



## Financial Intermediaries: Significant Reforms Proposed

*The Financial Intermediaries Task Force Report foreshadows significant legislative reforms for the largely unregulated financial services and advisory industry in New Zealand. All participants in the financial products and services industry in New Zealand need to be aware of the proposed reforms.*

The Financial Intermediaries Task Force Report was recently delivered to the Minister of Commerce and released to the public. The long awaited and wide ranging review contains a number of significant recommendations for reform that will ultimately become law. The Minister has signalled that it is expected that the regulatory framework will be completed by the middle of 2006 with the lawmaking process to follow. In taking a blank slate approach, the Task Force has not shied away from addressing, in some detail, a number of sensitive and complex issues that have for many years been a cause for concern, but were not adequately addressed by successive piecemeal reforms both at industry and Government level. The Task Force has brought together many loose strands, such as standards, registration, disclosure and disputes, that have not been previously drawn together in one comprehensive review.

### History

In New Zealand, financial intermediaries have largely been left unregulated with the result that the law applying to financial intermediaries or advisers is disjointed. For example, investment adviser disclosure was addressed as part of securities law reform. In the past, government agencies and industry advocates have argued over whether the financial adviser industry should remain self-regulated, with the result that consumers have been left to the mercy of a disjointed regulatory model.

The Task Force was established by Government, but drew its members from industry representatives, including consumer representation. Since its establishment in November 2004, the Task Force has embarked on an extensive consultative process and has produced a robust report containing a number of significant recommendations for reform.

Given the parallel policy themes of encouraging all New Zealanders to save for their future and increasing the level of confidence in financial markets generally, it would be fair to say that the Task Force's Report represents a positive step in the right direction in terms of both those objectives. The Report not only contains important recommendations affecting personal financial advisers, but also extends to intermediaries acting for financial products providers across the spectrum.

### Reform recommendations

In summary, the Task Force's main recommendations to Government fall into three categories. It is important, however, to be aware that the recommendations apply to financial intermediaries, that is both individuals and businesses who market financial products or provide financial advice (that is, advice about financial products or investments or savings decisions and choices) to members of the public:

- enhanced standards, including a statutory minimum conduct standard. Essentially, this recommendation relates to establishing legal obligations and standards for financial intermediaries and ensuring consistency in the obligations based on functions that are performed;

- providing an effective dispute resolution and disciplinary processes under a statutory based regime. There would be penalties for non-compliance and effective remedies for consumers;
- enhancing disclosure obligations as well as establishing initiatives for enhancing consumer financial literacy.

### **Co-regulatory regime**

The Task Force has recommended that the reforms be implemented under a co-regulatory framework. Essentially, this means that there will be an overarching statutory framework overseeing industry regulated participation. This requires an element of industry regulation, but moves away from the light handed model currently in existence. It is proposed that there would be a disputes resolution body and a disciplinary body.

A statutory regulator would have a market overview role to approve professional bodies and professional body rules, monitor those approved professional bodies and have the power to make various orders in relation to intermediaries. Approved professional bodies would make rules for professional financial advisers, monitor member compliance with rules and statutory standards, bring disciplinary proceedings, participate in consumer education and resolve low level disciplinary and dispute matters.

### **Three categories of intermediaries**

Significantly, the Task Force has recognised there are three different categories of financial intermediaries, namely personal financial advisers, product marketers, and information or execution only intermediaries. This categorisation is based on the functions carried out by the intermediary.

#### **Personal financial advisers**

Personal financial advisers provide financial planning advice or advice on financial products, and advise on the suitability or appropriateness for the consumer's personal circumstances. These intermediaries will need to be members of an approved professional body, entered on a register of personal financial advisers and would be subject to certain statutory standards in relation to conduct relating to the purpose of information, advice or the financial product, to exercise reasonable skill, care and diligence, having regard to the function being undertaken, and to be remunerated on a basis agreed in writing.

Personal financial advisers must have appropriate qualifications or experience for the functions undertaken. In the case of businesses, they must have adequate processes and policies to enable employees and the business to comply with statutory standards and the approved professional body's rules. There would also be standards addressing conflicts particularly where the intermediary is incentivised to sell particular products. The intermediary must ensure that the advice meets the client's interests and these are given priority. Personal financial advisers are also subject to enhanced disclosure obligations.

#### **Product marketers**

Product marketers promote financial products and provide more than factual information, but do not advise on the suitability or appropriateness of the product for the consumer's personal

circumstances. These intermediaries will be required to be subject to the statutory conduct standard not to engage in misleading or deceptive conduct as to the nature, characteristics or suitability for purpose of the information, advice or financial product, and also be subject to enhanced disclosure requirements.

### **Information/execution intermediary**

These are intermediaries who undertake a pure factual information function. Execution only intermediaries are those who execute client instructions. For both these intermediaries, they will be subject to the statutory conduct standard in relation to misleading or deceptive conduct and also the enhanced disclosure obligations.

### **Disclosure requirements**

A key recommendation is the introduction of enhanced disclosure requirements, which will differ according to the type of financial intermediary. These disclosure requirements will relate to:

- experience,
- qualifications,
- membership of professional bodies,
- nature and scope of any professional indemnity insurance,
- availability of dispute resolution facilities,
- disclosure for the past five previous years of any relevant convictions, bankruptcy, prohibitions from managing a company or business, and any successful Court action taken against that intermediary, and whether the intermediary has been expelled or prohibited by any professional body,
- nature and level of any charges,
- details of the financial products that the intermediary advises upon or where they are limited to particular product providers (called generators),
- periodic disclosure of the difference between the aggregate gross returns and actual return received by the consumer,
- disclosure of the benefits to the intermediary of the consumer's business if not already disclosed,
- the role undertaken by the intermediary and a statement as to whose interest the intermediary is acting including any limitations,
- remuneration options,
- disclosure of remuneration to the intermediary or the costs to the consumer where the advice relates to switching products and the benefit of the alternatives.

### **Key recommendations**

#### **Disputes resolution body established**

Another key aspect of the recommendations of the Task Force is the establishment of a single disputes resolution body. This body would have jurisdiction to consider and make binding decisions on any consumer complaint in relation to any financial intermediary. Complaints would arise where there is a breach of the statutory duty or of the relevant approved professional body's rules. The disputes resolution body would be able to award compensation up to a certain level.

#### **Disciplinary body established**

A second key recommendation is the establishment of a single disciplinary body which would have jurisdiction over all financial intermediaries. This body could impose sanctions such as temporary and permanent banning orders, orders for supervision or management of practice, orders for collection of information, orders for reimbursement of fees to consumers, and fines.

### **Government role**

A fundamental aspect of the co-regulatory regime proposed by the Task Force is the establishment of an authorisation framework for personal financial advisers. Approved professional bodies will be those approved by the Minister and with advice from the statutory regulator.

Approved professional bodies would have a statutory role to make rules for standards, subject to Ministerial approval/veto, resolve low level disciplinary consumer dispute matters, monitor compliance by members and bring disciplinary proceedings for material breaches, contribute to the funding of the disputes resolution body and the disciplinary body, promote to consumers their rights in the role of approved professional body, and where appropriate to make rules relating to the financial capacity of the businesses to provide for consumer redress for breaches of standards and rules.

Finally, the Task Force has recommended that a statutory regulator be empowered to provide advice to the Minister on the approval or disapproval of approved professional bodies and their rules, and to advise the Minister on the rules and procedures of the dispute resolution body.

### **No phased-in transition**

It is important to note that the Task Force has clearly stated that while some transitional flexibility is required it would prefer a specified notice period for introduction.

### **Where to next?**

The next step is for the Government to consider the recommendations, working closely with industry consumer representatives, with a view to having policy options ready this year. It is currently anticipated that detailed work on the regulatory framework would be completed by the middle of 2006 and that a Bill would follow.

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