

**STAFF PAPER**  
**ON**  
**REGULATING AND SUPERVISING FINANCIAL ADVISERS**

**New Zealand Securities Commission**

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### About this paper

1. This paper is a Securities Commission staff paper and represents the preliminary thinking of Commission staff on how the Commission might regulate and supervise financial advisers under the Financial Advisers Act 2008. We seek comments from financial advisers and their employers, consumers, and other interested parties before finalising recommendations to Members of the Commission.
2. While this paper outlines the regulation and supervision of financial advisers generally, it has a particular focus on the principles underpinning the supervision of advisers under the Act, and on Qualifying Financial Entities (“QFEs”). The Act itself is concerned with the occupational regulation of individual financial advisers, with individual advisers being supervised either directly by the Commission or indirectly through QFEs. Because QFEs will be responsible for a significant number of financial advisers, their frontline compliance role and the effective supervision of QFEs by the Commission will be central to the effective implementation of the Act.
3. In this paper we also discuss a number of QFE-related issues for Authorised Financial Advisers (“AFAs”). We will be developing more detailed proposals in relation to AFAs once the code of professional conduct is in place (noting also that the code committee to be set up under the Act will be consulting on the draft code).
4. We anticipate being in a position to consider applications for QFE status by the last quarter of 2009, and from potential AFAs by mid 2010. We expect the Act to be fully in force by the end of 2010.
5. The views expressed in this paper represent preliminary thinking of Commission staff and do not bind the Commission. They are made for the purpose of promoting discussion and public understanding of the Act and are without prejudice to any policy the Commission may adopt or any enforcement action the Commission may take in particular circumstances. The Act’s application is likely to depend on a range of factors specific to each individual or entity. If you are unsure whether the Financial Advisers Act will affect you, or if you are unsure of the legal consequences of becoming a QFE, we encourage you to seek legal advice. Nothing in this paper should be construed or relied upon as legal advice.

### Making a submission

6. Submissions should be sent to the Commission by 5.30pm on Thursday 30 July 2009.

**Email:** [faa.consultation@seccom.govt.nz](mailto:faa.consultation@seccom.govt.nz)

**Post:** Regulating and Supervising Financial Advisers Discussion  
Securities Commission  
PO Box 1179  
Wellington

**Facsimile:** (04) 472 8076

7. Submissions will be subject to the Official Information Act 1982. We may also make them available on our website, for example, and draw attention to them in any further

reports. If you would like us to withhold any commercially sensitive, confidential or proprietary information included in your submission please say so in your response. Any request to have information withheld will be considered in accordance with the Official Information Act.

## Regulating Financial Advisers

### Overview of the regulatory framework

8. The Financial Advisers Act is concerned with the occupational regulation of individual financial advisers and will impact those whose business involves:
  - (a) giving financial advice – making recommendations or giving opinions or guidance – in relation to acquiring or disposing of investments, insurance, or credit contracts;
  - (b) making investment transactions – the receipt, handling, payment or investment of money or other property on behalf of another person – in relation to acquiring or disposing of investments, insurance, or credit contracts; or
  - (c) providing a financial planning service.
9. The impact of the Act depends upon the type of financial adviser service, the products it relates to, and whether an adviser is an employee or agent of a QFE.
10. Financial advice, financial advisers, and the QFE regime are defined by reference to financial products, which the Act divides into two categories:
  - (a) Category 1 (higher risk or more complex products) – securities (other than those listed as category 2), real estate, and futures contracts.
  - (b) Category 2 (lower risk or less complex products) – call debt securities, bank term deposits, insurance products (other than life insurance issued after 31 December 2008), and consumer credit contracts.
11. Generally, an individual who advises on or undertakes investment transactions in respect of category 1 products, or who provides a financial planning service, will need to be **authorised** by the Securities Commission and **registered** on the financial service providers register. And, again generally, an individual who advises on or undertakes investment transactions in respect of category 2 products will need to be **registered** on the financial service providers register.
12. The main exceptions to the registration and authorisation requirements are that:
  - (a) an individual who is an employee or agent of a QFE may, in the course of a QFE's business, advise on or undertake investment transactions in respect of category 2 products without being registered; and
  - (b) an individual who is an employee of a QFE may, in the course of the QFE's business, advise on or undertake investment transactions in respect of

category 1 products of which the QFE is the issuer without being registered or authorised.

13. Financial advisers not covered by a QFE are subject to conduct and disclosure obligations and are personally liable in respect of them. AFAs are subject to more obligations than those who are merely registered and, in particular, are subject to the code of professional conduct to be established under the Act. The disciplinary committee to be set up under the Act will be responsible for disciplining AFAs for breaches of the code.
14. Financial advisers covered by a QFE are still personally subject to a number of conduct obligations under the Act but are not personally liable for any contravention. Instead the QFE is responsible for ensuring its advisers comply with their obligations and is itself subject to related conduct and disclosure obligations (for which it is liable). This gives QFEs a frontline compliance role.
15. A QFE's obligation to ensure its advisers comply with their obligations applies in respect of *all* financial advisers who are employees or agents of the QFE, including those who are AFAs. However, AFAs employed by a QFE remain personally liable in respect of their conduct and disclosure obligations.
16. A QFE is responsible for ensuring that all its advisers who are required to be authorised *are* authorised; and the QFE rather than the individual is liable if they are not.
17. All advisers, including those who are registered but not authorised and a QFE's advisers, are bound by the fundamental conduct obligation to exercise the care, diligence, and skill that a reasonable financial adviser would exercise in the same circumstances, taking into account the nature and requirements of the financial adviser's client and the nature of the service performed for the client.

#### Registration of financial adviser employers or principals

18. Any person (the "business owner") who employs or engages someone as an employee or agent to perform a financial adviser service in the course of its business for its client or clients must be registered on the financial service providers' register, irrespective of whether it is a QFE. If the financial adviser service is provided to the public then to be registered the business owner will need to belong to an approved dispute resolution scheme. Employees will not be required to separately belong to an approved dispute resolution scheme (even if they are required to be separately registered, for example AFAs employed by a registered financial service provider). However, this does not apply to agents, who must belong to an approved dispute resolution scheme individually.

#### Financial planning services

19. The Act defines a financial planning service as one "that analyses an individual's current financial situation, identifies his or her financial goals, and develops financial options for realising those goals." Under the Act, only an AFA may provide a financial planning service.

20. What constitutes a financial planning service is therefore material in determining whether an adviser will need to be authorised by the Commission (as opposed to merely being registered or operating under a QFE’s designation). A financial planning service could be interpreted as including a basic needs analysis for a particular product or advice combining, say, a credit contract with an insurance product relating to the credit contract. In our view, however, such an interpretation would catch too wide a range of financial advisers, making the Act unnecessarily restrictive and potentially undermining its objectives.
21. We therefore propose to interpret a financial planning service as involving more than merely doing a basic needs analysis for a particular product or combining two products where one product is ancillary to the other (such as life insurance taken out at the same time as a loan to cover the outstanding loan). We believe this is consistent with the intended application of “financial planning service” and allows product category 2 advisers and advisers covered by a QFE’s designation to give customers a professional level of service.
22. However, it is important to maintain the integrity of the boundary between authorised and non-authorised advisers (and between AFAs who are authorised to provide financial planning services and those who are not). We will therefore be monitoring how advisers who are not authorised to provide financial planning services actually provide their services.

#### **Discussion Question**

A Do you have any comments on the suggested approach to interpreting “financial planning services”?

#### **Registration as a financial service provider**

23. An individual or entity is entitled to be registered as a financial service provider if:
- (a) they are not disqualified from registering;<sup>1</sup>
  - (b) in the case of an individual or entity providing financial services to the public, they are a member of an approved dispute resolution scheme or the reserve scheme; and
  - (c) in the case of an individual or entity providing or offering to provide a licensed service – for example, a financial adviser service relating to a category 1 product or a financial planning service – they are a licensed provider.

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<sup>1</sup> An individual is disqualified if he or she is an undischarged bankrupt, prohibited from being a director or promoter or involved in the management of a company or issuer, subject to a management banning order under securities or takeovers legislation or an order under s 108 of the Credit Contracts and Consumer Finance Act, has been convicted of an offence against certain provisions of the Financial Service Providers (Registration and Dispute Resolution) Act or the Crimes Act within the past 5 years, has been convicted of a money laundering offence or an offence relating to the financing of terrorism, or is subject to a confiscation order under the Proceeds of Crime Act. An entity is disqualified if it has a controlling owner, director or senior manager who as an individual is disqualified.

24. The Registrar of Companies has been appointed as the Registrar of Financial Service Providers and will be providing information in due course about registration processes.

## Supervising Financial Advisers

### Supervision and the purpose of the Act

25. The overarching purpose of the Act is to promote the ***sound*** and ***efficient*** delivery of financial advice, and to encourage public confidence in the ***professionalism and integrity*** of financial advisers. In this section we explore what this purpose means in the context of our approach to supervision.

### *The sound delivery of financial advice*

26. Several factors contribute to the provision of *sound financial advice*, including the adviser's professionalism, and the degree of care, diligence and skill they exercise. These are broad concepts and we will focus on three key attributes – competence, capacity, and conduct:
- (a) *Individual competence*: The adviser must have the skills and competence to do the job.
  - (b) *Organisational capacity*: The organisation's capacity must be sufficient to support the advice process; that is, there must be adequate systems and procedures in place. Any financial adviser business – from a sole practitioner to a large institution – must have appropriate organisational capacity.
  - (c) *Conduct*: The adviser's conduct – especially in interacting with and servicing the client – must comply with mandated requirements (for example the Code of Professional Conduct for AFAs) or should otherwise follow best practice.
27. The required nature, scale and extent of these attributes will depend on the circumstances, for example the type of financial adviser service being performed. The relative weightings of the attributes will also vary according to the circumstances.

### *The efficient delivery of financial advice*

28. The Act's disclosure requirements and accountability mechanisms underpin the efficient delivery of financial advice across the market and are central to the ongoing supervision of financial advisers.
29. The regulatory and supervisory framework must also accommodate different ways of delivering financial advice to ensure business models and advice delivery methods are not unduly influenced by it. The framework should be neutral across models and methods, unless they raise particular issues to do with the sound delivery of financial advice. This is particularly so in the context of QFEs and between QFEs and non-QFE financial adviser businesses.

### *Professionalism and integrity of financial advisers*

30. We envisage a more expansive supervisory framework than one that focuses solely on advisers meeting core obligations. Core obligations must be supplemented by a culture of professionalism; this will ensure that meeting those obligations is not seen

as merely a matter of compliance but more as a matter of best practice in providing a financial adviser service. This is at the heart of increasing public confidence in financial advisers.

31. Just as a culture of professionalism will enhance public confidence, the degree of professionalism shown by an individual adviser or within a QFE will have a bearing on our assessment of the risk posed by that adviser or QFE. A professional culture is likely to reduce non-compliance with the Act and, other things being equal, make it less likely that an individual adviser or QFE would be subjected to more targeted supervision.

#### How the Commission will supervise financial advisers

32. All AFAs and QFEs will be subject to supervision, in the first instance through their applications to become AFAs and QFEs, and through the need to periodically apply for the renewal of authorisation or QFE status. In some circumstances – in addition to any information that applicants provide in their application – assessment or renewal may include onsite inspections and interviews by Commission staff.
33. Applicants for renewal will be reassessed against the then current eligibility criteria. For an AFA's authorisation to be renewed, the Commission must also be satisfied that the AFA has complied with the minimum professional standards set out in the code which will include requirements relating to continuing professional training.
34. QFEs are also required to provide the Commission with an annual report on Financial Adviser Act matters.
35. We are establishing a framework for the systematic oversight of all advisers, including registered (but not authorised) financial advisers, commensurate with the obligations imposed on those advisers and the risks posed to consumers. The effective oversight of registered (but not authorised) financial advisers is a crucial part of the wider regulatory framework, particularly in terms of maintaining the integrity of the boundary between authorised and non-authorised advisers.
36. Similarly, to maintain the integrity of the wider regulatory framework put in place by the Act, our oversight will extend to monitoring for unregistered financial advisers and other illegal advice activity.
37. These across-the-board activities are likely to be supplemented by a more targeted supervisory programme where we will follow up with particular individual advisers or QFEs if we have identified them as posing a higher risk of non compliance or where particular concerns have been identified.
38. Intelligence we receive from complaints made by consumers and investors about adviser conduct or from other sources may also direct our supervisory attention to specific individual advisers (including AFAs, advisers who are registered but not authorised, and QFE advisers) and QFEs.
39. Targeted supervision is likely to include onsite inspections and interviews in addition to requiring written information.



40. From time to time we may also carry out issue-specific supervision projects (as opposed to those targeting individual advisers or QFEs), such as a general review of disclosure obligation compliance.
41. We anticipate dealing with many issues primarily through constructive dialogue. However, an unremedied issue may be dealt with by imposing additional terms and conditions on an AFA or a QFE or by taking other enforcement action. In some circumstances it may be more appropriate to proceed straight to enforcement. Also, if the Commission receives a complaint about the conduct of an AFA, which in its opinion amounts to a breach of the code of professional conduct, then it must refer the complaint to the code disciplinary committee.

### **Discussion Question**

- B Do you have any comments we should take into account as we further develop the approach – outlined in summary above – for supervising financial advisers?

## **Complaints and Enforcement**

### Complaints about financial advisers

42. Anyone may complain to the Commission about the conduct of a financial adviser. The Act also expressly provides that the Commissioner for Financial Advisers may initiate a complaint. A complaint may lead to increased supervisory attention or enforcement action.

### General enforcement powers

43. If the Commission has reason to believe that a financial adviser is in breach of a disclosure or conduct obligation it may give the adviser a direction in relation to remedying that breach. Failure to comply with a direction is an offence.
44. The Commission may also exercise its powers under the Securities Act in performing its functions under the Financial Advisers Act. Those powers include:
- (a) requiring documents to be provided for inspection;
  - (b) summoning witnesses and receiving evidence in relation to any matter before the Commission; and
  - (c) accepting an enforceable undertaking.<sup>2</sup>

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<sup>2</sup> In cases where aspects of the law have not been fully complied with, the Commission is sometimes willing to accept a written undertaking from the party concerned. Generally, a party that offers the Commission an enforceable undertaking has acknowledged non-compliance with the law or other matters of concern, and agreed to take specific steps to address the breach. The Commission will accept an enforceable undertaking when it considers it to be the most appropriate outcome. Accepting an undertaking does not prevent the Commission from exercising any of its other enforcement powers. Enforceable undertakings are made public through the Commission's website. If the Commission considers that a term of an undertaking has been breached it may apply to the Court for an order directing: compliance with the undertaking; the payment to the Crown of an amount equal any financial benefit that is reasonably attributable to the breach; compensation for any other person who has suffered loss injury or damage as a result of the breach; or other consequential relief.

45. The Financial Advisers Act also includes offences relating to the failure to comply with conduct and disclosure obligations and the registration and authorisation requirements.

Enforcement powers specific to AFAs

46. The Commission has the following enforcement powers in relation to AFAs:
- (a) If it is satisfied that an AFA is no longer eligible to be authorised, has breached the Act or regulations (other than in relation to breaches of the code which are dealt with by the disciplinary committee), breached a term or condition of authorisation, is subject to a recommendation by the disciplinary committee to cancel or suspend authorisation or to cancel authorisation and debar the adviser from reapplying for a specified period, or has failed to pay a fee or levy as required by the Act or regulations, the Commission may:
    - (i) cancel the AFA's authorisation;
    - (ii) cancel the AFA's authorisation and debar him or her from reapplying for a specified time;
    - (iii) suspend the AFA's authorisation for a specified time or until he or she does any thing that the Commission may specify; or
    - (iv) amend the AFA's terms and conditions.
  - (b) If the Commission has reason to believe an AFA is in breach of the terms and conditions of the AFA's authorisation, it may give the AFA a direction in relation to remedying that breach. Failure to comply with a direction is an offence under the Act.
  - (c) The Commissioner for Financial Advisers may initiate a complaint about an AFA for the Commission to investigate and, as appropriate, take enforcement action or refer the matter to the code disciplinary committee.

*Breaches of the code of professional conduct*

47. The disciplinary committee to be set up under the Financial Advisers Act will be responsible for disciplining AFAs for breaches of the code of professional conduct. If the Commission receives a complaint about the conduct of an AFA, which in its opinion amounts to a breach of the code of professional conduct, it must refer the complaint to the disciplinary committee. If the disciplinary committee is satisfied that an AFA has breached the code it may:
- (a) recommend the Commission cancel the AFA's authorisation;
  - (b) recommend the Commission—
    - (i) cancel the AFA's authorisation; and
    - (ii) debar the AFA for a specified time from applying to be re-authorised;

- (c) recommend that the Commission suspend the AFA's authorisation for no more than 12 months or until he or she meets specified conditions relating to the authorisation (but, in any case, not for more than 12 months);
- (d) censure the AFA;
- (e) order that the AFA, for up to 3 years, may only perform a financial adviser service subject to conditions relating to employment, supervision, or as otherwise specified in the order;
- (f) order the AFA undertake training specified in the order;
- (g) order the AFA must pay a fine not exceeding \$10,000.

#### Enforcement powers specific to QFEs

48. The Commission has the following enforcement powers in relation to QFEs:
- (a) If it is satisfied that a QFE is no longer eligible for QFE status, or has breached the Act or regulations, breached a QFE term or condition, failed to comply with a direction given to it by the Commission under the Act, or failed to pay a fee or levy as required by the Act or regulations, it may:
    - (i) cancel the QFE's status as a QFE;
    - (ii) cancel the QFE's status as a QFE and debar it from reapplying for a specified time;
    - (iii) suspend the QFE's status as a QFE for a specified time or until the entity does any thing that the Commission may specify;
    - (iv) amend the QFE's terms and conditions;
    - (v) impose a fine of up to \$50,000; or
    - (vi) censure the QFE.
  - (b) If the Commission has reason to believe that a QFE is in breach of a disclosure or conduct obligation it may give the QFE a direction in relation to remedying that breach. Failure to comply with a direction is an offence under the Act.

### **Authorised Financial Advisers**

#### AFAs – general comments

49. An individual who gives financial advice or makes investment transactions in relation to category 1 products (except for category 1 products issued by a QFE which is that person's employer ) or who provides a financial planning service must be authorised by the Commission. An AFA may also be an employee or agent of a QFE and we discuss the possible implication of that in the section below on QFEs.

50. As noted above, AFAs are subject to a more extensive range of obligations than those who are merely registered. In particular, they are subject to the code of professional conduct to be established under the Act. The disciplinary committee to be set up under the Act will be responsible for disciplining AFAs for breaches of the code.

Becoming an authorised financial adviser

51. A person is eligible to be authorised if:
- (a) the Commission is satisfied that:
    - (i) the applicant is registered or is entitled to be registered as an authorised financial adviser once authorised by the Commission;<sup>3</sup>
    - (ii) the applicant is of good character;
    - (iii) the applicant meets the levels of competency, knowledge, and skills specified in the code for an authorised financial adviser; and
    - (iv) the applicant is not debarred from applying for authorisation; and
  - (b) the Commission is not aware, after due enquiry, that the applicant has been convicted by a court in New Zealand or elsewhere of an offence punishable by imprisonment for a term of 6 months or more, or if the Commission is aware that the applicant has been convicted of such an offence, it is satisfied that the offence does not reflect adversely on the applicant's fitness to act as an authorised financial adviser.
52. We will be developing specific guidelines detailing the application process and setting out what will be needed to support an application.
53. Applicants whose applications are declined have a right of appeal to the District Court.
54. An AFA will be authorised for a specified time in relation to one or more of: performing a financial adviser service in relation to a category 1 product; making an investment transaction in relation to a category 1 product; or providing a financial planning service. An authorisation may also be subject to terms and conditions.

**Qualifying Financial Entities**

QFEs – general comments

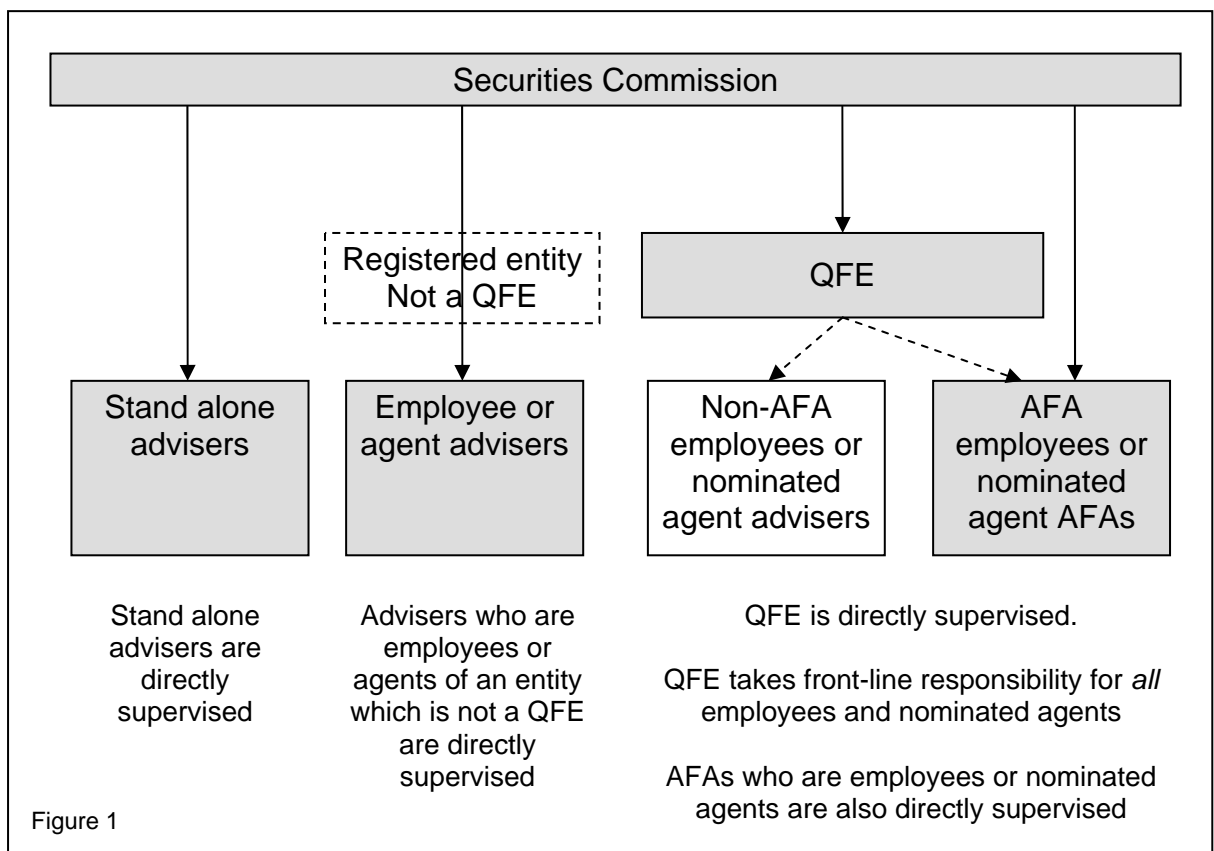
55. The QFE regime was included in the Act to avoid imposing what might otherwise be excessive compliance costs and requirements on firms with large numbers of advisers. In effect, the QFE regime is a means for the efficient regulation of individual advisers.
56. The Financial Advisers Act is concerned with the occupational regulation of individual financial advisers. An adviser will be supervised either directly by the

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<sup>3</sup> Note, however, that to be an AFA a person needs to be registered and have been authorised by the Commission.

Commission or, where a QFE is responsible for the adviser, indirectly through the QFE with the QFE assuming a frontline compliance role under the supervision of the Commission.

57. QFE status is granted by the Commission if, amongst other things, it is satisfied that the entity can and will ensure that its advisers meet and maintain appropriate standards. In this regard it is important to note that the same standards should be met and maintained by advisers performing similar roles, regardless of whether or not a QFE is responsible for them. The key point of difference is that, whereas a “non-QFE” adviser will be individually accountable under the Act, a QFE sits between its advisers and the Commission and is responsible for ensuring that its advisers meet and maintain appropriate standards. The QFE is then accountable to the Commission. AFAs employed by a QFE will also remain individually accountable. This is illustrated as follows:



Who and what a QFE is responsible for

58. In the context of the overarching purpose of the Act, a QFE is responsible for the sound delivery of financial advice by its financial advisers, and encouraging public confidence in the professionalism and integrity of its financial advisers.
59. More specifically, a QFE is responsible for:
- (a) ensuring that its advisers comply with their financial adviser obligations (which may be in addition to an AFA’s individual responsibility); and

- (b) the advice given by its financial advisers (which may be in addition to an AFA's individual responsibility).

*Agents of a QFE*

60. A QFE's advisers might be employees or agents of the QFE. It is clear who an entity's employees are, but less clear who its agents are for the purposes of the QFE regime. Agents could potentially include:
- (a) contractors;
  - (b) employees of related companies;
  - (c) franchisees and their employees; and
  - (d) stand alone product distributors.
61. In our view, it is consistent with the purposes and scope of the QFE regime for the agents covered by the QFE's designation to extend to (and be limited to) those who the QFE has accepted responsibility for.
62. We note that part of a QFEs annual reporting obligation under the Act is to list those who, as agents of the QFE, were financial advisers in that reporting year. It also seems desirable from a supervisory and enforcement perspective (and from a liability management perspective) for there to be a more active or forward-looking list of those who, as agents of a QFE, are financial advisers.
63. We therefore propose that as a standard QFE term and condition the entity will be required to establish and maintain a list of agents it has assumed responsibility for ("nominated agents"). This may also have to be supplemented by a further standard term and condition requiring QFEs to ensure that any agent who sells their products but who they are not responsible for does not hold themselves out as being a nominated agent of the QFE.

**Discussion Questions**

- C Do you think this approach, centred on the concept of responsibility, creates any difficulties for QFEs?
- D Do you have any suggestions for alternative ways of delivering more certainty about which agents a QFE is responsible for under the Act?
- E Do you agree that there should be a standard QFE term and condition that the entity establish and maintain a list of agents it has assumed responsibility for?
- F Should the QFE be required to publish the list of agents it is responsible for?

*AFAs who are employees or agents of a QFE*

64. QFE employees, and agents who a QFE is responsible for, (in either case a “QFE adviser”) will need to be separately authorised in the following circumstances:
- (a) the QFE adviser is an agent who gives advice on or makes investment transactions in relation to category 1 products issued by the QFE (noting that employees in this circumstance do not need to be authorised);
  - (b) the QFE adviser gives advice on or makes investment transactions in relation to category 1 products that are not issued by the QFE, which we have broken down into the following groups:
    - (i) products the QFE is responsible for and which are issued or provided by an entity the QFE exercises effective control over;
    - (ii) products the QFE is responsible for but which are issued or provided by an unrelated third party (for example, white-labelled products issued or provided by a third party which are sold as QFE-branded products);
    - (iii) products issued or provided by unrelated third parties but which the QFE has approved; and
    - (iv) products the QFE is not responsible for and which are selected at the sole discretion of the employee or agent; or
  - (c) the QFE adviser provides a financial planning service.
65. In all these circumstances, the QFE is responsible for its advisers (even though they are AFAs) and has an interest in ensuring that they are competent and professional. It may therefore be appropriate for the Commission to recognise that extra layer of responsibility in the authorisation and supervision processes. For example, it may be appropriate for the Commission to rely on a QFE’s employment or engagement processes to be satisfied that an applicant for authorisation is of good character. Similarly, it may be appropriate for the Commission to place some reliance on the QFE’s frontline compliance monitoring role.
66. Where an adviser can exercise wide discretion and more reliance is put on the adviser’s professional judgement, as opposed to relying on the QFE and its control and capacity, there is less scope for streamlining. Circumstances in (b)(iv) and (c) above are in this category. In contrast, the circumstances outlined in (a) and (b)(i) to (iii) bring the QFE more into the picture and present a quite different risk profile.
67. We therefore propose developing streamlined authorisation and supervision for AFAs who are employees of a QFE or agents a QFE is responsible for based on:
- (a) terms and conditions restricting the AFA’s area of practice to the products that the QFE is responsible for (or a subset of those products); and

(b) terms and conditions requiring the QFE to take full responsibility for nominated agents as if they were employees.

68. We note that this approach could be complemented by the code of professional conduct for AFAs including specific provisions for AFAs who are employees or agents of QFEs. This would involve the Commission and industry engaging with the code committee in the development of the code.

**Discussion Question**

G Do you agree that it is appropriate to streamline the authorisation and supervision of AFAs in some or all of the circumstances discussed and in the manner suggested?

Who might apply to be a QFE?

69. Just because a firm has employees or agents who are financial advisers does not mean that it will necessarily make sense for it to be a QFE.
70. Large financial institutions are clearly within the intended scope of the QFE regime. Smaller firms may be considering applying for QFE status too. Firms outside the finance sector may also be contemplating whether to apply for QFE status – the impact of the Financial Advisers Act extends beyond the finance sector to, for example, retailers and motor vehicle dealers in relation to consumer finance arrangements, and travel agents in relation to travel insurance. It may be relevant for those involved in point of sale distribution of consumer finance to consider whether it is more appropriate for, say, the retailer to be the QFE in respect of its employees or for the product provider to be the QFE in respect of the retailer's employees as agents of the product provider.
71. Those contemplating QFE status will need to consider a number of factors, including the costs and liability associated with the regime and what the practical efficiencies might be for the entity and its advisers in terms of registration, authorisation and supervision. Costs will include not only fees and levies under the Act but also the business costs involved in establishing and maintaining the requirements to be a QFE. For an entity that does not already have the practical and financial capacity to supervise its own advisers, the costs of meeting the requirements to become a QFE may be material. Similarly, if a firm is more in the nature of a group of individuals, with the firm not in practice adding any extra layer of responsibility, there may not be any practical efficiencies to be gained through the QFE regime.
72. There may, however, be benefits to establishing and maintaining the requirements to be a QFE, for example, centralising the management of regulatory risk which advisers face and any associated reputational risk their employer or principal may face.

**Discussion Question**

H Do you have any comments relating to the scope of the QFE framework, e.g. whether there should be any restrictions as to the types of businesses that may apply for QFE status and, if so, why?



Becoming a QFE

73. An entity is eligible for QFE status if the Commission is satisfied that:
- (a) it is registered or is entitled to be registered;<sup>4</sup> and
  - (b) it is not debarred from applying for QFE status; and
  - (c) on the grant of QFE status and at all times while a QFE, *it has the capacity to, and will,—*
    - (i) discharge its obligations under the Act; and
    - (ii) comply with the terms and conditions (if any) of the grant of QFE status.
74. To become a QFE an entity must therefore satisfy the Commission that it can and will ensure appropriate standards are met and maintained. This is largely a question of capacity – whether there are processes in place to identify training needs and to train and monitor employees and agents, and sufficient resources applied to ensure that those processes are effective. This amounts to whether an entity has the practical and financial capacity to supervise its own advisers. We envisage this involving an examination of systems and processes on the one hand and the culture of the entity on the other.
75. A prospective QFE must be able to demonstrate that it has policies and effective procedures to address and maintain the following:
- (a) competence of employees and agents;
  - (b) conduct of employees and agents;
  - (c) capacity of organisational processes and arrangements;
  - (d) compliance and risk management;
  - (e) compensation arrangements;
  - (f) culture, ethics and governance;
  - (g) communication with / disclosure to clients;
  - (h) conflicts of interest management; and
  - (i) complaints management.
76. We will be developing guidelines detailing the application process and setting out what we will require to support an application, based on the above matters.

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<sup>4</sup> Note, however, that to be a QFE an entity needs to be registered and have been granted QFE status.

77. QFE status will be granted for a specified time and may be subject to terms and conditions.
78. Applicants who are not granted QFE status have a right of appeal to the District Court.

#### **Discussion Questions**

- I Do you have any comments in relation to the matters that we propose the Commission take into account in considering an application for QFE status?
- J Are there any standards or certification processes we might consider relying on when assessing a prospective QFE's policies and procedures?
- K Are there any other matters you think the Commission should take into account in considering an application for QFE status?

#### Competence and standards of professional conduct for QFE Advisers

79. The overarching purpose of the Act is underpinned in particular by the obligation for individual advisers to exercise the care, diligence, and skill that a reasonable financial adviser would exercise in the same circumstances, taking into account the nature and requirements of the financial adviser's client and the nature of the service performed for the client. A QFE will be responsible for ensuring that its advisers comply with this obligation. An important aspect of that will be ensuring that its advisers are competent.
80. The general obligation to exercise due care, diligence and skill is objective (i.e. what the "reasonable" financial adviser would do). However, the steps a QFE takes with a view to its advisers meeting that obligation are subjective and, ultimately, only a court can rule on whether those steps meet the standard. It is open to industry to develop a common understanding of the standard applied by the "reasonable" financial adviser. A key aim of the QFE framework will be to work with industry to establish common standards that are consistent with the overarching purpose of the Act.
81. As discussed in the recent Securities Commission Staff Paper on AFA Competence (see [www.seccom.govt.nz](http://www.seccom.govt.nz)), the National Qualifications Framework (NQF) now includes unit standards for financial advisers. We plan to explore with potential QFEs how they might voluntarily map their training and competence arrangements to NQF standards. Our objectives here are to standardise skill levels, make training provision more competitive and accessible, promote portability of qualifications, reduce compliance costs and simplify regulation. We anticipate that this mapping exercise could be incrementally undertaken by QFEs over the next two to three years.

#### **Discussion Question**

- L Do you agree with the proposed policy of promoting the voluntary adoption of standardised competence measures across QFEs?

### Disclosure by QFEs

82. The Financial Advisers Act provides for regulations to prescribe the disclosures to be made by financial advisers and QFEs. For registered (but not authorised) financial advisers and authorised financial advisers the regulations may specify the form and content of disclosure. The Ministry of Economic Development (“MED”) convened an industry working group on financial adviser disclosure and will shortly issue a discussion document on the content of the disclosure regulations.
83. For QFEs, the regulations may specify the form and some content<sup>5</sup> of disclosure, and may further provide for additional disclosure requirements to be set out in a QFE’s terms and conditions. To the extent that any disclosure requirements are imposed through QFE terms and conditions, we expect they will be consistent with the approach taken in the regulations to individual financial adviser disclosures (particularly to facilitate comparability), adjusted where necessary to reflect the nature and context of the QFE’s business.
84. For example if a QFE is more in the nature of a small firm of individual advisers then disclosure about the individual adviser is likely to be more relevant whereas for a large institution disclosure relating to the institution may be more relevant.

### *Disclosure by wholesale financial advisers and research financial advisers*

85. The Commission may also grant exemptions in relation to financial adviser disclosure obligations if it is satisfied that compliance costs would be unreasonable or would not be justified by the benefits of compliance. Two areas that are likely to be relevant to QFEs here are advice to wholesale customers and advice given by research staff for frontline advisers to use. This may apply not only to advisers covered by a QFE’s designation but also to AFAs employed by a QFE. We note that advisers in these areas would still need to comply with their other financial adviser obligations but that alternative disclosure requirement may be warranted.

#### **Discussion Questions**

- M Further to any submissions you make on MED’s discussion document, do you have any comments on QFE disclosure or on disclosure exemptions from the Commission?
- N For specific adviser types (such as wholesale advisers) should disclosure requirements differ from those for other advisers? Should the answer depend on whether the adviser is employed by a QFE? We are interested in understanding any (financial and other) costs or benefits of different disclosure, and the practicality of implementation (for example, how a wholesale environment/customer can be clearly identified). Responses that include a client/customer viewpoint would be particularly helpful.

#### **Discussion Question**

- O Do you have any other comments you would like to make about the implementation of the Financial Advisers Act?

<sup>5</sup> QFE disclosure regulations may prescribe disclosure in relation to dispute resolution and whether the QFE provides any other licensed service. Further disclosure requirements may be set out in the QFE’s terms and conditions.