Section 55(1) of the Financial Advisers Act 2008 (the “**FAA**”) enables the Securities Commission (the “**Commission**”) to authorise a person to provide the following financial adviser services:

- financial advice in relation to a category 1 product;⁶
- discretionary investment management services in relation to a category 1 product;
- investment planning services; or
- financial advice or discretionary investment management service in relation to a category 2 product,⁷ where specified by regulations.

The effect of these provisions is that the Commission will not be able to authorise an adviser to provide financial adviser services solely in relation to category 2 products.

Prior to changes made under the Financial Service Providers (Pre-Implementation Adjustments) Bill (the “**Bill**”), advisers were able to seek authorisation solely to provide financial adviser services in relation to category 2 products. As a result of changes made during the Select Committee consideration of the Bill, advisers who provide advice on category 2 products who wish to become authorised will need to undertake investment-focused training that is not relevant to the services they provide (which was not initially required under the earlier version of the FAA).

Insurance advisers and mortgage brokers are concerned that many of them have signed up to undertake non-refundable training programmes with the objective of becoming authorised and may now no longer be able to do so without undertaking further investment-focused training that is not relevant to the category 2 services they provide. Accordingly, a number of advisers who had initially started working towards obtaining authorisation under the earlier version of the FAA, have indicated that they are unlikely to take advantage of becoming authorised given the costs and non-relevance of undertaking investment focused training. The requisite training may amount to approximately up to \$900 per adviser. Industry has indicated that there may be approximately 3,000 to 3,500 advisers who may seek authorisation. Accordingly, under the status quo, the additional costs of authorisation (in addition to the general cost of authorisation) are likely to be approximately \$2.7-3.15m in total. We also note that these costs are not likely to result in a direct benefit to consumers, as these advisers are unlikely to provide advice on investment matters in their daily practice.

⁶ Category 1 products include complex securities, futures contracts, investment linked insurance contract and land investment products

⁷ Category 2 products include simple securities, contracts of insurance (excluding investment linked insurance) and consumer credit contracts.

In addition, under the status quo a greater number of advisers would not be bound by the Code and the minimum standards of competence, knowledge, skills, ethical behaviour, client care and the continuing professional training requirements that go with it. While a number of insurance advisers and mortgage brokers and their industry bodies have embraced the objectives underpinning the new regulatory regime and are committed to being part of the shift of the financial advisory industry to becoming a true profession, it is likely that the number of category 2 advisers seeking authorisation will diminish if the status quo is maintained. Industry organisations have indicated that a significant number of their membership are unlikely to seek authorisation under the status quo. A number may also have to undertake further training before they will be able to meet the requisite competency standards. This, in turn, is likely to reduce the number of advisers who are authorised and provide advisory services in relation to category 2 products. Accordingly, the status quo may make it more difficult for consumers to access advisers who have been assessed by the Government as being of sufficient competency, experience and character to provide advice on category 2 products.

The FAA establishes a regulation making power that allows regulations to be promulgated that will allow the Commission to authorise a person to provide financial advice or discretionary investment management decisions in relation to category 2 products. This regulation making power was included in the FAA after concerns were raised during the Committee of the Whole House's consideration of the Bill.

OBJECTIVES

The purpose of the FAA is to promote the sound and efficient delivery of financial adviser services and to encourage public confidence in the professionalism and integrity of financial advisers. The objectives of this proposal are to ensure

- that there are available to retail clients financial advisers who have the experience, expertise, and integrity to match effectively a person to a financial product that best meets that person's need and risk profile; and
- that the costs of compliance associated with authorisation are minimised where possible.

REGULATORY IMPACT ANALYSIS

Three options have been considered to address the problem.

1. Maintain the status quo;
2. Allow advisers providing advice on category 2 products to seek authorisation from the Securities Commission; and
3. Require advisers providing advice on category 2 products to seek authorisation from the Securities Commission.

Maintaining the Status Quo

As noted, the FAA does not expressly prohibit a person who provides advice on category 2 products to become authorised. Rather, if the status quo is retained, the FAA requires that any person who seeks authorisation must be, at a minimum, authorised to provide advice relating to investment matters. Accordingly, under the status quo, if insurance advisers and mortgage brokers chose to seek authorisation, such advisers would need to seek authorisation for the purposes of undertaking investment planning services. These advisers would also be required to undertake the investment examinations (Unit standard Set D – Investments).

Benefits of Status Quo

Under the status quo, there would be increased clarity about the nature of the Authorised Financial Adviser (“**AFA**”) brand. All AFAs would have undertaken training to provide advice on investment matters. As such, consumers could legitimately expect that any person who has been granted status as an AFA would be competent to provide that consumer with advice on investment matters. The benefit of clarity of such branding is that consumers will have reduced search costs in seeking access to competent financial advice in relation to investment matters.

However, the likely magnitude of this benefit is significantly reduced given the variety of investment advisory services that exist, including full wealth management services and specialised derivatives and hedging advice through to simpler advice about retirement savings or product specific marketing. The range of investment advisory services that exist may in many instances necessitate varying degrees of competency. Unit standard Set D simply sets a minimum standard for all AFAs to comply with if they are providing advice on investment matters. The Code relies on the requirement that each adviser be satisfied that they are competent to provide advice before providing such advice to ensure that advisers have the necessary competencies across a range of services.

Accordingly, the AFA brand in itself will not provide sufficient clarity to consumers to have a significant impact on the consumers’ ability to access competent financial advice on investment matters.

A further benefit of the status quo is that the costs of providing category 2 advisory services will continue to be a relatively low cost service. If people providing advice on category 2 products were able or required to be authorised, the costs of providing category 2 advice would increase, assuming that a majority of advisers sought to become authorised. Advisers who choose not to become authorised may be able to charge less for their services. Currently, some advisers have indicated that the total costs of compliance with the new framework (including all requisite training) will be approximately \$5,000 per adviser. This will ultimately be borne by consumers. The status quo reduces the likelihood that such costs will be incurred in relation to category 2 products.

Costs of Status Quo

As noted in the Problem Definition section of this Regulatory Impact Statement, if the status quo were retained:

- there would be increased costs for category 2 advisers wishing to obtain authorisation; and;
- there is likely to be a reduction in the number of advisers who seek authorisation.

A related point is that there are a range of category 2 products that may be more complex or carry greater risks for consumers. While requiring all persons who provide advice on such products to seek authorisation may not be justifiable on the basis of the costs of authorisation, it may nonetheless be desirable to permit such advisers to seek authorisation if they wish. A good example of this may include risk planning. Many consumers may not be in a position to completely appreciate the nature or extent of the risks that they operate with. In such instances, it would be desirable for such consumers to have available to them suitable advisers who are able to assess and value the extent of those risks. If the status quo is retained, it is likely that there will be a reduced number of such advisers. This in turn is likely to have an impact on the nature of the financial decisions being undertaken by consumers. This could also have a broader economic impact where consumers make suboptimal decisions in greater numbers, as this could result in sectors carrying too much risk, over-leveraging or over insuring.

Voluntary Authorisation (Preferred Option)

This option would allow the Securities Commission to authorise a person to provide financial adviser services in relation to category 2 products. Such persons would have to meet all the standards that have been established for AFAs under the law as it stands. The fundamental point of difference is that they will not need to demonstrate that they are competent to provide financial advice on investment matters. Rather they will need to establish an equivalent competency either in relation to residential lending or insurance (Unit Standard Set E – Residential lending or Insurance).

Benefits of Voluntary Authorisation

The primary benefit of enabling people to become authorised voluntarily is that it would further the statutory objective of promoting the availability financial advisers who have the experience, expertise, and integrity to match effectively a person to a financial product that best meets that person's need and risk profile. It is likely to do this by providing incentives for advisers advising on category 2 products to aspire to a higher standard of regulatory coverage. Advisers providing advice on category 2 products would be able to distinguish themselves as higher quality advisers by opting into the AFA regulatory framework. As a result, such advisers would have to make more comprehensive disclosure, comply with the professional code of conduct and be subject to greater regulatory oversight by the Commission. This in turn, would encourage greater confidence in the use of advisers and would ensure the greater availability of high quality advisers.

This approach will also ensure that the costs of becoming authorised may be spread over a greater period of time. This will allow businesses to transition to the new framework in a timeframe that is consistent with their business model. For some advisers, who may be looking to grow their businesses, this may mean seeking authorisation as soon as they are able to, so that they can take advantage of the marketing benefits associated with being authorised. Others, who may have a more stable client base, may look to wait until the regime has bedded in properly before committing to making the changes.

We also note that other advisers who may not provide significant advisory services may choose not to seek authorisation and may continue operating as registered financial advisers. Accordingly, any direct costs of compliance are voluntarily incurred under this option.

Costs of Voluntary Authorisation

The introduction of a voluntary category of authorisation may create a de facto regulatory standard for insurance advisers and mortgage brokers. While no concerns have been raised as yet about the creation of such a voluntary standard, the creation of such a voluntary framework may make it more difficult for those not authorised to retain their current reputation without becoming authorised. However, as noted, this will further the statutory objective of encouraging the availability of advisers with greater expertise.

This option may also create greater confusion about what consumers could legitimately expect from their advisers, as it will create a category of AFAs who will not be able to, and will not be competent to, provide advice on investment matters. However, these risks may be mitigated by the imposition of terms and conditions by the Commission. Such terms and conditions could require advisers who are limited to providing category 2 services to disclose the scope of their authorisation to their clients. If the proposed regulations are promulgated, it is likely that the Commission will require such disclosure under their terms and conditions. The draft Code and the proposed disclosure regulations will also require advisers to disclose any limitations on their scope of their financial adviser services including any limitations on the financial products or range of financial products they are permitted to advise upon.

Compulsory Authorisation

A further option to address the problem identified is to require any person providing financial advice on category 2 products to become authorised. While this would ensure that there are high quality advisers to provide the entire spectrum of financial advice, this option is likely to significantly increase the costs of compliance. Any adviser who fails to become authorised would accordingly have to cease providing advisory services. Officials do not consider that the benefits of having all such advisers authorised outweigh the costs of creating a barrier to entry into the market for advice on category 2 products.

Further, officials also consider that this option is not feasible at this stage as it would require significant legislative amendment.

CONSULTATION

The Treasury, the Ministry of Consumer Affairs, the Reserve Bank and Securities Commission have been consulted on the contents of this paper. The Companies Office and the Department of Prime Minister and Cabinet have been informed.

Targeted consultation has also been undertaken with members of the financial adviser industry and the Code Committee for Financial Advisers. All advisers consulted were broadly supportive of the approach proposed. One adviser indicated that it would be useful to require authorised category 2 advisers to disclose the limits of their authorisation. This proposal is being addressed in the work that MED is undertaking on the disclosure requirements for financial advisers.

CONCLUSIONS AND RECOMMENDATIONS

Given the potential benefits of enabling authorisation, and the fact that the costs for the relevant advisers are voluntary, MED recommends that regulations be developed that allow a person to seek authorisation to provide financial adviser services in relation to category 2 products

IMPLEMENTATION

It is currently envisaged that the regime introduced by the FAA will be fully brought into force by July 2011. The Register of Financial Service Providers (the “**Register**”) was opened to applicants from mid August 2010.

These proposals will be implemented through regulations which we expect may be promulgated by mid November 2010.

The key implementation risk is that the regulations are delayed. If the regulations are delayed, persons who solely provide advice on category 2 products will not be able to be authorised by the Commission for a longer period of time. This may increase the numbers of category 2 advisers who choose not to seek authorisation

MONITORING, EVALUATION AND REVIEW

The Ministry is required to review the FAA within five years of commencement (section 161 of the Act). The Ministry is developing an evaluation plan. This is likely to involve the identification and recording of base data for the period in which the FAA commences to be compared against data at the end of the relevant period. The data will be qualitative and quantitative and will be gathered from surveys, interviews with relevant stakeholders, statistical information, international comparisons and other observable market and industry outcomes. The evaluation programme will include an assessment of the regulatory framework for AFAs who provide services on category 2 products, including the possible distortions to the market and the size of compliance costs imposed.

Upon completion of the review, the Ministry will prepare a report to the Minister of Commerce who will table the report to the House of Representatives.