



CONSULTATION ON STANDARD CONDITIONS FOR QUALIFYING FINANCIAL ENTITIES (QFEs)

28 September 2010

Introduction

The Financial Advisers Act 2008 (the Act) allows the Securities Commission (the Commission) to grant QFE status to an entity (or partner entities) for a specified period. The Commission is processing QFE applications now for QFE status. To be considered for QFE status before the Act comes into force, QFEs should submit their Adviser Business Statement to the Commission before 1 December 2010.

The Act provides that a grant of QFE status may be subject to terms and conditions and may also incorporate standard conditions. The Commission intends to maximise the use of standard conditions for all QFEs, unless there are particular circumstances requiring modifications. QFEs may also be subject to individual terms and conditions depending on their circumstances.

The Act requires that standard conditions must be consulted on before they are approved. This consultation paper is relevant for all QFE applicants.

Terms and conditions

This paper sets out the content of the proposed standard conditions, along with explanatory notes. Conditions appear in bold. This paper includes:

- ***Proposed Standard Conditions for QFEs***

These are standard conditions which the Commission expects to be fixed during the period of QFE status.

- ***Proposed Reporting and Notifications Guide for QFEs***

These are standard conditions relating to reporting to the Commission. The Act allows the Commission to vary these conditions from time to time during the period of QFE status, following consultation (s147A and B). These conditions form a separate Reporting and Notifications Guide. Once approved, the Guide will be published on the Commission's website. QFEs must provide information in accordance with the latest version of the Guide.

The Commission also expects a number of QFEs to have individual terms and conditions, for example terms and conditions in relation to the method of nominating representatives.

Period of grant of status

The Act requires the Commission to set a period of grant of status for each QFE. The Commission expects to set periods between three and five years. In general, periods for QFEs dealing with category 1 products will be shorter than for individual AFAs, as a QFE is responsible for a number of advisers. The particular period granted in each case will reflect the Commission's risk based assessment of the products and services provided by the QFE and the robustness of the QFE's governance and compliance arrangements.

The initial period will depend on the type of advisers within the entity applying for QFE status, as follows:

Category	Period of Grant
QFE with QFE Advisers on category 1 products - the QFE sets the competence and conduct standards for QFE Advisers - the QFE might also have AFAs and advisers on category 2 products	usually 4 years can be 3-5 years
QFE with only AFAs providing services in relation to category 1 products - the QFE might also have category 2 QFE Advisers	usually 4 years can be 3-5 years
QFE with QFE Advisers on category 2 products only	5 years

For example, where a QFE with QFE Advisers on category 1 products appears to the Commission to have a lower risk profile (for example robust systems or very few category 1 advisers) the period might be 5 years. If a QFE appears to have a higher risk profile, a shorter period of 3 years might be granted.

Initially the month of renewal of QFE status is likely to be the month the QFE renews its Financial Service Provider registration.

Subsequent renewal periods may vary from the initial period, based on the Commission's approach and risk based assessment of the QFE at the time of renewal.

The Commission's powers

The Commission may vary terms and conditions or the period of QFE status before renewal, on application by the QFE or on the following grounds:

- the business of the QFE has changed in such a way that there is a material risk to consumers; and/or
- the QFE has been or is involved in market practices that are in material respects inconsistent with the purpose of the Act.

In addition, the Act allows the Commission to vary standard conditions before renewal in some circumstances, including where the standard conditions relate to reporting and accounting.

The Commission intends to take a risk-based approach to its monitoring of QFEs. The Commission will work with industry to encourage high standards of professionalism, consumer protection and compliance. It will deal with issues through constructive dialogue, but will take action when standards fall below the required level.

The Commission has a range of powers under the Act which it can use to address any default by a QFE, including a breach of the Act or breach of the terms and conditions of QFE status. Powers include the ability to cancel or suspend QFE status or to debar an entity from reapplying for QFE status for a specified period. The Commission can also amend the QFE's terms and conditions in the event of a default by the QFE. The Commission will use a range of sources of information to inform its responses under the Act. Any action taken may be publicised by the Commission.

Failure to comply with the terms and conditions of QFE status is an offence under the Act and carries a maximum penalty of \$25,000.

Request for comment

This paper can be downloaded from the Securities Commission website: www.seccom.govt.nz/qfe. Printed copies are also available from the Commission.

Please forward written submissions:

By post to:
The Securities Commission
PO Box 1179
Wellington 6140

By courier to:
The Securities Commission
8th Floor,
Unisys House
56 The Terrace
Wellington 6011

or email submissions to: QFEenquiries@seccom.govt.nz with "QFE standard conditions submission" as the subject.

Submissions close at 5.00pm on 22 October 2010.

Submissions will be subject to the Official Information Act 1982. The Commission may also make submissions available on its website or draw attention to submissions in internal or external reports. If you would like the Commission to withhold any commercially sensitive, confidential or proprietary information included in your submission, please say so in your submission. Any request to have information withheld will be considered in accordance with the Official Information Act.

Next steps

Once submissions have been considered, the Commission will finalise and approve the standard conditions by notice in the *Gazette*. These will be published on our website and will also be available in printed form. All grants of QFE status will be subject to the standard conditions unless there are modifications by the Commission.

Proposed Standard Conditions for Qualifying Financial Entities (QFEs)

1. CAPACITY

1.1 The QFE must at all times maintain governance and compliance arrangements appropriate to the financial adviser services of the QFE, the QFE Group and its nominated representatives.

1.2 The QFE must at all times maintain procedures to:

- i) ensure that retail clients receive adequate consumer protection, including clients of the QFE, any member of the QFE Group and its nominated representatives; and**
- ii) for personalised services provided by QFE advisers in relation to category 1 products, ensure that consumer protection is of a similar standard to that provided by advisers who are subject to the Code of Professional Conduct for Authorised Financial Advisers taking into account the scope of category 1 products for which the financial adviser service is provided; and**
- iii) train employees of the QFE and the QFE Group and nominated representatives; and**
- iv) set standards for employees of the QFE and the QFE Group and nominated representatives.**

1.3 The QFE must maintain procedures for monitoring the matters referred to in 1.2.

1.4 The QFE must ensure that its governance and compliance arrangements and procedures are substantially the same as, or improve on, the arrangements and procedures set out in the QFE's Adviser Business Statement (ABS) referred to in the letter of grant of QFE status from the Securities Commission (the QFE's 'Initial ABS').

1.5 The QFE must maintain and keep current a written ABS, in accordance with the current QFE ABS Guide.

The QFE must ensure that this accurately reflects at all times:

- i) the financial adviser services of the QFE, the QFE Group and its nominated representatives; and**
- ii) the governance and compliance arrangements of the QFE over these services.**

The QFE must provide a copy of its ABS to the Securities Commission with its Annual Report and on request within the time period specified.

1.6 The QFE must notify the Securities Commission in writing within five business days if the QFE or any member of the QFE Group believes it does not, will not or is likely not to comply with the QFE's governance and compliance arrangements in 1.4.

- 1.7 The QFE must notify the Securities Commission in writing within five business days of any matter that the QFE or any member of the QFE Group believes will affect, affects or is likely to affect the capacity of the QFE to fulfil its financial adviser service obligations.**
- 1.8 The QFE must notify the Securities Commission if it has any intention to significantly change:**
- i) the governance and compliance arrangements or**
 - ii) the financial adviser services of the QFE, a member of the QFE Group or its nominated representatives, including introduction of new product types and changes to key personnel from those set out in the QFE's Initial ABS.**
- 1.9 When making any notification under 1.6 to 1.8 above, the QFE should indicate to the Securities Commission its planned actions to maintain its capacity under section 1 and its compliance with its obligations under the Act.**

Explanatory notes:

1.1 to 1.3 of the terms and conditions reflect that:

- the Act requires an entity to set out in its QFE application (s65(3)) procedures for training and for setting standards for its employees and nominated representatives and for monitoring those standards
- the Act requires the Commission, at licensing, to consider an entity's capacity to maintain procedures to ensure that retail clients of the QFE receive adequate consumer protection (including of a standard equivalent to that provided by advisers subject to the Code, where QFE advisers provide personalised services in relation to category 1 products subject to the scope of that service) (s66(1)(iii) and (2))

1.4 reflects that the Commission's satisfaction with an entity's capacity starts from the ABS document in which the QFE sets out its business and its governance and compliance arrangements. This term requires a QFE to maintain procedures taken into account at licensing, but also allows flexibility for these procedures to be improved.

1.5 reflects that having and maintaining an ABS is a core requirement of grant of status. It provides the Commission with important information about the QFE's business and its capacity to comply with its obligations under the Act in relation to its financial adviser services business. The Reporting and Notifications Guide for QFEs requires a QFE to submit a copy of its ABS as part of its Annual Report to the Commission.

The QFE ABS Guide can be found at www.seccom.govt.nz/qfe. QFEs should develop and submit their ABS based on the current Guide, which is published for licensing purposes. As part of this consultation, we welcome any comments on Parts 1 and 2 of the current published Guide. The Commission reserves the right to change the QFE ABS Guide from time to time, following consultation.

1.6 to 1.9 require the QFE to notify the Commission of material changes to the QFE's business and governance and compliance arrangements set out in the QFE's ABS. The Commission will then consider whether it remains satisfied that the QFE will

maintain capacity during, and after, any change and, therefore, whether the QFE remains eligible for QFE status.

The Commission believes that the approach set out in section 1 'Capacity' is preferable to prescribing detailed rules for QFEs.

2. REPORTING AND NOTIFICATIONS

2.1 The QFE must report in accordance with the reporting and accounting requirements contained in the Reporting and Notifications Guide for QFEs.

Explanatory note:

The proposed Reporting and Notifications Guide for QFEs is set out on pages 8 to 10.

3. RECORDS

3.1 The QFE must ensure that all records pertaining to the financial adviser services of the QFE or QFE Group (including previous members of a QFE Group) and its nominated representatives are available for inspection by the Securities Commission at any time.

3.2 The QFE must ensure that all records pertaining to the financial adviser services of the QFE, QFE Group (including previous members of a QFE Group) or its nominated representatives are kept for a minimum of seven years.

3.3 The QFE must ensure that it keeps complete lists of the QFE's nominated representatives including commencement and termination dates.

Explanatory notes:

3.2 imposes record keeping requirements on QFEs based on those imposed on AFAs through Code Standard 13.

The Commission expects the seven year period generally to commence on the last date that the relevant financial adviser service was provided to the client. However, for information relating to a financial product transaction entered into by the client as a result of the financial adviser service, the seven year minimum period for that information commences on the date that all benefits potentially available to the client from the financial product have been realised or that all obligations owed by the client have been discharged.

3.3 places a requirement on the QFE to keep historic records of nominated representatives, supplementing the requirement to keep an up to date list as required by s76 (1)(f). The Commission may request a list of nominated representatives as at the date of grant of status.

4. DISCLOSURE

Explanatory note:

It is expected that regulations will allow the Commission to include disclosure requirements for QFEs in terms and conditions. The Commission is aware that the industry is keen to understand the disclosure requirements and will issue a separate consultation paper dealing with terms and conditions for disclosure by QFEs.

5. RESTRICTION ON PROVIDING FINANCIAL ADVISER SERVICES

5.1 The QFE must ensure that its employees and the employees of the QFE Group are adequately supervised so that no financial adviser services are provided, except to the extent set out in the QFE's Initial ABS.

Explanatory note:

All employees of a QFE and members of the QFE Group fall within the definition of QFE Advisers in the Act (unless they are AFAs). This term requires the QFE to restrict the provision of advice to the adviser groups as described in the ABS – ie, the QFE should have procedures in place, as necessary, to ensure that employees whose normal role does not involve the provision of financial adviser services do not step beyond their role and that advisers do not step beyond the parameters of their role. It prevents, for example, employees of an Associated Entity from providing advice where the QFE's ABS indicates that the entity is intended only to provide products. This allows the Commission to tailor its monitoring accordingly.

6. NO ENDORSEMENT

6.1 The QFE, any member of the QFE Group and its nominated representatives must not at any time state or imply that the Securities Commission has endorsed or approved the QFE's business, financial adviser services, or solvency, or any other agreements or business arrangements of the QFE.

7. COMMUNICATION IN A QFE GROUP

7.1 The QFE must ensure that the QFE, any member of the QFE Group and its nominated representatives refer to the QFE Group name approved by the Securities Commission in any communication relating to their financial adviser services.

Proposed Reporting and Notifications Guide for Qualifying Financial Entities (QFEs)

Explanatory note:

Standard conditions relating to reporting to the Commission are presented as a separate Reporting and Notifications Guide. This Guide and the QFE ABS Guide set out reporting conditions. The Act allows the Commission to change these from time to time during the period of QFE status, subject to appropriate consultation (s147A and B). QFEs must provide information to the Commission in accordance with the latest versions of the Guides, which will be published on the Securities Commission's website.

The standard conditions below form the Reporting and Notifications Guide, referred to in standard condition 2.1.

1. NOTIFICATIONS

Explanatory note:

All QFEs will be asked to notify the Commission of information in accordance with the requirements set out in the Reporting and Notifications Guide. These notifications form part of the reporting requirements but are ongoing obligations. They must be made to the Commission within five business days unless another period is specified. Please note that sections 1.6 to 1.9 of the standard conditions also contain notifications to the Securities Commission that are additional to those contained in the Reporting and Notifications Guide.

The Commission may issue requirements relating to the form of notifications. The Commission will consider issuing guidance on the sorts of matters that are expected to be reported under these terms and conditions.

NG1.1 The QFE must notify the Securities Commission in writing, within five business days, of any significant matter concerning the QFE's grant of status or financial adviser activities, including:

- a If the QFE or any member of the QFE Group (which was registered or eligible to be registered when approved by the Securities Commission as a partner or associated entity) becomes unregistered or becomes ineligible to be registered**
- b Changes that may impact on the QFE grant, the period of grant, or any exemption granted by the Securities Commission**
- c If the QFE, or any member of the QFE Group, intends to change the structure of its adviser force, for example, if it intends to appoint nominated representatives where previously there were none, or where the appointment of nominated representatives changes the nature of the QFE's financial adviser services**

- d Any serious breach by the QFE, a member of the QFE Group, their employees or its nominated representatives of the QFE's terms and conditions, the Financial Advisers Act or any regulations, the Securities Act or the Securities Markets Act**
- e Any multiple client complaints about a particular matter, where the QFE or a member of the QFE Group believes that this may indicate a significant or systemic problem with the QFE's governance and compliance arrangements or its financial adviser services, including its products**
- f Any adverse findings or rulings by any regulator, or any court in New Zealand or overseas relating to the QFE, a member of the QFE Group or its employees or nominated representatives where such finding or ruling may impact on the QFE grant, the period of grant, or any exemption granted to the QFE by the Securities Commission**
- g Any matter which may have a material detrimental impact upon clients of the QFE, member of the QFE Group or its nominated representatives.**

Explanatory notes:

b and c - When making a notification under b and c, the QFE should provide information on its planned actions to maintain its capacity and its compliance with its obligations under the Act.

d to g - When making a notification under d to g, the QFE should provide such information as is available to explain the matter, including the QFE's approach to remedying the matter.

The Commission will decide the extent of its own enquiries or actions based on the information provided with the notification, including the QFE's timetable for any proposed action.

NG1.2 The QFE must notify the Securities Commission in writing, within ten business days, of:

- a the termination of a nominated representative as a result of misconduct in relation to his/her financial adviser activities, together with an explanation of the circumstances and any steps being taken to ensure consumer protection**
- b any formal disciplinary action against an AFA employee or AFA nominated representative in relation to his/her financial adviser activities, together with an explanation of the circumstances and any steps being taken to ensure consumer protection.**

2. REPORTING

RG2.1 The QFE must include a copy of its up to date ABS, which has been reviewed and approved by the governing body, as part of its Annual Report and must highlight any areas of change since the Initial ABS or the ABS included in the last Annual Report, whichever is the latest.

Explanatory note:

All QFEs will provide an Annual Report to the Commission including the information required by s77 of the Act and information in accordance with the requirements in the Reporting and Notifications Guide for QFEs.

The Commission intends to consult separately on regulatory reporting requirements (in addition to condition RG2.1 above). Any obligations will not take effect before 1 July 2011 and time for consultation and implementation will be allowed.

The information will be used to focus the Commission's monitoring on QFEs at higher risk of damaging public confidence and serious non-compliance with the Act. Information requested is likely to be high level and of the type used by QFEs to monitor their own business and compliance, for example, information on business volumes for major product groups and service types, number of customers and advisers, and complaints information.

The Commission may issue requirements relating to the form of notifications. The requirements will be supplemented by guidance where necessary.