



Corporate Advisory

SIMPSON GRIERSON

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Financial adviser rules pass with strong bipartisan support

New rules relating to the New Zealand finance industry have been passed by Parliament. As discussed in an earlier FYI (February 2008), the Financial Advisers Act 2008 (**FA Act**) and Financial Service Providers (Registration and Dispute Resolution) Act 2008 (**FSP Act**) aim to develop a more comprehensive system to regulate financial advisers. Both Acts underwent select committee scrutiny and, as a result, the final rules passed by Parliament were different to those originally proposed.

In this FYI we review what impact the new rules will have on the finance industry, where residual uncertainty remains and the likelihood of further amendments in the future.

Financial Advisers Act

The FA Act imposes professional conduct and competence requirements on financial advisers and provides for a regime to regulate financial advisers.

Financial Advisers

Under the FA Act, a "financial adviser" is an individual who provides a "financial adviser service". An individual performs a financial adviser service when he or she provides financial advice, makes an investment transaction or provides a financial planning service.

The FA Act provides for three different types of financial advisers:

- a financial adviser who is an Authorised Financial Adviser (**AFA**);
- a financial adviser who is registered, but who is not authorised; and
- a financial adviser who is registered and an employee or agent of a Qualifying Financial Entity (**QFE**), but who is not authorised.

“The FA Act now provides for a number of exemptions from the definition of financial adviser.”

A criticism of earlier versions of the FA Act was the uncertainty around who would be captured under the definition of "financial adviser". The FA Act now provides for a number of exemptions from the definition of financial adviser. The exemptions are intended to cover those individuals who

have an ancillary role in investment decisions, such as lawyers and accountants (who provide their services as part of a transaction) and employers (who provide KiwiSaver information to their employees).

Financial Products

The FA Act introduces a two-tiered approach to classifying financial products:

- Category 1 products include complex products, such as securities and future contracts; and
- Category 2 products include simpler products, such as bank term deposits, consumer credit contracts and insurance contracts.

An AFA can advise on both category 1 and category 2 products. Advisers who only advise on category 2 products do not need to be an AFA. Advisers who are advising on category 2 products will be subject to less stringent conduct and disclosure requirements. All financial advisers must register as a financial service provider under the FSP Act and will be subject to its registration and dispute resolution provisions.

The FA Act introduces the concept of a QFE. Advisers who are employees or agents of QFEs can advise on category 2 products. Employees or agents of a QFE who advise on category 1 products must be individually authorised as an AFA. Under the FA Act, the QFE is accountable for the conduct and disclosure obligations of its employees offering advice on category 2 products. The QFE model has been introduced to reduce the compliance costs for institutions with large numbers of advisers who would otherwise need to register individually.

This tiered approach of classification is designed to impose different standards on financial advisers, depending on the complexity of the products on which they advise. There will be some uncertainty with the classification of some products.

Regulatory Model

The FA Act replaces the proposed co-regulatory model with a sole regulatory model. This is a fundamental change. The Securities Commission is the sole regulator and charged with various tasks including:

- setting and monitoring industry standards;
- determining breaches and enforcing penalties;
- authorising AFAs;
- granting QFE status; and
- recommending the approval of a code of conduct developed by a code committee comprising industry representatives.

The Minister of Commerce, Lianne Dalziel, has indicated that the shift away from self-regulation results from the current public feeling of mistrust of, and betrayal by, the finance industry. Finance industry participants indicated some concern about the proposed lack of industry involvement in setting rules. The FA Act looks to alleviate these concerns by providing for a Code Committee and a Disciplinary Committee. Both committees will include industry representatives who will work together to develop an industry

code of conduct (**Code**) and adjudicate on disciplinary matters. A Commissioner for Financial Advisers will be appointed to oversee the committee.

The finance industry will have a key role in developing and maintaining the Code under the FA Act.

The disclosure and conduct obligations are largely unchanged from the Bill, with only minor changes to reflect the new tiered approach. More onerous disclosure and conduct obligations, such as adhering to the Code, will only apply to AFAs. The final form of disclosure and conduct obligations will be finalised in regulations which are still to be drafted.

The complaints and disciplinary procedures are also tailored, depending on whether or not the financial adviser is an AFA. It will be an offence to perform a financial adviser service without being registered under the FSP Act (maximum penalty of \$5,000 for an individual and \$10,000 for an organisation).

Any financial adviser advising on category 2 products as an employee or agent of a QFE cannot be held liable for contravention of a financial adviser obligation.

Timing

Full implementation of the FA Act is expected by 2010. Further amendments to the FA Act are likely if there is a change of government. National Party MP Simon Power has indicated his party's desire to amend the categorisation of financial products.

Financial Service Providers (Registration and Dispute Resolution) Act

Alongside the FA Act, the FSP Act establishes a registration system for all financial service providers and requires them to join an approved industry-led dispute resolution scheme.

Registration

A person must not be in the business of providing a financial service unless they are registered under the FSP Act. The definition of "financial service" includes reference back to a "financial adviser service" under the FA Act, which effectively requires those individuals subject to the FA Act to be registered under the FSP Act.

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Dispute Resolution

The FSP Act creates an industry-wide dispute resolution system. A notable change made by the select committee is to force every provider of a financial service to be a member of either an approved dispute resolution scheme (ADRS) or the default dispute resolution scheme (**Reserve Scheme**). The FSP Act adds to information requirements, such as requiring a list of the members of an ADRS to be displayed on the website of that scheme. The proposal that costs of the ADRSs were to be directly allocated to consumers has been removed.

A two year transition period is proposed in order to allow ADRSs to be set up. The Reserve Scheme will be established when registration commences.

Impact

The Minister of Commerce anticipates that the new regime will improve investor confidence, encourage market participation and facilitate investment growth. These are lofty goals indeed. It will be interesting to monitor the impact of the Acts in the coming years.

This article was prepared by Stephen Ward, partner, and Jonty Vavasour, associate.

Contact Information

**Stephen Ward, Partner**

DDI: 04 924 3418 Fax: 04 472 6986
Mobile: 021 987 056
stephen.ward@simpsongrierson.com

**Don Holborow, Partner**

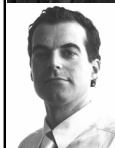
DDI: 04 924 3423 Fax: 04 472 6986
Mobile: 029 924 33423
don.holborow@simpsongrierson.com

**Shelley Cave, Partner**

DDI: 09 977 5260 Fax: 09 977 5067
Mobile: 021 660 090
shelley.cave@simpsongrierson.com

**Kevin Jaffe, Partner**

DDI: 09 977 5057 Fax: 09 977 5036
Mobile: 021 987 430
kevin.jaffe@simpsongrierson.com

**Alex Campbell, Senior Associate**

DDI: 09 977 5094 Fax: 09 977 5067
Mobile: 021 918 311
alex.campbell@simpsongrierson.com

**Caroline Sigley, Senior Associate**

DDI: 09 977 5160 Fax: 09 977 5067
Mobile: 021 558 602
caroline.sigley@simpsongrierson.com

**Stephen Flynn, Special Counsel**

DDI: 04 924 3405 Fax: 04 472 6986
Mobile: 021 432 391
steve.flynn@simpsongrierson.com

**Peter Hinton, Partner**

DDI: 09 977 5056 Fax: 09 977 5067
Mobile: 021 446 866
peter.hinton@simpsongrierson.com

**Michael Pollard, Partner**

DDI: 09 977 5432 Fax: 09 977 5067
Mobile: 021 400 852
michael.pollard@simpsongrierson.com

**Mark Verbiest, Consultant**

DDI: 04 924 3603 Fax: 04 472 6986
mark.verbiest@simpsongrierson.com

**Charlotte Clitherow, Senior Associate**

DDI: 09 977 5411 Fax: 09 977 5067
Mobile: 021 410 577
charlotte.clitherow@simpsongrierson.com

**Jonty Vavasour, Associate**

DDI: 04 924 3475 Fax: 04 472 6986
jonty.vavasour@simpsongrierson.com



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Office Locations

Auckland Office

88 Shortland Street,
Private Bag 92518, Auckland, New Zealand
Tel +64 9 358 2222 Fax +64 9 307 0331
DX CX 10092.

Wellington Office

HSBC Tower, 195 Lambton Quay,
PO Box 2402, Wellington, New Zealand
Tel +64 4 499 4599 Fax +64 4 472 6986
DX SX 11174.

Christchurch Office

PO Box 874, Christchurch 8140,
New Zealand
Tel +64-3-365 9914 Fax +64-3-379 5023