REVIEW OF FINANCIAL PRODUCTS AND PROVIDERS: PLATFORMS AND PORTFOLIO MANAGEMENT SERVICES

Discussion Document

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1. Executive Summary

1. This discussion document covers platforms and portfolio management services. Platforms and portfolio management services are neither securities in their own right, nor are they schemes – they are services. This is the main reason why platforms and portfolio management services do not fall within the proposed definition of and regulatory framework for collective investment schemes ("CISs").

2. Platforms are computerised administration services designed to hold, trade and report on investments. There are three separate functions that can be bundled together in the offer of a platform namely, a financial adviser, an administrator (which, in this discussion document, we have called the "platform provider") and a custodian. Portfolio management services offer similar services to platforms. The main difference between portfolio management services and platforms is that there are usually only two functions associated with the portfolio management service, that is, that of the manager/broker/financial adviser (in this document referred to as the "portfolio service provider") and the custodian.

3. Platforms and portfolio management services are generally only offered through financial advisers, although some platforms can be offered directly to investors and some portfolio management services are offered by specialist firms.

4. Currently there are few regulatory protections for consumers using platforms and portfolio management services. Platforms and portfolio management services do not fall within the Securities Act 1978. Many investors may not know that their investments are being channelled through platforms or they may not be informed about all the fees and charges associated with platforms or the portfolio management service. Platform providers and custodians are not subject to supervision, and there is no requirement that either platform providers or custodians comply with minimum governance requirements (that is, they are not currently required to demonstrate that they have the competence and capacity to perform their functions).

5. While platform providers perform similar administration functions to issuers of CISs and custodians perform similar custodial functions to CIS trustees it is recognised that platforms and portfolio management services have unique features that require a slightly different regime.

1.1 GOVERNANCE

6. This discussion document proposes a consistent framework for governance and supervision of platforms and portfolio management services. Platform providers, portfolio service providers and custodians (of both platforms and portfolio management services) will be required to be registered and to meet entry and ongoing requirements, including demonstrating that they have the capability and capacity to perform their respective roles. Platform providers, portfolio service providers and custodians will each be approved and supervised by the Securities Commission (the "Commission"). The framework is based on the entry and ongoing requirements for issuers of CISs and for CIS trustees.

7. This discussion document proposes minimum duties of the platform provider and the custodian.

   a. The proposed duties of the platform provider are:

      - To appoint a registered custodian;
      - To use its best endeavours and skill to ensure that the platform facility is operated in a proper and efficient manner;
      - To use due diligence and care in the exercise and performance of its duties and powers as platform provider;
      - To give effect to investors' authorities, including from financial advisers;
      - To pay to the custodian all money received in respect of investors purchasing or subscribing for interests in securities through the platform service and to segregate the assets of investors from the assets of the platform provider;
      - To hold personal profits and/or benefits (except remuneration) by directors of the platform provider on trust for the benefit of investors;
      - To report to the Commission that: it continues to meet the ongoing fit and proper requirements; on the performance of its duties and powers; on the operation of the platform facility; and to report statistical data;
      - To comply with reasonable requests for information from the Commission and to allow the Commission to make inspections; and
      - To comply with any requests, directions or orders issued by the Commission.

   b. The proposed duties of the custodian are:

      - To only accept an appointment to act as custodian from a registered platform provider;
      - To perform its obligations with the same care, diligence and skill as a professional custodian trustee;
      - To hold investors’ assets in safe custody as bare trustee on behalf of the investor (including segregating investors’ assets from its own assets);
      - To account for the assets;
      - To deal with investors’ assets in accordance with the platform provider’s/investor’s directions;
      - To act on authorised instructions;
      - To ensure that investors are promptly paid;

- To hold personal profits and/or benefits (except remuneration) by directors of the custodian on trust for the benefit of investors;

- To have an independent auditor carry out a systems audit to ensure the custodian has the appropriate systems in place;

- To report to the Commission that: it continues to meet the ongoing fit and proper requirements; on the performance of its duties and powers; and statistical data;

- To comply with reasonable requests for information from the Commission and to allow the Commission to make inspections; and

- To comply with any requests, directions or orders issued by the Commission.

8. It is proposed that the platform provider and the custodian have the necessary powers to perform their functions and carry out their duties.

9. In respect of portfolio management services we seek your comments on the duties that should be imposed on portfolio service providers. In particular, we query whether the duties should be broadly similar to the duties of platform providers or to those issuers of CISs.

10. We also briefly discuss the role of financial advisers; however, the proposals for reform in respect of financial advisers are set out in the *Financial Intermediaries* discussion document, which was released in July 2006.

11. It is proposed that the regulator will be the Commission. The Commission will be responsible for:

- Enforcing compliance with the proposed disclosure requirements;

- Approving an applicant as a platform provider, a portfolio service provider or a custodian, and monitoring and enforcing the ongoing fit and proper requirements; and

- Enforcement, where there is non-compliance by the platform provider, the portfolio service provider or the custodian of its duties and obligations.

1.2 DISCLOSURE

12. This discussion document also proposes that all investors in platforms and portfolio management services will receive an additional disclosure document, that is, a portfolio service disclosure statement (a “PSDS”) before investing. The PSDS aims to fill any gaps that exist between product and adviser disclosure so that the investor is fully informed about his or her investment through the platform or portfolio management service, including the total cost associated with investing through the service. The PSDS will be required to disclose information about:

- The platform service and any risks associated with participation in the platform service;

- The identity of the platform provider and the custodian, and their respective obligations and responsibilities;

- Investors' rights under the platform service; and

- The fees, charges and expenses associated with the service.

13. In addition, where an investor has given a power of attorney to another person to make investment decisions on the investor's behalf, the investor will also be required to receive disclosure about the adviser service level agreement. Disclosure about the underlying products will be provided to the attorney making the investment decision.

2. Introduction

14. This discussion document discusses the regulation of platforms and portfolio management services. That is, those wrap and other nominee services that do not come within the proposed definition of CIS in paragraph 39 of the *Collective Investment Schemes* discussion document.

15. We consider platforms and portfolio management services will not come within the proposed definition of CIS because:

- Although people who use these services pool their assets (generally in the name of the custodian), the assets are pooled for transaction purposes only (that is, they are not pooled for joint asset accumulation);

- Investors on the platform or through the portfolio management service maintain full day-to-day control (unless they assign control over via a power of attorney); and

- Platforms and portfolio management services are neither securities in their own right, nor are they schemes – they are services.

16. For the avoidance of doubt, when we use the term "platform" we do not include master trusts. Instead, master trusts will come within the proposed definition of CIS and will be regulated in accordance with the proposed regulatory framework for CISs.

2.1 WHAT ARE PLATFORMS?

17. Platforms are computerised administration services designed to hold, trade and report on investments. Platforms consolidate reporting and keep track of all of an investor's investments. A "wrap account" is one type of platform. Wrap accounts "wrap" an investor's investments into a single account.

18. Platforms facilitate reporting by financial advisers to investors and can result in easier to understand, consolidated, reporting to investors. Platforms can enable investors to access a wider range of investments and can enable investors to have a diversified investment portfolio. Because platforms provide "bulk purchasing" power, investors may get the benefit of wholesale rates which generally results in platforms offering lower fund management fees than where an investor invests directly into managed funds. However, it should be noted that after the addition of fees associated with the platform service (including the platform provider's fees and the custodian's fees) the cost to the investor may be higher or lower than if the investor invested directly.

19. There are three separate functions that can be bundled together in the offer of a platform namely, a financial adviser, an administrator/platform provider and a custodian. In some platforms, the separation of functions is clear, whereas in other platforms the roles may be combined, with entities or groups performing two or all three functions. Because platforms are currently structured in different ways, we seek your feedback on how each of these separate functions should be defined, so that each function can be appropriately regulated.

20. Platforms are generally only offered through financial advisers, although some platforms can be offered directly to investors. The regulation and definition of

financial advisers is discussed in the *Financial Intermediaries* discussion document, which was released in July 2006.

2.2 WHAT ARE PORTFOLIO MANAGEMENT SERVICES?

21. Portfolio management services are similar to platforms in that generally, financial advisers provide portfolio management services to investors. Like platforms, the custodian has legal title to the assets and the investor retains beneficial ownership of the assets. The main difference between portfolio management services and platforms is that there are usually only two functions associated with the portfolio management service; that is, that of the manager/broker/financial adviser and the custodian. There is no administration service between the manager/broker/financial adviser and the custodian. In most cases a portfolio service provider is given a broad discretion, via a power of attorney, to make and manage the client's investments in their name. However, unlike a CIS, investments of several clients are not pooled into a unit trust or similar arrangement, but are maintained on an individual basis.

22. Although there are generally only two functions in portfolio management services and although portfolio management services tend to be less formalised than that of a platform, they do have similar features to platforms. Because these services have similar features to platforms, we consider the objectives for regulating platforms and the problems identified with the current regulatory regime (below) apply equally to portfolio management services.

23. In light of the objectives and problems identified, this discussion document focuses its discussion on the proposed option for regulating platforms. However, most of the issues raised concerning platforms also raise issues for portfolio management services. Where relevant, we ask whether you consider the proposed regulation should also extend to portfolio management services.

Question for Submission

1. How do you consider we should define what we have called in this document a "platform provider", a "portfolio service provider" and a "custodian"?

3. Objectives for Regulating Platforms

24. The objectives identified for a regulatory regime for platforms are to:

- Provide consistent regulation across similar products and services so that platform providers comply with the same requirements, custodians comply with the same requirements, and so that both platform providers and custodians operate fairly and with transparency;

- Encourage soundly governed institutions and ensure that platform providers and custodians meet fit and proper entry and ongoing requirements. Such regulation will ensure that institutions that offer these services are honest, competent and have the capacity to perform their functions;

- Have effective supervision to monitor the platform provider and the custodian, and enforce compliance with the regulatory requirements;

- Promote well-informed investors/consumers through relevant disclosure, enabling investors to make informed decisions, such that they are able to take responsibility for their investment decisions;

- Apply minimum regulatory standards to platform services, so that investors' interests are adequately protected and so that investors have confidence in investing their funds through platforms; and

- Be fair and treat those affected by the regulation equitably.

4. Problems with the Current Regulatory Regime

25. The Financial Intermediaries Task Force noted the increased use of platform technology in the financial planning sector.

26. Platforms are not currently regulated. Because the investor has direct ownership of specific assets (as opposed to a shared interest in assets) the platform itself does not constitute a separate security interest and is not subject to the disclosure obligations in the Securities Act 1978, nor the prudential requirements of the Unit Trusts Act 1960. Instead, the platform relies on the regulatory disclosure literature of the underlying product issuer.

27. Because wraps and other similar platforms are not subject to the disclosure obligations under the Securities Act, investors may not be informed about all the fees and charges involved with these services, and the impact of those fees and charges on their returns.

28. Custodians currently do not comply with Recommendation 23 of the Financial Action Task Force ("FATF") Recommendations.[1]

29. As there is neither any entry criteria nor monitoring of platform providers or custodians, there is currently scope for misconduct to occur, for example there is scope for platform providers to offer services without the appropriate competency or capacity to operate a platform service, or for fraudulent activity to occur.

30. Although platforms provide services and not products, we consider that platform providers perform similar administration functions to issuers of CISs, and custodians perform similar custodial functions to CIS trustees, and therefore consider that equivalent regulation to ensure platform providers and custodians are soundly governed institutions should apply.

31. Similar governance and disclosure issues arise in respect of portfolio management services.

32. It is however recognised that platforms and portfolio management services have unique features, and that any regulatory regime for the regulation of these services needs to have regard to these features.

[1] New Zealand is a signatory to (and must ensure compliance with) the FATF Recommendations. Recommendation 23 is attached at Appendix 1.

5. Proposed Option for Regulating Platforms

33. We do not consider that platforms (that is, wrap and other nominee services) and portfolio management services will fall within the proposed definition of CIS. The basic framework proposed for CISs will therefore not apply to platforms and portfolio management services.

34. We consider regulatory intervention is necessary however because a party other than the investor (that is, the custodian) has legal title to the securities and because of the problems identified with the current regulatory regime. We propose regulating:

- The governance arrangements for both platform providers and custodians, to ensure that platform providers and custodians are registered and comply with fit and proper entry and ongoing requirements; and

- Disclosure, such that investors have information about the service, charges and fees, and other information associated with investing through a platform, and are equipped to make informed decisions about their investments.

5.1 GOVERNANCE

35. It is proposed that the governance requirements for platforms will include:

- Fit and proper entry and ongoing requirements for platform providers and custodians;

- Specification of duties, powers and liabilities for platform providers and for custodians;

- Certain rights of investors; and

- Supervision by the Commission.

5.1.1 Platform Providers and Custodians will be Registered

36. Registration will be a two step process. It is proposed that an entity will provide:

a. The Registrar of Companies with negative assurances. The Registrar will be able to confirm the veracity of such negative assurances (see the *Overview of the Review and Registration of Financial Services Institutions* discussion document for a discussion of the objectives of the registration system and the proposed registration function); and

b. The Commission with information demonstrating that it is fit and proper (that is, that it has the competency and capacity to perform its functions and duties: see paragraph 46 for platform providers and paragraph 46 for custodians).

37. An entity will not be required to complete one step before the other; however, it will also not be able to be registered until it has completed both steps of the registration process.

38. Requiring platform providers and custodians to be registered will help to reduce any misconduct by platform providers and custodians, and ensure that these entities are

subject to minimum regulatory requirements and are supervised and monitored. Further, the registration process will assist in ensuring that platform providers and custodians have the appropriate governance structures and competency and capacity to carry out their functions.

39. In addition, registration of custodians is necessary to ensure that New Zealand complies with its obligations as a signatory to the FATF Recommendations. Recommendation 23 of the FATF Recommendations requires that directors and senior management of financial institutions subject to the Core Principles (the banking, insurance and securities sectors) should be evaluated on the basis of "fit and proper" criteria, including those relating to expertise and integrity.

40. Currently, there is no comprehensive way of identifying or monitoring providers of financial services and no reliable means of determining whether regulatory requirements are being met. In order to comply with FATF Recommendation 23, New Zealand is required to have a comprehensive supervisory framework for identifying financial institutions, including custodians.

41. Thus, registration of both custodians and platform providers will also ensure that investors are able to identify persons and entities that offer financial services, which will allow investors to find out more information about the platform provider and the custodian and will enable investors to make informed investment decisions.

5.1.2 Platform Providers and Custodians will be Approved by the Commission

42. As part of the registration process, platform providers and custodians will be required to be approved by the Commission.

43. Platform providers and custodians will be required to demonstrate to the Commission that they meet fit and proper entry requirements (including elements of capability, capacity and independence) before they are approved.

5.1.3 Platform Providers and Custodians Must Satisfy Entry Requirements

44. Requiring platform providers and custodians to be registered and to meet fit and proper entry and ongoing requirements will ensure that platform providers and custodians comply with minimum governance standards, that they have honest and competent management, and are capable and have the capacity to carry out their functions. Such requirements will enhance accountability, reduce the risk of fraudulent conduct and the possibility of breach by a platform provider or a custodian of its duties and obligations, and will enhance investor protections.

45. In addition, requiring custodians to comply with the fit and proper entry requirements will also enable New Zealand to comply with Recommendation 23 of the FATF Recommendations.

5.1.3.1 Entry Requirements for Platform Providers

46. To reduce misconduct, to ensure that platform providers have the necessary competence and capacity to operate a platform facility and considering that platform providers perform a similar function to the administrative function that issuers of CISs perform, we propose requiring platform providers to demonstrate similar entry

requirements to those we propose imposing on issuers of CISs (see paragraph 126 of the *Collective Investment Schemes* discussion document). That is, in addition to the negative assurances provided to the Companies Office for registration purposes, each applicant will be required to demonstrate to the Commission that it is subject to fit and proper requirements. An applicant to become a platform provider will be required to:

- Demonstrate that it is competent and has adequate capacity to perform its function of operating the platform facility including, for example:
    - the appropriate skills, qualifications and experience of management (at both the individual director level and the entity level);
    - ensuring that adequate infrastructure and organisational (including governance) accounting, computer and operating systems are in place; and
    - capital adequacy: ensuring appropriate levels of capital to enable the platform provider to carry out its function (that is, to operate the platform facility) and to manage an orderly wind-down of its services should it face financial difficulty.
- Where the platform provider has outsourced any of its obligations, confirm to the Commission that any agent engaged by the platform provider has the relevant competence and capacity to perform the outsourced component of the platform provider's functions. In order to make such a confirmation, it would be a term of the platform provider's approval that the platform provider monitor the agent. This requirement only relates to the outsourced component of the platform provider's duty – the platform provider will not be required to confirm or monitor the competence or capacity of other agents (for example, financial advisers).

5.1.3.2 Entry Requirements for Custodians

47. A custodian is anyone who holds securities, assets or other scheme property on behalf of another person. We also propose imposing similar entry and ongoing requirements on custodians to reduce the potential for misconduct and to ensure that custodians have the necessary competence and capacity to perform their function. That is, in addition to the negative assurances provided to the Companies Office for registration purposes, each applicant will be required to demonstrate to the Commission that it meets fit and proper requirements.

48. An applicant will be required to demonstrate to the Commission that it is competent and has adequate capacity to perform its function of holding assets on trust as bare trustee on behalf of investors including, that the custodian:

    a. Is a body corporate (see paragraph 49);

    b. Has the appropriate skills, qualifications and experience to hold the assets on trust (at both the individual director level and the company level);

    c. Has adequate infrastructure and organisational (including governance) accounting, computer and operating systems in place;

d. Has the appropriate levels of capital to enable it to carry out its function and to manage an orderly wind-down of its services should it face financial difficulty;

e. Has adequate professional indemnity insurance and undertakes that adequate professional indemnity insurance cover will be maintained; and

f. Has an element of directors on the board independent from the platform provider (see paragraph 50).

Requirement for Corporate Form

49. We consider that custodians should be required to be bodies corporate and that the body corporate carries out no activity other than holding assets on trust as bare trustee for investors. The advantages of requiring a body corporate for the custodian are that:

- It provides for perpetual succession, such that there will be no need to change registered ownership where there is a change of director. There would be a need to change registered ownership if there was a change of a natural person trustee; and

- It protects the assets for the benefit of investors.

An Element of Independence

50. We do not propose requiring the custodian to be completely independent from the platform provider. We consider that full independence from the platform provider is not required because the platform provides only an administration service and therefore does not require a complete separation of roles and an additional layer of independent monitoring on behalf of investors.

51. This said, we consider the custodian should have at least one independent director, to ensure the custodian complies with its duties and responsibilities.

52. Such a requirement meets the objectives for regulating platforms because it provides some degree of independence to allow the custodian to perform a limited role in monitoring the platform provider and is cost effective. We consider that an element of independence on the board of directors will meet the objectives for regulating platforms and that the requirement for full independence would go further than necessary to meet the objectives.

5.1.3.3 The Entry Requirements will be Flexible

53. The proposed entry requirements for both platform providers and custodians will need to be flexible so that they can be tailored to suit the particular competency and capacity requirements necessary for the particular services offered by the platform provider and the custodian. Ultimately, in determining whether or not to approve an applicant as a platform provider or a custodian, the Commission will exercise its discretion to determine whether a particular applicant is competent and has the appropriate capacity to perform its functions.

54. The entry requirements discussed in paragraphs 46 and 48 will not limit the scope of the Commission's approval process. That is, the Commission will be able to place terms and conditions on an applicant's approval as it sees fit.

55. We need to consider what requirements should be prescribed in the primary legislation, what (if any) should be in regulations, and what (if any) should be left to the Commission's discretion. We need to achieve a balance between certainty and flexibility – to have all requirements in primary legislation would provide the greatest level of certainty, but would be inflexible and more difficult to change. An approval system which gave total discretion to the Commission would be flexible and adaptable, but would lack transparency for applicants.

56. A question exists around what should happen in the event the Commission does not approve a particular applicant? The consequence of failing to meet the fit and proper requirements is that an applicant will not be approved as a platform provider or a custodian. It is important that applicants have some protections. However, it must also be borne in mind that we do not want undesirable platform providers or custodians, or platform providers or custodians without the necessary competence and capacity to carry out their functions. There should also be some degree of finality in a determination made by the Commission. If the Commission determines that the applicant does not meet the entry requirements the Commission must give the applicant its reasons for making that determination. We seek your comments on the process that you consider should be followed in the event an applicant is declined approval by the Commission. Should it be able to present further information to the Commission, or should the applicant be allowed to appeal the Commission's decision to the High Court?

Questions for Submission

2. Do you consider that the requirement that platform providers and custodians be registered meets the objectives for regulating platforms? Why/why not?

3. Do you consider any of the fit and proper entry requirements that applicants must satisfy before being approved as a platform provider or a custodian are inappropriate? Why/why not?

4. Do you consider platform providers or custodians should be required to comply with any other fit and proper entry requirements? Why/why not?

5. Do you consider the custodian should be a body corporate? Why/why not?

6. Do you consider the custodian should be fully independent from, or have an element of independence from, the platform provider? Why/why not?

    - If you consider the custodian need only have an element of independence, is it sufficient that the custodian has only one independent director, or should there be a requirement to have a proportion of independent directors? If the latter, what should the proportion of independent directors be?

7. What process do you consider should be followed in the event an applicant is declined approval by the Commission?

    - Should it be able to present further information to the Commission, should the applicant only be allowed to appeal the decision to the High Court or should the applicant have some other form of appeal process? What are your reasons?

5.1.4 A Company will not be able to be Approved as Both the Platform Provider and the Custodian

57. We considered whether one company that complied with both sets of entry and ongoing requirements could be both the platform provider and the custodian.

58. In our discussions with advisory group members we received some feedback that the platform provider and the custodian could not be the same entity, as the custodian's sole function is to hold investors' assets on trust as bare trustee on behalf of investors (see paragraph 87) and the assets of investors must be held separately from the assets of the platform provider (see paragraph 74(e)). We consider it will be impossible for one company to meet both sets of entry requirements and be approved as both the platform provider and the custodian.

59. However, this would not preclude the platform provider and the custodian being part of a group of related companies (for example, subsidiaries), provided the related companies had processes in place to ensure that any conflicts of interest were appropriately managed.

Question for Submission

8. Considering the entry and ongoing requirements, and the functions and duties of platform providers and custodians, do you consider the platform provider and the custodian can be part of the same group of companies? Why/why not?

5.1.5 Ongoing Requirements will be Monitored by the Commission

60. Once approved, the platform provider and the custodian will need to satisfy the Commission that they continue to meet the fit and proper entry requirements, that is, that they continue to be competent and have adequate capacity to perform their functions.

5.1.5.1 Reporting to the Commission

61. To ensure that the Commission has sufficient information to monitor the fit and proper requirements of the platform provider and the custodian, and to ensure effective supervision and accountability, it is proposed that platform providers and custodians will be required to report to the Commission:

    a. When any matter material to its approval changes (event based reporting). The platform provider or the custodian would be required to self-report to the Commission if it breached any of its approval requirements, and describe how it is addressing that breach. The platform provider or the custodian will also be required to report to the Commission any material change to its approval that falls short of a breach of the fit and proper entry requirements; and

    b. Periodically, to confirm the fit and proper requirements continue to be met (periodic reporting). The periodic reports will provide the Commission with information on an annual basis demonstrating that the entity continues to satisfy the fit and proper entry requirements. A requirement to report to the Commission on an annual basis will provide investors with some assurance that

platform providers and custodians are subject to monitoring and reporting requirements. As part of the Commission's power to impose terms and conditions on the approval of a particular entity, the Commission will have the ability to require a particular entity to report more frequently than annually if the Commission considers it necessary for it to effectively supervise that entity.

Question for Submission

9. Do you consider the proposed reporting requirements relating to the ongoing monitoring of the fit and proper requirements are appropriate or inappropriate? Why?

5.1.6 Breach of the Ongoing Fit and Proper Requirements

62. A platform provider or a custodian will be found in breach if it breaches the fit and proper requirements after its initial approval, or if it breaches the terms and conditions attached to its approval.

63. It is proposed that the Commission will have a range of powers to deal with a breach of the ongoing fit and proper requirements. The response necessitated will depend on the severity of the breach – being a week late with a periodic report should not incur the same penalty as, in an extreme example, failure of an entity to report to the Commission that it no longer has the capacity to carry out any of its functions.

64. We consider there needs to be a graduated system of mechanisms and penalties for dealing with breaches. It is proposed that the Commission will have the powers to:

    a. Request information from the entity and, where necessary, carry out, or appoint another person to carry out, inspections or reviews. For example, if a report is late the Commission would be able to seek an explanation from the entity as to why the report is late. If the Commission was not satisfied with the explanation, it could question the entity about it;

    b. Issue directions or order the platform provider or the custodian to comply with the terms and conditions of its approval or the fit and proper requirements within a specified time frame. Such a direction may be in greater or lesser degrees of specificity – for example, the Commission may, if it sees fit, direct the platform provider or the custodian as to *how* to fix the breach;

    c. Impose conditions on the platform provider or the custodian relating to the breach of the relevant fit and proper requirement/s; and

    d. Revoke the entity's approval and de-register it where it continues to be non-compliant with the fit and proper requirements. In practice, this will result in the removal of the platform provider or the custodian, which will require all of the platform's clients to be transferred to another platform provider or custodian.

65. It is proposed that the Commission will be able to exercise any of the powers in paragraph 64 for the purposes of the proposed legislation. This will give the Commission the necessary powers to effectively carry out its supervisory function.

66. Given the consequence of failing to continue to satisfy the fit and proper requirements (that is, revocation of an entity's approval and deregistration), it is important that platform providers and custodians have some protections and avenues for redress. If the Commission determines that an entity no longer satisfies the fit and proper requirements, it must give the entity its reasons for making that determination. While the Commission's actions will be subject to judicial review, further protection could be afforded by an appeal process to the High Court. We seek your feedback on the appeal processes that an entity can pursue if it is unhappy with a decision of the Commission.

Questions for Submission

10. Do you consider the proposed options for remedying a breach by the platform provider or the custodian of the fit and proper entry requirement are appropriate, or are there any that are inappropriate?

11. What appeal rights do you consider a platform provider or a custodian should have if the Commission determines that the entity no longer continues to satisfy the fit and proper requirements and revokes an entity's approval and deregisters it?

5.1.7 Governance Requirements for Financial Advisers and Portfolio Service Providers

5.1.7.1 Financial advisers

67. Some providers of portfolio management services are also financial advisers (broadly, a financial adviser is a person who provides financial advice about financial products to members of the public: see the *Financial Intermediaries* discussion document), and will be regulated as such.

68. Financial advisers, including some portfolio service providers, will be captured by the governance requirements in the legislation relevant for financial intermediaries: see the *Financial Intermediaries* discussion document. That is, where:

    a. A financial adviser provides financial advice it will be subject to competency, disclosure and conduct obligations; and

    b. An intermediary executes transactions on behalf of its client or holds client funds, it will be subject to money handling processes and disclosure obligations.

69. In addition, any intermediary who is a financial institution within the meaning of the FATF Recommendations will be monitored by the supervisory framework for financial institutions and will be required to comply with fit and proper entry requirements, including those relating to expertise and integrity: see the *Overview of the Review and Registration of Financial Institutions* discussion document.

5.1.7.2 Portfolio service providers

70. In the case of specialised firms that only offer portfolio management services (i.e. those persons who will not come within the proposed legislation for financial intermediaries), we propose that entry and ongoing requirements should be similar to

those proposed for platform providers, taking into account the skills and experience needed to manage a portfolio of investments. Broadly, portfolio service providers will be required to demonstrate to the Commission that they are fit and proper and have the competency and capacity to perform their functions and duties. In particular they will be required to demonstrate that they have the appropriate skills, qualifications, experience, infrastructure and organisational, accounting, computer and operating systems in place, as well as ensuring they have appropriate levels of capital to enable the portfolio service provider to manage a portfolio of investments and to manage an orderly wind-down.

Question for Submission

12. Do you agree with the proposed approach for ensuring financial advisers and portfolio service providers have the appropriate competence and capacity to perform their functions and duties? Why/why not?

5.2 FUNCTION, DUTIES AND POWERS OF THE PLATFORM PROVIDER

5.2.1 Function of the Platform Provider

71. Functions set the scope for the platform provider's duties and powers. They provide a general overview of the role of the platform provider, and what we expect the platform provider will do and will be responsible for.

72. The proposed function of the platform provider is to operate and provide the administration services for the platform facility.

Question for Submission:

13. Do you consider there should be any other functions for platform providers in addition to the one set out above, or do you consider the proposed function inappropriate? Why?

5.2.2 Duties of the Platform Provider

73. Platform providers are currently not required to comply with any legislative obligations.

74. It is proposed that the platform provider will owe the following duties to investors:

    a. To appoint a custodian who is registered or will be registered at the same time as the platform provider;

    b. To use its best endeavours and skill to ensure that the platform facility is operated in a proper and efficient manner. Because investors do not have any control over the operation of the facility or the platform provider, and the custodian merely holds the assets (rather than acting as a "supervisory trustee" under the new trustee supervisory model), this duty focuses the platform

provider's mind that it must actually use its best endeavours and skill. Without such a duty a platform provider could be negligent or reckless in operating the administrative functions of the platform facility;

c. To use due diligence and care in the exercise and performance of its duties and powers as platform provider. We consider that a lesser duty should be imposed on platform providers than on issuers of CISs because platform providers are only offering a service, whereas issuers of CISs offer interests in products, thus requiring a higher duty to be imposed on them to protect the interests of investors;

d. To give effect to investors' authorities, including from financial advisers. Such a duty will ensure that investors' instructions are carried out as each investor intended them to be;

e. To pay to the custodian all money received by the platform provider in respect of investors purchasing or subscribing for interests in securities through the platform service and to segregate the assets of investors from the assets of the platform provider. This duty ensures the platform provider is accountable for any monies it receives from investors and that the assets of investors are not combined with the assets of the platform provider;

f. To hold personal profits and/or benefits (except remuneration) by directors of the platform provider on trust for the benefit of investors. Thus, directors of the platform provider will not be able to use their position to profit personally or benefit from holding investors' funds. Instead, such benefit will be held on trust for the benefit of investors. It is proposed that this duty will be similar to that contained in section 26 of the Unit Trusts Act;

g. To report to the Commission that it continues to meet the ongoing fit and proper requirements (see paragraph 61) and to report on the performance of its duties and powers and on the operation of the platform facility;

h. To report statistical data to the Commission. Statistical data contributes to a high-level overview of the financial sector, which is of interest to both the industry and government policy-makers. We received feedback from the CIS and superannuation advisory groups that statistical information is readily extractable at any given month or quarter end. However, it is recognised that the gathering of statistical data is not without cost, so any requirement needs to be put in place only after careful consideration of, for example, the necessity of the information, and who is the best source of the information. It is proposed that the statistical data would be collated and made publicly available on the Companies Office's website. It is likely that there will be a distinction between data that will be made public and data (particularly commercial data) given in confidence that will be kept private. The data that is made public will generally be amalgamated with that of other platform providers to provide an overview of the whole sector;

i. To provide the Commission with such information it reasonably requests relating to the platform facility, or to the business, property or the affairs of the platform provider or relating to its compliance with the ongoing fit and proper requirements, and to allow the Commission, or a person appointed by the Commission, to inspect the books and records of the platform provider and the

platform facility. Apart from the reporting requirements to the Commission, this will be the main tool the Commission has to monitor the platform provider and the platform service; and

j. To comply with any requests, directions or orders issued by the Commission.

75. In our discussions with advisory group members we received some comments that some of the duties we propose to impose on platform providers (for example, the duties set out at paragraphs 74(b) and (c)) ought to be imposed on custodians instead of platform providers, as the investor has a direct relationship with the custodian, whereas the platform provider merely provides a back office administration service to financial advisers, with no direct relationship with investors. However, we understand that various platform services are structured in different ways and we seek your feedback on which way you consider best meets the objectives for regulating platforms (see paragraph 24).

5.2.2.1 Proposed Duties for Portfolio Service Providers

76. Portfolio service providers are likely to have fiduciary obligations to their clients if they manage their investments under a power of attorney. In light of this we think that broadly similar statutory duties imposed for platform providers (above) would be appropriate for these people. However, we acknowledge that the role of the platform provider is different from the role of the portfolio service provider in that portfolio service providers offer more than computerised administration services. As portfolio service providers with powers of attorney in relation to investments will be responsible for taking investment decisions on behalf of their clients, we consider that the legislation should also contain a duty on these people to act in the best interests of their clients as well as with due care and skill in the investment of client monies.

77. Alternatively, because portfolio service providers with powers of attorney in relation to investments are responsible for taking investment decisions on behalf of their clients, you may consider that the portfolio service provider is more akin to the fund manager/issuer of a CIS, and therefore that broadly similar statutory duties to those imposed on CIS issuers would be more appropriate to impose on portfolio service providers. The duties of CIS issuers are set out in paragraph 150 of the *Collective Investment Schemes* discussion document. We seek your comments on whether you consider the proposed duties for portfolio service providers should be broadly similar to those we propose imposing on platform providers, or to those we propose imposing on issuers of CISs.

Questions for Submission:

14. Do you consider there should be any other duties in addition to those set out above that should be imposed on platform providers? Why?

15. Do you consider any of the proposed duties are inappropriate or instead ought to be imposed on custodians? Why?

16. In relation to the requirement to report statistical data to the Commission, what information should be included in any statistical data return and what data, if any, should be provided to the Commission in confidence?

17. Are the proposed duties for platform providers appropriate to impose on portfolio

service providers?

- If so, do you consider portfolio service providers should have an additional duty to act in the best interests of their clients and to act with due care and skill in the investment of client monies? Why?

- If not, do you consider the duties of CIS issuers are more appropriate to impose on portfolio service providers? Why?

    - If not, what duties should be imposed on portfolio service providers?

5.2.3 Powers of the Platform Provider

78. The platform provider will have the power to administer investments on behalf of the investor. This power is necessary to enable it to carry out its function and duties owed to investors. The source and extent of the power arise out of the contract between the platform provider and the investor and, as such, it is not proposed that this power will be prescribed in legislation.

Question for Submission:

18. Apart from the powers set out in the contract between the platform provider and the investor, do you consider the platform provider requires any other powers to enable it to carry out its functions and duties? Why?

5.2.4 Breach by the Platform Provider of its Duties Owed to Investors

79. This section discusses what happens if the platform provider is not performing its duties. It discusses who can enforce the performance of the platform provider's duties and the proposed remedies available.

80. In the event the platform provider breaches any of its duties owed to investors, it is proposed that the platform provider will be directly liable to investors. It is proposed that investors will be able to take an action to court to seek a remedy for breach by the platform provider of any of its duties owed to investors. However, this may be extremely costly for an individual investor to pursue.

81. It is proposed that the Commission will also have a range of powers to deal with the platform provider's breach of its duties. It is proposed that the Commission will have the powers to:

    a. Request information from the platform provider and, where necessary, make inspections;

    b. Issue directions or order the platform provider to comply with its duties;

    c. Impose conditions on the platform provider; and

    d. Take an action to the High Court to seek a remedy for the breach. Such remedy may include compensation where investors have suffered loss as a

result of the breach, or other orders. In light of the fact that investors may find it expensive or inequitable for an individual or several investors to take an action against the platform provider we consider there may be some public interest in the Commission taking an action to court to enforce the platform provider's compliance with its duties. We seek your comments on the orders that the Commission should be able to seek to enforce platform provider compliance with the proposed legislation.

82. It is proposed that the Commission will be able to exercise any of the powers in paragraph 81 for the purposes of the proposed legislation. This will give the Commission the necessary powers to effectively carry out its supervisory function.

Questions for Submission:

19. Do you consider the proposed remedies for breach by the platform provider of its duties owed to investors are appropriate, or are there any that are inappropriate? Why?

20. Other than compensation, what orders do you consider the court should be able to make to enforce platform provider compliance with the proposed legislation? What are your reasons?

5.2.5 The Platform Provider will also be Subject to Financial Adviser Legislation where the Platform Provider also Provides Financial Advice

83. Currently, in certain platforms, the platform provider (i.e. the person providing the administration service) also provides financial advice to investors. We wish to clarify and unbundle these two roles so that each role is regulated separately.

84. Where the platform provider provides financial advice as well as the administration service to an investor then, in respect to that advice, the platform provider will also be a financial adviser. An example of financial advice may be where a platform provider makes a recommendation, rather than merely listing products in a menu from which an investor (or the investor's adviser or attorney) may select.

85. It is proposed that the two currently bundled roles will be unbundled, and each role will be regulated separately, that is, in respect of the administration services the entity will be required to comply with the proposed requirements set out in this document for platform providers and, in respect of any financial advice associated with the platform, the entity will be subject to the financial adviser legislation (see the *Financial Intermediaries* discussion document, which was released in July 2006).

86. Whilst we consider that financial advice and administration services can be bundled together to be offered to investors by one entity (provided it meets the regulatory requirements for both regimes), we received some comments querying whether there should be a requirement that the platform provider and the financial adviser must each be separate entities. We seek your comments on this issue.

Questions for Submission:

21. Do you consider the roles of platform providers and financial advisers should be regulated separately? Why/why not?

22. Do you consider a person can be both the platform provider (i.e. providing the administration service) and the financial adviser? Why/why not?

6. Functions, Duties and Powers of the Custodian

6.1 FUNCTIONS OF THE CUSTODIAN

87. As a bare trustee, the custodian is still a trustee, but its functions and duties are more limited than those of other trustees. The functions of a bare trustee are limited to holding assets, settling transactions and acting only on the instructions of a beneficiary. As a bare trustee, the functions of the custodian will be to hold investors' assets on trust on behalf of investors/beneficiaries, to settle transactions and to act on every instruction given to it, provided it is in accordance with the authority provided by the investor.

88. In light of these differences (i.e. between a bare trustee and other trustees), we do not consider it appropriate for the custodian to have a monitoring role over the platform provider. In addition, as it is not proposed that the custodian be totally independent from the platform provider it is inappropriate for it to have a supervisory function (see paragraph 51).

6.2 DUTIES OF THE CUSTODIAN

89. It is proposed the custodian will owe the following duties to investors/beneficiaries:

    a. To ensure that, before it accepts an appointment to act as custodian, the platform provider is registered or will be registered at the same time as the custodian;

    b. To perform its obligations with the same care, diligence and skill as a professional custodian trustee (see paragraph 94);

    c. To hold investors' assets in safe custody as bare trustee on behalf of investors (including segregating investors' assets from its own assets);

    d. To account for the assets;

    e. To deal with investors' assets in accordance with the platform provider's/investor's directions;

    f. To act on authorised instructions – this is considered to be wider than the duty proposed in paragraph 89(e);

    g. To ensure that investors are promptly paid;

    h. To hold personal profits and/or benefits (except remuneration) by directors of the custodian on trust for the benefit of investors. It is proposed that this will be the same duty as that proposed for platform providers and issuers of CIS (see paragraph 74(f));

    i. To have an independent auditor carry out a systems audit to ensure the custodian has the appropriate systems in place (see paragraph 90);

    j. To report to the Commission that it continues to meet the ongoing fit and proper requirements (see paragraph 61), and to report on the performance of its duties

and powers (including providing a copy of the annual independent systems audit: see paragraph 92);

k. To report statistical data to the Commission. It is proposed that this will be the same duty as that proposed for CIS trustees (see the paragraph under the heading "How the Securities Commission will get information" of the *Supervision of Issuers* discussion document);

l. To provide the Commission with such information it reasonably requests relating to the platform facility, or to the business, property or the affairs of the custodian or relating to its compliance with the ongoing fit and proper requirements, and to allow the Commission, or a person appointed by the Commission, to inspect the books and records of the custodian. Apart from the reporting requirements to the Commission, this will be the main tool the Commission has to monitor the custodian; and

m. To comply with any requests, directions or orders issued by the Commission.

6.2.1 Audit Requirements

90. An audit is necessary to ensure the custodian has properly registered, accounted for, and kept beneficiary property. Consideration needs to be given as to what requirements there are for an annual audit and what it is an audit of.

91. The audit could be an audit of the custodian's systems and processes in accordance with international best practice (systems audit) or an audit of the assets held under custody (financial audit).

92. We received some feedback from the Wellington and Auckland CIS advisory groups that there should be a requirement to have an audit, but that the costs of requiring a financial audit could considerably outweigh the benefits investors would receive in the event something went wrong. We seek your comments on the costs of having either a financial audit or a systems audit and the benefits for investors, and where the appropriate balance for investor protection lies.

93. We propose that the custodian be required to have a systems audit and not a financial audit. An independent auditor would be required to assess how the custodian's systems and processes fit within guidelines based on international best practice and how, for example, those systems assist the custodian to carry out its functions and duties. Information from the audit could be linked to the ongoing fit and proper requirements – where custodians must demonstrate to the Commission on an ongoing basis that they have adequate infrastructure and organisational (including governance) accounting, computer and operating systems in place to perform their functions: see paragraph 48(c). However we also seek your comments on whether there may be a more appropriate means of ensuring the custodian's compliance with its duties to hold and account for investors' property.

Questions for Submission

23. Do you consider there should be any other duties for custodians in addition to those set out above, or are there any that you consider inappropriate? Why?

24. In relation to the requirement to report statistical data to the Commission, and

considering the discussion in the *Supervision of Issuers* discussion document, what information should be included in any statistical data return?

25. In relation to the safe custody of assets, how should assurance be ensured?

- Do you consider there should be a requirement to carry out an audit and to have an auditor? What are the costs and benefits of requiring a financial audit and a systems audit?
- If you consider there should be a requirement to carry out an audit, should the auditor be independent?
- If you consider there should be a requirement to carry out an audit, do you consider a systems audit (where an external auditor reviews the custodian's systems and processes in accordance with international best practice) is more cost effective than a financial audit? Why/why not? Or do you consider there is some other more cost effective means of ensuring the custodian's compliance with its duties? If so, what are the costs and benefits of your option?
- Who should the auditor report to and how frequently?

6.3 CUSTODIAN AS FIDUCIARY AND THE STANDARD OF CARE OWED TO INVESTORS

94. Because the custodian will hold the assets on trust for investors, we consider:

- The relationship between custodian and investor will be fiduciary in character; and
- The custodian will be required to perform its obligations with the same care, diligence and skill as a professional custodian trustee.

95. The custodian would therefore have the same liability for its acts and omissions in the exercise of its functions as a professional custodian trustee.

6.4 POWERS OF THE CUSTODIAN

96. It is fundamental to the nature of the platform that a custodian is a bare trustee and has limited powers. If it has trustee powers, duties and obligations then it is arguable that a trust is created which could be deemed a unit trust for the purposes of the income tax legislation.

97. It is proposed that the custodian's powers will therefore be limited to the powers necessary to properly act on the directions from a platform provider/investor. It will also have the power to realise assets to pay proper fees, liabilities and tax.

Question for Submission

26. Do you consider the custodian requires any other powers in addition to the limited powers set out above, or do you consider the proposed powers are inappropriate?

6.5 BREACH BY THE CUSTODIAN OF ITS DUTIES OWED TO INVESTORS

98. In the event the custodian breaches any of its duties owed to investors, it is proposed that the platform provider will be directly liable to investors. It is proposed that investors will be able to take an action to court to seek a remedy for breach by the custodian of any of its duties owed to investors. However, this may be extremely costly for an individual investor to pursue.

99. It is proposed that the Commission will also have a range of powers to deal with the custodian's breach. It is proposed that the Commission will have the same powers as those set out in paragraph 81 in relation to breach by the platform provider of its duties owed to investors. That is, the powers to:

    a. Request information from the custodian and, where necessary, make inspections;

    b. Issue directions or order the custodian to comply with its duties;

    c. Impose conditions on the custodian; and

    d. Take an action to the High Court to seek a remedy for the breach. Such remedy may include compensation where investors have suffered loss as a result of the breach, or other orders. We seek your comments on the orders that the Commission should be able to seek to enforce custodian compliance with the proposed legislation.

100. It is proposed that the Commission will be able to exercise any of the powers in paragraph 99 for the purposes of the proposed legislation. This will give the Commission the necessary powers to effectively carry out its supervisory function.

Questions for Submission

27. Do you consider the proposed remedies for breach by the custodian of its duties owed to investors are appropriate, or are there any that are inappropriate? Why?

28. Apart from compensation, what orders do you consider the court should be able to make to enforce custodian compliance with the proposed legislation? What are your reasons?

6.6 FUNCTIONS, DUTIES, AND POWERS OF THE CUSTODIAN OF A PORTFOLIO MANAGEMENT SERVICE

101. We consider that the same issues arise for the custodian of portfolio management services because the nature of the role of the custodian is identical in both situations – it holds and accounts for the assets of the investors. We seek your feedback as to whether the proposed regulation should extend to these services.

Question for Submission

29. Do you consider the proposed functions, duties and powers of the custodian of a platform service should extend to the custodian of a portfolio management service? Why/why not?

7. Other Protections

7.1 WHISTLE-BLOWING PROVISION

102. We are proposing to introduce whistle-blowing provisions in relation to CISs, similar to sections 18A and 18B of the Superannuation Schemes Act: see paragraphs 158 to 164 under the heading “Other Protections” in the *Collective Investment Schemes* discussion document.

103. The proposed provision would allow an administration manager, investment manager, actuary or auditor of a CIS, who forms an opinion in the course of, or in connection with, the performance of the functions of that office that there is a serious problem with the scheme, to disclose that information to the CIS trustee. It is proposed that any persons who disclose information in good faith under the provision would be protected from any liability for such disclosure. The “exemption” from liability will encourage those parties with knowledge to come forward with the information, without fear of reprisal.

104. We consider that such a duty and corresponding exemption from liability should also apply to platforms. That is, a custodian, platform provider or auditor, who forms an opinion in the course of, or in connection with, the performance of the functions of that office that there is a serious problem with the platform, to disclose that information to the Commission.

105. Such a provision will encourage those parties who have knowledge about any serious problems with the platform to give that information to the Commission.

106. Inclusion of a whistle-blowing provision will minimise the risk of unfair and fraudulent conduct as it provides another check and balance on the platform provider and the custodian, and enhances investor protections.

Questions for Submission

30. Do you consider whistle-blowing provisions should apply to platform providers and custodians? Why/why not?

31. Do you consider the proposed whistle-blowing provisions should extend to portfolio management services? Why/why not?

8. The Role of the Regulator

107. It is proposed the regulator will be the Commission.

8.1 FUNCTIONS OF THE COMMISSION

108. The Commission will be responsible for:

- Enforcing compliance with the proposed disclosure requirements (see the paragraphs under the heading “Disclosure”);
- Approving an applicant as a platform provider, a portfolio service provider or a custodian, and monitoring and enforcing the ongoing fit and proper requirements; and
- Enforcement, where there is non-compliance by the platform provider, the portfolio service provider or the custodian of its duties and obligations.

9. Disclosure

109. Appropriate disclosure about the platform service is required so that investors obtain sufficient relevant, easily comprehensible information with which to make their investment decisions and which will foster well-informed investors. At paragraph 119 we propose a portfolio service disclosure statement ("PSDS"), which sets out the information that should be disclosed about the platform service.

110. It is proposed that all investors in platforms and portfolio management services will receive the PSDS. The goal of the PSDS is to fill any gaps that exist between product and adviser disclosure so the investor is fully informed about his or her investment through the platform service, including the total cost associated with investing through the service.

111. In addition, where an investor has given a power of attorney to another person to make investment decisions on the investor's behalf, the investor will also be required to receive disclosure about the adviser service level agreement: see paragraph 135. Disclosure about the underlying products will be provided to the attorney making the investment decision.

112. Where an investor retains the discretion to make all investment decisions, the investor will also be required to receive disclosure about each of the underlying investments.

113. We note that some members of the advisory groups did not agree that the disclosure an investor receives about the underlying investments should be dependent on whether the investor retains the discretion to make his or her own investment decisions, or whether the investor has delegated his or her decision-making to another person. We consider the distinction is consistent with current New Zealand securities laws where disclosure can be made to the holder of a bona fide power of attorney on behalf of the donor of that attorney. Disclosure can also be made to the person holding a power of attorney (and not directly to the consumer) under the Credit Contracts and Consumer Finance Act 2003. As discussed (see paragraph 109), disclosure provides investors with relevant information so they can make well-informed investment decisions. We consider that where an investor has given away his or her right to make investment decisions there is no need at law to require disclosure about the underlying investment to be made to that investor prior to the attorney making the investment decision.

114. Australian regulation is based on the underlying principle that for an arrangement to be treated as an investor directed portfolio services ("IDPS"), it must involve the investor having the discretion to make all investment decisions.[2]

9.1 FINANCIAL ADVISERS WILL BE REQUIRED TO PROVIDE THE PSDS TO INVESTORS

115. The platform provider will be required to ensure the information contained in the PSDS (see paragraph 119) is accurate.

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[2] Paragraph 148.13, ASIC Policy Statement 148 *Investor directed portfolio services*.

116. However, from an investor perspective, the key relationship an investor has is with his or her financial adviser. Platform providers generally do not have face-to-face contact with investors. We therefore consider the most practical way to address disclosure about the platform service is to require financial advisers to provide the PSDS to investors.

117. Where the platform provider is also the financial adviser, the platform provider/financial adviser must ensure the investor receives the PSDS.

118. Requiring financial advisers to provide the platform disclosure to the investor is consistent with their current obligations. For example, because the financial adviser selects the menu of products from which an investor (or the investor's attorney) may choose, the financial adviser will therefore already be responsible for ensuring the investor receives the underlying product disclosure.

9.2 PORTFOLIO SERVICE DISCLOSURE STATEMENT

119. So that investors are fully informed about the platform service, we propose that the PSDS contain information about the following:

    a. The platform service and any risks associated with participation in the platform service;

    b. The identity of the platform provider and the custodian, and their respective obligations and responsibilities;

    c. Their rights under the platform service; and

    d. The fees, charges and expenses associated with the service.

120. We consider the PSDS should include the information set out below.

9.2.1 Disclosure about the Platform Service

121. It is proposed the PSDS includes the following information about the service:

- What the service is and how the service differs from investing directly; and
- Any material risks associated with participation in the platform service.

9.2.2 Disclosure about the Platform Provider

122. It is proposed the PSDS includes the following information about the provider:

- Who the platform provider is;
- Who the directors of the platform provider are; and
- The platform provider's role/function.

9.2.3 Disclosure About the Custodian

123. It is proposed the PSDS includes the following information about the custodian:

- Who the custodian is;
- Who the directors of the custodian are; and
- The custodian's role/function.

124. The PSDS should also contain a statement that the securities are being held by the custodian in the beneficiary's name (that is, that the investor is not the legal owner of the securities, but that the custodian is the legal owner of the securities and the investors are the beneficial owners of the securities), and the consequences of the securities being held by the custodian (for example, that certain information regarding securities will be sent to the custodian and not to the investor).

9.2.4 Disclosure About Investment Options

125. It is also proposed the PSDS should include statements that:

- The investor or the investor's attorney must receive copies of the disclosure documents before investment; and
- The issuers of securities available through the platform have agreed that their securities can be offered through the platform.

9.2.5 Disclosure about Investors' Rights in the Platform Facility

126. It is proposed the PSDS includes the following additional information:

- How the investor can communicate instructions to the platform provider;
- How the investor can communicate with the custodian;
- How the investor can withdraw from the platform facility (which may be contingent on the underlying products);
- The investor's rights to disclosure;
- Who the investor can complain to; and
- What other information can be obtained from the platform provider in relation to the platform facility.

9.2.6 Disclosure about Fees, Charges and Expenses

127. There must be transparent disclosure about the total cost of all fees, charges and expenses associated with the investment to the investor.

128. The PSDS must disclose the method and extent of all charges associated with the platform and any right to deduct funds from investments to pay fees or recoup expenses.

129. From a practical perspective, we consider financial advisers (including those platform providers that also provide financial advice) will be required to give to a potential investor, before he or she invests,[3] a disclosure document that sets out both the initial and ongoing total fees, charges and expenses in both dollar and percentage terms tailored to the amount of funds the investor wishes to invest and the time period the investor wishes to invest his or her funds for. These fees, charges and expenses will include:

    - All fees associated with the product/products, as stated in the disclosure document/s;
    - All fees associated with the platform, as set out in the PSDS;
    - All fees associated with the financial adviser, including all relevant remuneration; and
    - Any right to deduct funds from investments to pay fees and expenses.

130. Whilst these fees, charges and expenses are, in most cases, currently disclosed to potential investors, some rebates and other fees may not be currently included in the total cost of fees to investors.

131. We propose requiring the financial adviser to highlight any related party fees associated with the investment, and any commissions the financial adviser may receive.

132. Disclosure around the total cost of all fees, charges and expenses will ensure transparency and will enable investors to compare the fees associated by investing in/through different products, platform facilities and/or financial advisers.

133. We acknowledge it will be difficult to calculate some costs accurately to the last cent (for example, fees that are dependent on overall volume, or the legal fees of the underlying product). We therefore seek your comments on how the total cost of all fees, charges and expenses associated with the investment should be calculated. For example, should they be calculated using an assumed fee schedule (based on last year's historical costs) plus the known fixed fees, or should the financial adviser have an obligation to use his/her best endeavours to accurately calculate the total cost of all fees, charges and expenses to the investor?

134. We also recognise that the financial adviser may not be in a position to calculate the total costs to investors. We therefore consider the financial adviser will contract with the platform provider (which has the administrative capacity) to provide this information.

[3] Note: Recent amendments to the Supplementary Order Paper to the Securities Legislation Bill allow financial advisers to make some fee disclosure *after* advice has been given.

9.3 DISCLOSURE FOR INVESTORS WHO DO NOT MAKE INVESTMENT DECISIONS

135. In addition to the PSDS, where an investor does not retain the discretion to make investment decisions (because he or she has given a power of attorney to another person to make investment decisions on the investor's behalf), the investor will be required to receive disclosure about the service level agreement between the investor and the adviser.

136. We would expect when investors are not making investment decisions there will be a service level agreement in place between the investor and the adviser which will set out the roles/functions, responsibilities and duties of the adviser and the authorities and discretions that the investor gives the adviser. This should include the granting of a power of attorney by the adviser for the purposes of investment disclosure. It is also important that the service level agreement includes a clear statement of the authorities and powers given to the adviser by the investor in making investment decisions.

137. It is also proposed that the disclosure required by the adviser to the investor will include:

- The roles, responsibilities and duties of the adviser;
- That the investor has given investment discretion to the adviser and what the effect of this is;
- That the investment adviser is managing and administering the investments;
- The material matters of the service level agreement; and
- The reports the investor will receive and the frequency of those reports.

138. Where an investor has given a power of attorney to another person to make investment decisions on the investor's behalf (for example, to the investor's financial adviser or to some other person who holds a power of attorney in respect of investment decisions) disclosure about the underlying products will be provided to the person who holds the power of attorney. We consider there is no utility in providing product disclosure to investors who give away their ability to make investment decisions because such investors rely on the expertise and ability of the adviser to make the investment decisions for them.

139. Where an investor has given another person a power of attorney in respect of investment decisions, we consider that reporting becomes extremely relevant to such investors. If an investor is unhappy with his or her returns, reporting will allow an investor to seek advice about his/her investment and, based on that information, can then instruct his or her attorney.

Questions for Submission

32. Do you think there should be a PSDS in respect of platforms? Why/why not?
    - If yes, what information do you think it should contain?

33. If a financial adviser/attorney is making investment decisions on behalf of the investor, do you agree that:
    - Disclosure of the service level agreement between the financial adviser and the investor should be made to the investor; and
    - Disclosure about the underlying investment products should be made to the adviser (and not to the investor)?

34. If you agree that disclosure of the service level agreement should be made to the investor, do you consider the proposed information to be disclosed is appropriate? Why/why not?

35. Do you consider the platform provider should be required to ensure the information contained in the PSDS is accurate?

36. Do you consider the financial adviser should be required to ensure that the investor receives the PSDS? Why/why not?

37. Do you think the financial adviser should be responsible for making disclosure to an investor of:
    - The total fees, costs and expenses payable?
    - The material terms of the service level agreement?

38. How should the total cost of all fees, charges and expenses associated with the investment be calculated? For example:
    - Could fees be calculated using an assumed fee schedule (based on last year's historical costs) plus the known fixed fees? What fees would be variable (and therefore need to be based on historical data), and what fees would be fixed? Why would or wouldn't this option for calculating fees work?
    - Should the financial adviser have an obligation to use his/her best endeavours to accurately calculate the total cost of all fees, charges and expenses to the investor? Should this obligation stand on its own, or be in addition to a method of calculating fees (for example, based on historical fees and fixed fees)? What are your reasons?
    - How else do you consider variable fees should/could be calculated?

39. Should disclosure of the total cost of all fees, charges and expenses be required to be:
    - Made in dollar terms only;
    - Made in percentage terms only;

- Made in both dollar and percentage terms;
- Set out in an illustrative management expense ratio ("MER"). If so, will this be meaningful to investors? Why/why not?;
- Made in dollar and percentage terms and set out in an illustrative MER;

for each investor?

9.4 LIABILITY

9.4.1 Liability for Failure to Disclose or for Deceptive, Misleading or Confusing Disclosure

140. We propose that the platform provider will commit an offence where it discloses information in the PSDS that is deceptive, misleading or confusing.

141. We propose that the financial adviser will commit an offence where it fails to disclose to provide the investor with the appropriate disclosure documents.

142. We consider the platform provider and the financial adviser will be liable for the same penalties as are currently proposed under Part 4 to the Securities Markets Act 1988 contained in the proposed draft Securities Legislation Bill. These can be summarised as follows:

- Liability for failure to disclose information that a person is aware requires disclosure, or ought reasonably to be aware requires disclosure;
- Liability for deceptive, misleading or confusing disclosure;
- Liability for deceptive, misleading or confusing advertisements.

143. If a person is held liable for any of the above offences he, she or it will be subject to a maximum penalty of $100,000 fine for an individual, or a $300,000 fine for a body corporate. We propose that the penalties for the offences proposed in paragraphs 140 to 142 should be consistent with the penalties contained in the draft Securities Legislation Bill.

144. It is proposed the Commission will also have the powers to prohibit or suspend an advertisement or a PSDS if it does not comply with the proposed legislation or if it is misleading, deceptive or confusing.

Question for Submission

40. Do you consider the proposed offences and penalties are appropriate? Why/why not?

9.5 DISCLOSURE FOR PORTFOLIO MANAGEMENT SERVICES

145. We consider that the same issues arise in respect of disclosure to investors about the portfolio management service. We seek your feedback as to whether the proposed regulation in respect of disclosure should extend to portfolio management services.

Question for Submission

41. Do you consider the proposed regulation in respect of disclosure should extend to portfolio management services? Why/why not?

Appendix 1: Excerpt from the FSAP Report

Excerpt from the Financial Sector Assessment Programme ("FSAP") report on New Zealand's compliance with the Financial Action Task Force Recommendations

Financial Action Task Force Recommendations

Following is Recommendation 23 of the Financial Action Task Force ("FATF") Recommendations, followed by the Financial Sector Assessment Programme ("FSAP") report on New Zealand's compliance with the Recommendation.

Recommendation 23

Countries should ensure that financial institutions are subject to adequate regulation and supervision and are effectively implementing the FATF Recommendations. Competent authorities should take the necessary legal or regulatory measures to prevent criminals or their associates from holding or being the beneficial owner of a significant or controlling interest or holding a management function in a financial institution.

For financial institutions subject to the Core Principles, the regulatory and supervisory measures that apply for prudential purposes and which are also relevant to money laundering, should apply in a similar manner for anti-money laundering and terrorist financing purposes.

Other financial institutions should be licensed or registered and appropriately regulated, and subject to supervision or oversight for anti-money laundering purposes, having regard to the risk of money laundering or terrorist financing in that sector. At a minimum, businesses providing a service of money or value transfer, or of money or currency changing should be licensed or registered, and subject to effective systems for monitoring and ensuring compliance with national requirements to combat money laundering and terrorist financing.

FSAP response

There are reasonably comprehensive measures to prevent criminals taking control or acquiring a significant participation in a registered bank, and there are also some requirements, though less comprehensive, for sharebrokers. However, there are no requirements for other types of financial institutions, and this deficiency should be rectified.

As noted above, in order to ensure compliance with the anti-money laundering and countering the financing of terrorism ("AML/CFT") measures, New Zealand relies on framework based on industry discipline. There is no programme of supervision or monitoring. The Financial Transactions Reporting Act 1996 contains sanctions for failing to comply with the different provisions of the Act, and the New Zealand Police can conduct an investigation for such offences in the same way as for other offences. Both the Reserve Bank and the Securities Commission have the ability to conduct on-site inspections in banks and sharebrokers respectively, but AML/CFT requirements do not fall within the scope of the supervision. Otherwise there are effectively no oversight or monitoring mechanisms.

Appendix 2: Summary of Questions for Submission

1. How do you consider we should define what we have called in this document a "platform provider", a "portfolio service provider" and a "custodian"?

2. Do you consider that the requirement that platform providers and custodians be registered meets the objectives for regulating platforms? Why/why not?

3. Do you consider any of the fit and proper entry requirements that applicants must satisfy before being approved as a platform provider or a custodian are inappropriate? Why/why not?

4. Do you consider platform providers or custodians should be required to comply with any other fit and proper entry requirements? Why/why not?

5. Do you consider the custodian should be a body corporate? Why/why not?

6. Do you consider the custodian should be fully independent from, or have an element of independence from, the platform provider? Why/why not?
    - If you consider the custodian need only have an element of independence, is it sufficient that the custodian has only one independent director, or should there be a requirement to have a proportion of independent directors? If the latter, what should the proportion of independent directors be?

7. What process do you consider should be followed in the event an applicant is declined approval by the Commission?
    - Should it be able to present further information to the Commission, should the applicant only be allowed to appeal the decision to the High Court or should the applicant have some other form of appeal process? What are your reasons?

8. Considering the entry and ongoing requirements, and the functions and duties of platform providers and custodians, do you consider the platform provider and the custodian can be part of the same group of companies? Why/why not?

9. Do you consider the proposed reporting requirements relating to the ongoing monitoring of the fit and proper requirements are appropriate or inappropriate? Why?

10. Do you consider the proposed options for remedying a breach by the platform provider or the custodian of the fit and proper entry requirement are appropriate, or are there any that are inappropriate?

11. What appeal rights do you consider a platform provider or a custodian should have if the Commission determines that the entity no longer continues to satisfy the fit and proper requirements and revokes an entity's approval and deregisters it?

12. Do you agree with the proposed approach for ensuring financial advisers and portfolio service providers have the appropriate competence and capacity to perform their functions and duties? Why/why not?

13. Do you consider there should be any other functions for platform providers in addition to the one set out above, or do you consider the proposed function inappropriate? Why?

14. Do you consider there should be any other duties in addition to those set out above that should be imposed on platform providers? Why?

15. Do you consider any of the proposed duties are inappropriate or instead ought to be imposed on custodians? Why?

16. In relation to the requirement to report statistical data to the Commission, what information should be included in any statistical data return and what data, if any, should be provided to the Commission in confidence?

17. Are the proposed duties for platform providers appropriate to impose on portfolio service providers?

    - If so, do you consider portfolio service providers should have an additional duty to act in the best interests of their clients and to act with due care and skill in the investment of client monies? Why?

    - If not, do you consider the duties of CIS issuers are more appropriate to impose on portfolio service providers? Why?

    - If not, what duties should be imposed on portfolio service providers?

18. Apart from the powers set out in the contract between the platform provider and the investor, do you consider the platform provider requires any other powers to enable it to carry out its functions and duties? Why?

19. Do you consider the proposed remedies for breach by the platform provider of its duties owed to investors are appropriate, or are there any that are inappropriate? Why?

20. Other than compensation, what orders do you consider the court should be able to make to enforce platform provider compliance with the proposed legislation? What are your reasons?

21. Do you consider the roles of platform providers and financial advisers should be regulated separately? Why/why not?

22. Do you consider a person can be both the platform provider (i.e. providing the administration service) and the financial adviser? Why/why not?

23. Do you consider there should be any other duties for custodians in addition to those set out above, or are there any that you consider inappropriate? Why?

24. In relation to the requirement to report statistical data to the Commission, and considering the discussion in the *Supervision of Issuers* discussion document, what information should be included in any statistical data return?

25. In relation to the safe custody of assets, how should assurance be ensured?

- Do you consider there should be a requirement to carry out an audit and to have an auditor? What are the costs and benefits of requiring a financial audit and a systems audit?

- If you consider there should be a requirement to carry out an audit, should the auditor be independent?

- If you consider there should be a requirement to carry out an audit, do you consider a systems audit (where an external auditor reviews the custodian's systems and processes in accordance with international best practice) is more cost effective than a financial audit? Why/why not? Or do you consider there is some other more cost effective means of ensuring the custodian's compliance with its duties? If so, what are the costs and benefits of your option?

- Who should the auditor report to and how frequently?

26. Do you consider the custodian requires any other powers in addition to the limited powers set out above, or do you consider the proposed powers are inappropriate?

27. Do you consider the proposed remedies for breach by the custodian of its duties owed to investors are appropriate, or are there any that are inappropriate? Why?

28. Apart from compensation, what orders do you consider the court should be able to make to enforce custodian compliance with the proposed legislation? What are your reasons?

29. Do you consider the proposed functions, duties and powers of the custodian of a platform service should extend to the custodian of a portfolio management service? Why/why not?

30. Do you consider whistle-blowing provisions should apply to platform providers and custodians? Why/why not?

31. Do you consider the proposed whistle-blowing provisions should extend to portfolio management services? Why/why not?

32. Do you think there should be a PSDS in respect of platforms? Why/why not?

    - If yes, what information do you think it should contain?

33. If a financial adviser/attorney is making investment decisions on behalf of the investor, do you agree that:

    - Disclosure of the service level agreement between the financial adviser and the investor should be made to the investor; and

    - Disclosure about the underlying investment products should be made to the adviser (and not to the investor)?

34. If you agree that disclosure of the service level agreement should be made to the investor, do you consider the proposed information to be disclosed is appropriate? Why/why not?

35. Do you consider the platform provider should be required to ensure the information contained in the PSDS is accurate?

36. Do you consider the financial adviser should be required to ensure that the investor receives the PSDS? Why/why not?

37. Do you think the financial adviser should be responsible for making disclosure to an investor of:

    - The total fees, costs and expenses payable?
    - The material terms of the service level agreement?

38. How should the total cost of all fees, charges and expenses associated with the investment be calculated? For example:

    - Could fees be calculated using an assumed fee schedule (based on last year's historical costs) plus the known fixed fees? What fees would be variable (and therefore need to be based on historical data), and what fees would be fixed? Why would or wouldn't this option for calculating fees work?
    - Should the financial adviser have an obligation to use his/her best endeavours to accurately calculate the total cost of all fees, charges and expenses to the investor? Should this obligation stand on its own, or be in addition to a method of calculating fees (for example, based on historical fees and fixed fees)? What are your reasons?
    - How else do you consider variable fees should/could be calculated?

39. Should disclosure of the total cost of all fees, charges and expenses be required to be:

    - Made in dollar terms only;
    - Made in percentage terms only;
    - Made in both dollar and percentage terms;
    - Set out in an illustrative management expense ratio ("MER"). If so, will this be meaningful to investors? Why/why not?;
    - Made in dollar and percentage terms and set out in an illustrative MER;

    for each investor?

40. Do you consider the proposed offences and penalties are appropriate? Why/why not?

41. Do you consider the proposed regulation in respect of disclosure should extend to portfolio management services? Why/why not?