



Cabinet Economic Growth and Infrastructure Committee

EGI (10) 242

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Summary of Paper

18 October 2010

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Financial Advisers Act 2008 and Financial Service Providers (Registration and Dispute Resolution) Act 2008: Proposed Definition, Exemption and Disclosure Regulations

Portfolio	Commerce
Purpose	<p>This paper seeks policy approval for the development of various regulations under the Financial Advisers Act 2008 (the FAA) and the Financial Service Providers (Registration and Dispute Resolution) Act 2008 (the FSPA).</p> <p>Approval is also sought for the submission to the Executive Council of the Financial Advisers (Disclosure) Regulations 2010.</p>
Previous Consideration	<p>On 17 February 2010, EGI agreed to require advisers to make disclosure of certain information before providing financial adviser services under the FAA [EGI Min (10) 2/3].</p> <p>The FAA and the FSPA, which were enacted in 2008, came fully into force on 16 August 2010 [LEG Min (10) 18/2].</p>
Summary	<p>Policy approval for regulations</p> <p>Policy approval is sought for the drafting of various regulations under the FAA and FSPA.</p> <p>The FAA left several key definitions to be developed in regulations – proposals relating to the following terms are discussed on pages 2-4:</p> <ul style="list-style-type: none"> • land investment product; • call credit union shares; • investment linked contract of insurance; • cash and term portfolio investment entity. <p>Regulations are also proposed to exempt various categories of person from particular provisions in the FAA and the FSPA (discussed on pages 4-15). The proposed exemptions include:</p> <ul style="list-style-type: none"> • exemptions for low value non-cash payment facilities from the FSPA's dispute resolution obligations; • complete exemptions from the FSPA for: gift cards and loyalty schemes that are incidental to retailing; credit arranged at point of sale under the "assignment model"; directors of promoters of securities; individual trustees of superannuation schemes; angel investors; the New Zealand Police; Lloyd's underwriters; and financial services between related companies;

- exemptions from the FAA for superannuation advice from related companies and financial adviser sole traders;
- exemptions from both the FAA and the FSPA for the Board of Trustees of the National Provident Fund and Annuitas Management Limited.

Regulations are also proposed to establish the fees that the Securities Commission may charge for considering and processing exemption applications (discussed on pages 15-16).

Disclosure regulations

The Financial Advisers (Disclosure) Regulations 2010 (attached) prescribe, for the purposes of the FAA, information that authorised financial advisers, qualifying financial entities, and other financial advisers who provide a personalised service to a retail client must disclose to those clients. The Regulations also specify the form in which the disclosure must be made.

The Regulations incorporate some modifications to the proposals earlier agreed to by EGI (discussed on pages 18-20).

Regulatory Impact Analysis

Regulatory Impact Statements (RISs) relating to the following issues are attached:

- the definition of "land investment product" (pages 28-34);
- exemptions from the FAA and FSPA (pages 35-52);
- the disclosure exemption for telephone advice (pages 53-61);
- fees to be charged by the Securities Commission for the consideration of exemption applications (pages 62-67).

The RIS relating to the Disclosure Regulations was submitted to EGI in February 2010 at the time the original policy approval was sought.

In relation to the "land investment product" RIS, the Ministry of Economic Development and the Regulatory Impact Analysis Review Pan consider that this RIS partially meets the quality assurance criteria (comments on pages 17-18).

Baseline Implications

The fees proposal may have some fiscal implications (at this stage, the likely implications cannot be quantified).

Legislative Implications

New regulations under the FAA and the FSPA are proposed.

Parliamentary Counsel have certified the Financial Advisers (Disclosure) Regulations 2010 as being in order for submission to Cabinet.

Timing Issues

The Financial Advisers (Disclosure) Regulations 2010 will come into force on 1 July 2011. This will provide advisers and adviser firms with sufficient time to develop their disclosure statements and compliance systems.

Announcement

The Minister of Commerce will issue a press release. This paper will be published on MED's website.

Consultation

Paper prepared by MED. Consumer Affairs, Companies Office, Treasury, Justice, Reserve Bank and the Securities Commission were consulted. DPMC and PCO were informed. Targeted consultation has also been undertaken with industry and affected stakeholders.

The Minister of Commerce indicates that discussion is not required with the government caucus or with other parties represented in Parliament.

The Minister of Commerce recommends that the Committee:

Background

- 1 note that the Financial Advisers Act 2008 (the FAA) and the Financial Service Providers (Registration and Dispute Resolution) Act 2008 (the FSPA) came fully into force on 16 August 2010 [LEG Min (10) 18/2];
- 2 note that as part of the implementation of the FAA and the FSPA, various regulations need to be promulgated, including regulations to:
 - 2.1 define key terms in the FAA;
 - 2.2 exempt various categories of person from the provisions of the FAA and FSPA;
 - 2.3 establish fees that the Securities Commission may charge for considering and processing exemption applications;

Definitions

- 3 agree that the definition of "land investment product" in the FAA be focussed on complex land investment schemes rather than relatively simple land investments;
- 4 agree that a credit union share subject to the statutory 60 day withholding period be categorised as a category 2 product;
- 5 agree that an investment linked contract be a contract aimed at generating a return, as opposed to a contract aimed at mitigating the risk of an event occurring;
- 6 agree that "a unit in a cash or term portfolio investment entity" be defined to cover portfolio investment entities that:
 - 6.1 are invested entirely in category 2 term or call securities;
 - 6.2 are issued by the same business as these underlying securities;

Exemptions

Financial Service Providers (Registration and Dispute Resolution) Act 2008

- 7 note that regulations granting exemptions from the obligation to belong to a dispute resolution scheme must not be recommended unless:
 - 7.1 the exemption is consistent with the purposes of the FSPA;
 - 7.2 the costs of compliance with the obligation would be unreasonable or not justified by the benefits of compliance;
- 8 agree that providers of low value non-cash payment facilities be exempted from the obligation to be a member of a dispute resolution scheme;

- 9 note that regulations exempting a person or service from the application of the entire FSPA must not be recommended unless:
- 9.1 the Minister of Commerce has had regard to New Zealand's obligations under the Financial Action Task Force (FATF) Recommendations;
 - 9.2 the Minister of Commerce is satisfied that the costs of compliance with the obligation would be unreasonable or not justified by the benefits of compliance;
- 10 agree to the following exemptions from the FSPA:
- 10.1 providers of gift cards and loyalty schemes that are incidental to retailing be exempted from the FSPA entirely;
 - 10.2 retailers, when this obligation is only derived from the fact that they provide credit under a credit contract that is assigned to a financial service provider by the end of the next working day;
 - 10.3 directors of promoters of securities, in so far as this obligation is only due to their position as directors of a promoter of securities;
 - 10.4 individual trustees of superannuation boards of trustees, provided the board is registered as an unincorporated body;
 - 10.5 the New Zealand Police;
 - 10.6 financial services between related companies;
- 11 note that in most instances angel investors are unlikely to be caught by the FAA, but that some activities within angel investor networks could be caught;
- 12 agree that any natural person who is a member of an angel network or group be exempted from registering on the Register of Financial Service Providers if the angel network or group:
- 12.1 is registered as a financial service provider; and
 - 12.2 maintains a register of all natural persons who are members of that angel network or group; and
 - 12.3 makes the register available to the Registrar of Financial Service Providers whenever reasonably requested;
- 13 agree that an angel network or group be defined as any incorporated or unincorporated body that:
- 13.1 is established with the purpose of establishing a forum for investors to pool resources with the objective of providing capital for start-up companies; and
 - 13.2 does not directly provide capital for such companies;
- 14 agree that the members of Lloyd's be exempted from the FSPA, provided the only financial service they provide is acting as a Lloyd's underwriter;
- 15 agree that temporary transitional regulations be promulgated to enable Lloyd's to register before the Insurance (Prudential Supervision) Act 2010 comes into force in September 2013;

- 16 agree that sole trader financial advisers not be required to register their legal entity, provided:
- 16.1 the legal entity is a member of a dispute resolution scheme; and
- 16.2 the financial adviser identifies the legal entity in his/her application to register under the FSPA;

Financial Advisers Act 2008

- 17 agree that regulations be drafted exempting from the disclosure obligations persons giving advice on category 2 products, provided those persons disclose verbally:
- 17.1 the fact that the adviser is a registered financial adviser, authorised financial adviser (AFA), or qualifying financial entity (QFE);
- 17.2 the fact that the adviser has a dispute resolution procedure available to the consumer, should the consumer have a complaint;
- 17.3 the fact that the adviser will provide a written disclosure statement to the customer upon request;
- 17.4 in the case of an AFA or QFE, any other matters required to be disclosed under the terms and conditions imposed by the Securities Commission;
- 18 agree that the verbal disclosure referred to above be permitted to be automated in some way;

Financial Advisers Act 2008 and Financial Service Providers Act 2008

- 19 agree that regulations be promulgated exempting the Board of Trustees of the National Provident Fund from the FAA and the FSPA;
- 20 agree that regulations be promulgated exempting Annuitas Management Limited from the FAA and FSPA in respect of services provided to the Board of the National Provident Fund and other Crown organisations;

Fees

- 21 note that officials are undertaking a detailed review of the Securities Commission's fees, and will report to the Minister of Commerce on FAA exemption fees as a part of this process;
- 22 note that the Securities Commission needs to have fees set as soon as possible so that it can process applications for exemptions before the regime is fully implemented;
- 23 agree that regulations be promulgated enabling the Securities Commission to charge for processing an application for exemption from the FAA;
- 24 agree that the fees for processing an application for exemption from the FAA be based on the fees charged for applications for exemption from the Securities Act 1978;
- 25 agree that the costs recoverable by the Securities Commission in respect of an application for exemption from the FAA be based on the model used for exemptions from the Securities Act 1978;

Drafting instructions

- 26 invite the Minister of Commerce to issue drafting instructions to the Parliamentary Counsel Office for regulations to give effect to paragraphs 3 to 25 above;

Disclosure

- 27 note that:
- 27.1 on 17 February 2010, the Cabinet Economic Growth and Infrastructure Committee (EGI) agreed to require advisers to make disclosure of certain information before providing financial adviser services under the FAA [EGI Min (10) 2/3];
 - 27.2 note that the proposed Financial Advisers (Disclosure) Regulations 2010 will give effect to the decision referred to above;
- 28 agree that AFAs be required to disclose details of any instance in which they have been admitted to the “no asset procedure” under the Insolvency Act 2006 within the last five years;
- 29 agree that AFAs be required to disclose if they have been expelled or prohibited from a relevant professional body within the last five years;
- 30 agree that AFAs be required to disclose whether they have been expelled or barred from a professional organisation within the last five years, and whether they have any criminal convictions or have had other adverse findings against them by a court or disciplinary tribunal;
- 31 27.1 note that on 17 February 2010, EGI agreed that AFAs’ disclosure statements be no longer than two A4 pages using a reasonable font size [EGI Min (10) 2/3, paragraph 12.3];
- 27.2 agree to recommend that Cabinet rescind the above decision; and instead
- 32 agree that AFAs be required to provide:
- 32.1 a primary disclosure statement in the prescribed format; and
 - 32.2 a secondary disclosure statement or statements;
- as described in the Financial Advisers (Disclosure) Regulations 2010;
- 33 agree that financial advisers, other than QFEs and AFAs, be required to make disclosure in accordance with Schedule 3 of the proposed Financial Advisers (Disclosure) Regulations 2010;
- 34 agree that QFEs be able to make disclosure in any form, provided the QFE makes available to customers a written disclosure statement in accordance with regulation 8(5) of the proposed Financial Advisers (Disclosure) Regulations 2010 when requested by a customer;
- 35 note that:
- 35.1 section 154 of the FAA requires the Minister of Commerce to consult with the Securities Commission;
 - 35.2 the Minister of Commerce is satisfied that this requirement has been met;

- 36 authorise the submission to the Executive Council of the Financial Advisers (Disclosure) Regulations 2010 [PCO 14251/10.0];
- 37 note that the Regulations will come into effect on 1 July 2011;

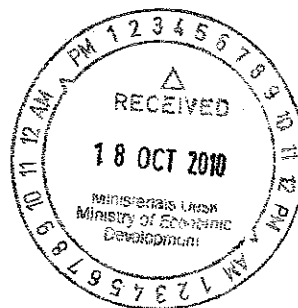
Publicity

- 38 note that the paper under EGI (10) 242 will be posted on the Ministry of Economic Development's website, subject to any necessary withholdings that may be required in accordance with the Official Information Act 1982.

Janine Harvey
Committee Secretary

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CABINET ECONOMIC GROWTH AND INFRASTRUCTURE COMMITTEE

FINANCIAL ADVISERS ACT AND FINANCIAL SERVICE PROVIDERS ACT
DEFINITION, EXEMPTION AND DISCLOSURE REGULATIONS

PROPOSAL

- 1 This paper proposes the development of various regulations under the Financial Advisers Act 2008 (the "**FAA**") and the Financial Service Providers (Registration and Dispute Resolution) Act 2008 (the "**FSPA**").

EXECUTIVE SUMMARY

- 2 As part of the implementation of the FAA and the FSPA, there are various regulations that must be promulgated. This paper is divided into two parts.
- 3 **Part One** of this paper seeks Cabinet policy approval for the drafting of various regulations to:
 - i Define key terms in the FAA;
 - ii Exempt various categories of person from provisions in the FAA and the FSPA; and
 - iii Establish fees that the Securities Commission (the "**Commission**") may charge for considering and processing exemption applications.
- 4 **Part Two** of this paper seeks Cabinet agreement to promulgate regulations providing for disclosure by financial advisers.

BACKGROUND

- 5 The FAA and the FSPA were passed in 2008 to improve confidence in New Zealand's financial markets.
- 6 The FSPA requires all persons in the business of providing financial services to register with the Registrar of Financial Service Providers (the "**Registrar**") and, if they offer services to retail clients, to belong to a dispute resolution scheme ("**DRS**"). The register will be publicly searchable.

- 7 The FAA imposes obligations on financial advisers, including the obligation to be registered under the FSPA and to belong to a DRS. All advisers are subject to minimum statutory standards of conduct and competence. Advisers who deal in complex "category 1" products¹ must be authorised by the Commission and are subject to a Code of Professional Conduct. In some instances such advice may also be provided by employees and representatives of "qualifying financial entities" ("QFEs").

PART ONE – NEW POLICY APPROVALS

DEFINITIONS

- 8 The FAA left several key definitions to be developed in regulations, which are addressed in this paper. Specifically, this paper proposes the development of regulations defining:
- i A land investment product;
 - ii A call credit union share;
 - iii An investment-linked contract of insurance; and
 - iv A unit in a cash or term portfolio investment entity.

Land Investment Product

- 9 A land investment product is a category 1 financial product and is to be defined by regulations.
- 10 As land is a common investment choice in New Zealand, there is potentially merit in regulating a wide range of property advice.
- 11 However, a wide range of professions give advice on land in many contexts and it is difficult to assess the full impact that a broad definition might have. For example, if a very broad definition is adopted builders could well give "financial advice" under the FAA definition when advising on house extensions. These people are not the intended subject of the regime.
- 12 I also note that the Code of Professional Conduct does not contain educational standards specific to advice on investment in real estate at this time.
- 13 In short, although there is a theoretical case for a broad definition, the costs and benefits are uncertain at this stage.
- 14 There has been, however, significant evidence of poor advice relating to land investment schemes such as Blue Chip. In order to ensure that people providing advice on such schemes are accountable for any advice tendered, it is necessary to ensure that the definition of land investment product, at a minimum, includes such schemes.

¹ Relatively complex products are category 1, being most types of securities, futures contracts, "land investment products" and "investment-linked contracts of insurance". Category 2 products are relatively simple and well understood, including consumer credit contracts, bank term deposits and basic insurance.

- 15 I therefore recommend that the definition of "land investment product" be focussed on relatively complex land investment schemes like Blue Chip. This will ensure that products designed to avoid securities legislation are still caught by the FAA.
- 16 My officials will also conduct a process to determine whether further forms of land investment product should be caught.

Credit Union Shares

Call credit union shares are deemed category 2 products, as such shares are relatively simple, well understood products. However, under the definitions in the FAA in order for a credit union share to avail itself of category 2 status, it is necessary that: "The credit union has an obligation to repay the value of the share in full not later than 1 working day after the demand is made." This is intended to ensure that the share is available on call. However, the Friendly Societies and Credit Unions Act 1982 ("FSCUA") states "shares in a credit union shall be withdrawable; but a credit union shall not issue shares except on terms enabling it to require not less than 60 days notice." In effect, the credit union would therefore have a right to withhold payment for up to 60 days when a customer seeks to cash in a share. This means that credit unions' deposit account products will be category 1.

- 17 I am satisfied that despite this technicality, credit union shares are relatively simple and well understood products and would be better classified as category 2 products. Furthermore, I understand that, in practice, the right to defer payment for 60 days is not used.
- 18 I also note that work is being undertaken to remove this limitation in the FSCUA when it is expedient to do so.

Investment Linked Contract of Insurance

- 19 The FAA categorises an investment-linked contract of insurance as a category 1 financial product, while delegating the definition of "an investment-linked contract of insurance" (an "investment-linked contract") to regulations. All other insurance contracts are categorised as category 2 products. (Financial advisers who provide advice on investment linked contracts will need to be authorised by the Commission, while those providing advice on other insurance products will not need to be authorised).
- 20 The distinction between an investment linked contract and other insurance products is intended to distinguish between products that aim in large part to generate returns on premiums paid and other insurance products that use the premiums to mitigate the risk of financial loss in certain eventualities. All insurance products are likely to fall into one of these two categories. Accordingly, I propose that the distinction between category 1 insurance and category 2 insurance be that contracts of insurance aimed at investment returns be category 1, while contracts of insurance aimed at risk mitigation be category 2.

Cash and Term Portfolio Investment Entity

- 21 Under the FAA, "a unit in a cash or term portfolio investment entity" is classified as a category 2 product. The exact definition of this product must be set by regulations.
- 22 Portfolio investment entities ("PIEs") are a specialised form of managed fund (often a unit trust) aimed at allowing the investor to benefit from certain tax advantages. When the assets underlying these funds are simple products issued by the same business as the issuer of the PIE, the investment is essentially a tax-advantageous way of investing in the underlying securities. For example, a PIE that is wholly invested in a bank term deposit is a tax-advantageous way for an investor to invest in that term deposit. This process is generally well understood by investors.
- 23 Therefore, I recommend that "a unit in a cash or term portfolio investment entity" be defined to cover PIEs that:
 - a are invested entirely in category 2 term or call securities; and
 - b are issued by the same business as these underlying securities.
- 24 This recommendation would leave in category 1 all PIEs that are invested in category 1 products. Similarly, this recommendation would leave in category 1 those PIE products that are invested in third party category 2 products. This is appropriate, as the complexity of such PIEs is greater and more difficult for investors to assess.

EXEMPTIONS - OVERVIEW

- 25 The FSPA provides the Governor-General with the power to promulgate regulations, on the recommendation of the Minister of Commerce to exempt any service or person from the FSPA. The Minister of Commerce may only recommend the promulgation of such regulations if:
 - a The Minister of Commerce has had regard to New Zealand's obligations under the Financial Action Task Force's ("FATF") recommendations²; and
 - b The Minister of Commerce is satisfied that the costs of compliance with the FSPA are unreasonable or are not justified by the benefits of compliance
- 26 The FSPA also provides the Governor-General with the power to promulgate regulations, on the recommendation of Minister of Consumer Affairs, to exempt any service or person from the FSPA. The Minister of Consumer Affairs may only recommend the promulgation of such regulations if:
 - a the exemption is consistent with the purposes of the FSPA; and
 - b the costs of compliance with the obligation would be unreasonable or not justified by the benefits of compliance.

² The Financial Action Task Force (FATF) is an inter-governmental body whose purpose is the development and promotion of national and international policies to combat money laundering and terrorist financing.

- 27 The purposes of Part 2 of the FSPA relate to FATF compliance and access to information about financial service providers. These are not affected by dispute resolution scheme membership.
- 28 The purposes of Part 3 of the FSPA relate to dispute resolution and are "to promote confidence in financial service providers by improving consumers' access to redress from providers through schemes to resolve disputes. The schemes are intended to be accessible, independent, fair, accountable, efficient, and effective."
- 29 The Minister of Commerce also has powers of exemption under the FAA. I also note that the FAA allows exemptions to be granted by the Commission, under slightly different circumstances. There is a similar crossover of exemption powers between the Minister of Commerce and the Minister of Consumer Affairs under the FSPA. In order to ensure that a whole-of-government approach to exemptions is taken, I have instructed my officials at the Ministry of Economic Development ("MED") to liaise with the Ministry of Consumer Affairs and the Commission to establish a framework for managing this overlapping authority.
- 30 At this time I propose a number of exemptions be developed under the exemption powers of the Minister of Commerce and Minister of Consumer Affairs, including:
- a Exemptions from the FSPA's dispute resolution obligations:
 - i Low value non-cash payment facilities.
 - b Complete exemptions from the FSPA:
 - i Gift cards and loyalty schemes that are incidental to retailing;
 - ii Credit arranged at point of sale under the "assignment model";
 - iii Directors of promoters of securities;
 - iv Individual trustees of superannuation schemes;
 - v Angel investors;
 - vi The New Zealand Police;
 - vii Lloyd's underwriters; and
 - viii Financial services between related companies.
 - c Exemptions from the FAA:
 - i Superannuation advice from related companies; and
 - ii Financial adviser sole traders.
 - d Exemptions from both the FAA and the FSPA:
 - i the Board of Trustees of the National Provident Fund and Annuitas.

- 31 As the FSPA comes into force on 1 December in respect of all financial services except for financial advice, I am likely to seek a waiver of the 28 day rule for the promulgation of the exemption regulations once drafting is complete. The waiver is not likely to be controversial, as without a waiver certain businesses covered by the proposed exemptions would be in breach of the FSPA until the exemptions come into force.

FSPA exemptions from the dispute resolution obligations

- 32 The FSPA requires persons that are in the business of providing financial services to be registered as financial service providers and, if they provide services to retail clients, to belong to an approved dispute resolution scheme.

Low value non-cash payment facilities

- 33 Section 5 (f) and (g) of the FSPA catch persons who are in the business of operating a money or value transfer service or issuing and managing a means of payment. It is important that these services be covered because many examples, such as travellers' cheques and 'moneygram' services, pose a significant money laundering risk.
- 34 However, a number of services are potentially caught by the FSPA that do not require the full level of regulation that this Act imposes. Examples include certain billing service providers such as providers of taxi chits and services such as Snapper cards. The former business effectively coordinates billing accounts between taxi companies and businesses that use the taxi chits, allowing payment for taxi services to be made some time after the service has been provided. The latter service allows clients to charge a card that can later be used for bus rides and other services.
- 35 I consider that providers of such low value non-cash payment facilities should be exempted from the obligation to belong to a dispute resolution scheme. Such services are generally well understood by consumers and are of sufficiently low value that the benefits of increased consumer access to redress are outweighed by the costs to providers of belonging to a dispute resolution scheme. These costs include the cost of joining a scheme (approximately \$1000 per year) plus the uncertain cost of paying for complaint investigations, which could be as high as \$3000 per complaint.
- 36 A definition of "low value non-cash payment facility" could include those facilities under which:
- a The maximum amount available for non-cash payments held by any person at one time (being the amount owed by the client in the case of services like taxi chits and the amount pre-paid in the case of services like Snapper cards) does not exceed:
 - i \$1000 in the case of a natural person using or holding the facility for personal or domestic purposes; or
 - ii \$15,000 in the case of any other person; and

- b The total amount available to all clients of the service provider under the facility does not exceed \$15,000,000 at any time; and
 - c The facility is not part of another type of financial service under the FSPA aside from issuing and managing a means of payment or operating a money or value transfer service.
- 37 Part (c) of this draft definition will ensure that other financial service providers, such as providers of credit contracts, are not accidentally excluded from the dispute resolution obligations.
- 38 I therefore recommend that providers of low value non-cash payment facilities be exempted from the obligation to be a member of a dispute resolution scheme. This recommendation is consistent with the equivalent Australian regime.

Complete FSPA exemptions

Gift cards and loyalty schemes that are incidental to retailing

- 39 As noted above, the FSPA captures persons that are "in the business" of providing defined financial services, including operating a money or value transfer service and issuing and managing a means of payment. It is possible that the FSPA would therefore catch gift cards and loyalty schemes; services that are incidental to general retailing business.
- 40 Gift cards and loyalty schemes are relatively simple and well understood by consumers, meaning that consumers do not make significant gains from increased access to redress through a dispute resolution scheme. Therefore, I consider that the benefits of improved consumer access to redress are outweighed by the costs to retailers offering these services of registering and belonging to a dispute resolution scheme.
- 41 Furthermore, exempting these services will not undermine New Zealand's compliance with its FATF obligations, as indicated in the 2003 FATF document *The FATF 40 Recommendations* states:
- When a financial activity is carried out by a person or entity on an occasional or very limited basis (having regard to quantitative and absolute criteria) such that there is little risk of money laundering activity occurring, a country may decide that the application of anti-money laundering measures is not necessary, either fully or partially.
- 42 Such means of payment that are incidental to a retailing business are likely to fall within this category.
- 43 I therefore recommend that providers of gift cards and loyalty schemes be exempted from the coverage of the FSPA, insofar as they are incidental to a standard retailing business.
- 44 This recommendation is in line with the equivalent Australian regime.

- 45 I note that the definition will need to be crafted carefully in order to ensure that the exemption does not cause gaming activity, such as businesses attempting to claim that consumer credit contracts qualify as exempted services in order to avoid the coverage of the regime.
- 46 I also note that related exemption regulations are being developed under the Anti-Money Laundering and Countering Financing of Terrorism Act 2009 (the "AML Act"). Officials at MED are liaising with officials at the Ministry of Justice to ensure that the exemptions are consistent, insofar as is practical.

Credit arranged by retailers at point of sale

- 47 Under the FSPA, a person who is in the business of providing credit under a credit contract must register and be a member of a DRS if that person provides credit to retail clients.
- 48 Usually when credit is provided to customers in the context of retailing, a financier provides the credit to the customer. The financier pays the retailer for the product bought by the customer and then collects the debt from the customer. In this situation, the retailer does not provide credit in its own name and is therefore not a FSP. Accordingly it does not have to register or be a member of a DRS (the "**direct credit model**").
- 49 However, in some retail credit situations, once the customer has been approved for credit by the financier, the retailer enters into a credit agreement in its own name. This credit agreement is then assigned to the financier, who pays the retailer for the customer's purchase and then collects the debt from the customer, as per the first scenario, above. The transfer of the credit agreement from the retailer to the financier typically occurs in a very short period, often effectively contemporaneously and the assignment is often part of the credit contract as the retailer technically provides credit, albeit for a very short period, it would have to register and be a DRS member under the FSPA (the "**assignment model**").
- 50 In the two scenarios above, the practical process is almost identical. In both cases the financier decides whether or not to extend credit and then collects the debt from the customer. However, because of the distinction in the process of legal documentation, the retailer must register and be a DRS member under the assignment model but not the direct credit model.
- 51 Given the fact that the two scenarios are functionally identical, a requirement for the users of one business model to be registered and a member of a DRS but not users of the other is likely to lead to unnecessary distortions. Affected retailers would need to change their business practices, such as preparing new contracts or else register at a cost of around \$400 and join a DRS at a cost of around \$1000.
- 52 I am satisfied that exempting retailers that provide credit for only a very short period before assigning the credit contract to a financier would not create undue additional money laundering risks. The financier will still be required to register as a FSP and will still have the obligations imposed on it by the AML regime, including the obligation to do 'customer due diligence'.

- 53 Similarly, as it is the financier and not the retailer that assesses the customer, makes the decision to extend credit and eventually collects the debt, there are minimal risks to consumer protection objectives.
- 54 I therefore recommend that regulations be drafted exempting retailers from the obligation to register and be DRS members, when this obligation is only derived from the fact that they provide credit under a credit contract that is assigned to a financial service provider by the close of the business day after the credit agreement is signed by the customer.

Directors of Promoters of Securities

- 55 The FSPA is intended to primarily be a register of entities that provide financial services. In order to register, the directors, controlling owners and senior management must pass a number of negative checks, such as checks that they are not undischarged bankrupts and have not been convicted of crimes of dishonesty.
- 56 Under the FSPA, a person who participated in an offer of securities to the public as a promoter under the Securities Act must register. The definition of a promoter in the Securities Act (which is defined to include all directors of a promoter that is a body corporate) means that not only do companies that design securities have to register, but their directors would technically have to register also. This was not intended.
- 57 As the company will still have to register as an FSP, it will still be readily identifiable. Furthermore, its directors will still have to pass the negative checks in order for the company to register. Therefore, exempting directors of promoters from the obligation to register does not threaten New Zealand's compliance with the FATF recommendations.
- 58 Furthermore, as the company will also have to be a member of a DRS, consumers' access to redress will not be undermined by this exemption.
- 59 Therefore, I recommend that directors of promoters of securities be exempted from the obligation to register, insofar as this obligation is only due to their position as directors of a promoter of securities.

Individual Trustees of Superannuation Schemes

- 60 As noted above, under the FSPA it will generally be entities, not individuals, that register. However, with respect to superannuation trustees this might not be the case. In contrast to other trustees under the Securities Act, superannuation trustee services are often provided by individuals in their capacity as a member of an unincorporated board of trustees. It is likely that such trustees would need to register on an individual basis. This result would not be consistent with Government policy and in my view it would present unnecessary compliance costs not justified by the benefit of compliance. In particular, it would mean that the Register would have to be updated whenever an individual superannuation trustee is appointed or ceases being a superannuation trustee.

- 61 Therefore, I recommend that individual trustees of superannuations schemes be exempted from the requirement to register if the board of trustees is registered as an unincorporated body. As members of the board of trustees, the trustees would still have to meet the minimum checks under the FSPA, ensuring that the benefits of registration are not lost.

Angel Investors

- 62 Generally speaking, angel investors are not likely to be caught by the FAA, as they do not usually provide financial adviser service in the ordinary course of a business. Furthermore, financial advice provided within angel investor groups, when caught at all, is subject to a lighter handed wholesale regime under the FAA.
- 63 However, angel groups remain concerned that some individual angel investors continue to be required to register under the FSPA.
- 64 As a consequence, angel investor groups remain concerned that the requirement to register may inhibit a number of angels from continuing to provide angel investment. This may result in significant reductions in the capital available for local start up business. The primary concern raised by individual angel investors was that a number of angel investors would not want to be identifiable on a public register, which was a necessary consequence of registration. The Commerce Select Committee considered this issue during the passage of the Bill and it was considered that the issue may be best addressed through a specific exemption.
- 65 Angel investors are generally wealthy individuals who use their own funds to help provide capital for business start-up. Many angel investors are organised into angel groups or networks so that they can better share research and pool their investment capital. An angel deal may typically happen in the following way:
- An entrepreneur proposes an idea, product or existing business to a group of angel investors.
 - If any of the angel investors are interested in the proposal, they may decide to do further due diligence to explore the proposal further.
 - This due diligence may be undertaken by a lead investor, several of the possible angel investors or the staff of an angel network who then reports back to the interested angels with some recommendations.
- 66 In this type of situation it is possible that the lead investor could be caught by the FAA, depending on the frequency with which he or she advises colleagues on investments.

67 This type of business start up funding is a critical aspect of encouraging our smaller start up businesses to grow. However, it is also important from a FATF compliance perspective that that we are able to identify these professional angel investors who routinely provide financial advice so that we identify possible money laundering risks in our economy. To addresses these concerns, I propose that any natural person who is a member of an angel network or group be exempted from registering on the Register of Financial Service Providers if the angel network or group:

- Is registered as a financial service provider;
- Maintains a register of all natural persons who are members of that angel network or group; and
- Makes the register available to the Registrar whenever reasonably requested by the Registrar.

68 It will also be important to define the type of groups that may constitute an angel network or group. I propose that an angel network or group be defined as any incorporated or unincorporated body:

- that is established with the purpose of maintaining a forum for investors to pool resources with the objective of providing capital for innovative and early stage businesses; and
- that does not directly provide capital for such businesses.

New Zealand Police

69 The New Zealand Police (the “**Police**”) offer insurance and superannuation services to its staff. As a consequence, the Police will have to register under the FSPA. There is an exemption in the FSPA for government departments, statutory entities under the Crown Entities Act 2004 and for the Reserve Bank. However, the Police do not fit into any of these categories, being established and continued under a series of separate pieces of legislation, most recently the Policing Act 2008.

70 As a creature of statute within the government, the Police are already subject to more direct instruments of government control and are subject to the Ombudsman. Therefore, the Police should be treated in the same manner as other forms of Crown organisation. This is consistent with the approach taken under the Anti-Money Laundering and Countering Financing of Terrorism Act 2009.

71 I therefore recommend that the New Zealand Police be exempted from the FSPA.

Lloyd's underwriters

- 72 Rather than underwriting insurance in its own right, Lloyd's operates and regulates a market in which its members select risks to underwrite in their own names. This is a unique structure that does not fit comfortably into general regulatory frameworks. As a consequence, the members of Lloyd's have special provisions in United Kingdom and under New Zealand's Insurance (Prudential Supervision) Act 2010.
- 73 Under Lloyd's arrangement each of its members would, at present, need to register under the FSPA as an underwriter of insurance. This is highly onerous, as Lloyd's has over 2000 members. All of these members effectively operate under the same organisation but due to its unique legal structure each would have to register and be a member of a DRS.
- 74 Given these costs, I consider that Lloyd's underwriters should be exempted from the FSPA.
- 75 This will not create problems with New Zealand's compliance with FATF, as Lloyd's maintains an up-to-date list of its members, enabling rapid identification if required by New Zealand regulators. Furthermore, senior managers of Lloyd's members are checked against the criteria set by the Financial Services Authority in the United Kingdom. These are stricter criteria than those imposed under the FSPA.³
- 76 Furthermore, there should be no significant implications for consumers. Lloyd's will be a member of an approved DRS, ensuring that these objectives of the FSPA are satisfied.
- 77 Given the significant costs of compliance caused by Lloyd's unique structure and the alternative mechanisms in place to ensure that FATF and consumer protection objectives are met, I recommend that members of Lloyd's be exempted from the FSPA. This exemption would only apply in respect of the members' activities as a Lloyd's underwriter. Members that provide other financial services would still need to register.
- 78 However, due to the technical details of the territorial scope of the FSPA Lloyd's will not be able to register until the Insurance (Prudential Supervision) Act 2010 is in force, as it does not have a place of business in New Zealand. Once the IPSA is in force Lloyd's will be providing a "licensed service" under the FSPA and will have to register. Transitional regulations will therefore be needed to allow Lloyd's to register in the meantime.

Financial services between related companies

- 79 The FSPA requires companies that provide financial services to related companies to register as financial service providers.

³ See *The Fit and Proper Test for Approved Persons* by the Financial Services Authority.

- 80 However, when a company "provides a financial service" to a related company, this is effectively a single business taking action on its own account. As a consequence, there are no real money laundering or consumer risks associated with such services. Therefore, I recommend that financial services provided between related companies be excluded from the FSPA.

FINANCIAL ADVISERS ACT EXEMPTIONS

Superannuation advice from related companies

- 81 The FAA already exempts advice provided to employees in connection with a financial product made available through the employees' workplace. Workplace superannuation schemes are an example of this type of service.
- 82 As noted above, many businesses operate as groups of related companies. In many cases, it could be more practical for one company in the group to advise the employees of other members of the group on workplace investments. In order to enable this to occur without being subject to the FAA, I recommend that regulations be promulgated to exempt advice provided by a company or its employees to the employees of a related company in relation to financial products made available through the workplace.

Financial adviser sole traders

- 83 With a few exceptions, the FAA and FSPA require that individual financial advisers and the entities that employ them register as financial service providers. This is intended to enable easy identification of approved individual advisers and of the firms that operate in the financial adviser market. However, in the case of sole traders – being individuals operating through a company of which they are the sole director and shareholder – registration of both the individual adviser and the company would impose undue compliance costs.
- 84 Sole trader advisers would effectively need to register twice, as in both cases the checks conducted on financial service providers would be conducted in respect of the same individual.
- 85 I therefore recommend that in the case of sole traders, the individual adviser should have to register but the company should not.
- 86 This exemption should be on the condition that the company is a member of a dispute resolution scheme. This ensures that the advisory services provided are still covered by the consumer protection elements of the regime.
- 87 Furthermore, the exemption should be on the condition that the adviser notifies the Registrar of the name of the company that he or she operates through at the time of registration. I understand that the registration system has components that allow this. This condition will ensure that regulators have access to information on adviser firms, allowing effective identification for anti-money laundering purposes. It will also enable the public to search the Register for the company as well as for the name of the adviser.

Disclosure over the telephone

- 88 As outlined below in Part Two of this paper, regulations containing the details of financial advisers' disclosure obligations are ready to be promulgated, with Cabinet approval. However, the provision of financial advice over the telephone presents complex regulatory compliance challenges not present in advice provided face to face. This was reflected in the Securities Markets Act 1988. In the FAA, disclosure is only required to be made before giving financial advice if it is practicable to do so. It was intended that this would provide sufficient flexibility for advice over the telephone.
- 89 However, officials have received comment from numerous stakeholders that this position is not certain enough with regards to category 2 products and that specific allowance needs to be made for telephone advice in certain circumstances.
- 90 In relation to advice on category 2 financial products, I recommend that advisers be exempt from the disclosure obligation so long as the client receives verbal disclosure outlining:
- a the fact that the adviser is a registered financial adviser, AFA or QFE;
 - b the fact that the adviser has a dispute resolution procedure available to the consumer, should the consumer have a complaint;
 - c the fact that the adviser will provide a written disclosure statement to the customer upon request; and
 - d in the case of AFAs and QFEs, any information required to be disclosed over the phone under the terms and conditions of authorisation imposed by the Commission.
- 91 This disclosure should be able to be delivered mechanically, rather than by the adviser him/herself.
- 92 This exemption will require the drafting of regulations in addition to the attached Financial Advisers (Disclosure) Regulations 2010 (see Part Two, below).

Exemption from the FSPA and the FAA

The Board of Trustees of the National Provident Fund and Annuitas Management Limited

- 93 Crown organisations are exempted from the FAA and FSPA completely. The Board of Trustees of the National Provident Fund (the "**Board**") is a statutory body corporate, but is not a crown organisation. Accordingly, it is not currently exempt from the FAA or FSPA.
- 94 Similarly, Annuitas Management Limited ("**Annuitas**"), a joint venture between the Board and the Government Superannuation Fund Authority (the "**GSFA**"), is similarly not exempt. Neither the GSFA nor the Board have employees of their own. Their functions are staffed by Annuitas.

- 95 Given that the Board is a statutory creature and that Annuitas is a wholly owned subsidiary of the Board and the GSFA, both organisations are subject to significant scrutiny and oversight. For example, the Minister of Finance appoints the members of the Board and can issue it with directions. In addition, the Board's superannuation schemes are closed to new members. Accordingly, I am satisfied that there are negligible money laundering risks associated with the operations of these organisations.
- 96 If Annuitas or the Board is subject to the FAA it will have to register as a financial service provider and will have to comply with the statutory conduct standards for financial advisers. These costs are not justified by the benefits of compliance. This is because these organisations are effectively under the control of the Crown and, as a consequence, there are more direct levers available to control them, where necessary.
- 97 I therefore recommend that regulations be promulgated exempting the Board of Trustees of the NPF from the FAA and the FSPA.
- 98 I further recommend that Annuitas be exempted from the FSPA and FAA in respect the services it provides to the Board or to other Crown organisations.

FEES FOR EXEMPTIONS

- 99 Under the FAA, the Commission can grant an exemption to any person, service, transaction or class thereof from compliance with the FAA, regulations or code of professional conduct, or the registration requirement (if that obligation arises because of the provision of a financial adviser or broker service). The Commission may also impose any terms and conditions on the exemption as the Commission thinks fit.
- 100 The Commission has a similar power to create exemptions from the Securities Act 1978 (the "**Securities Act**") under section 5(5) of that Act. In order to meet the costs of processing the applications, the Commission is entitled to charge applicants for applications for exemptions under the Securities Act. The fees have been set at the following rates:
- i fee of \$112.50 for an application; and
 - ii a fee calculated at the following hourly rates in respect of any of those applications:
 - (a) for work carried out by a member of the Commission, an hourly rate of \$225;
 - (b) for work carried out by an officer or employee of the Commission who holds a qualification in accountancy, business, commerce, economics, or law, an hourly rate of \$163; and
- 101 The Commission is also able to recover from applicants costs incurred by the Commission in:
- i printing or publishing the necessary exemption notices; and

- ii the obtaining of expert advice or expert assistance in respect of an application.

- 102 I note that the FAA enables regulations to be developed allowing the Commission to charge for processing an application for exemptions. As the benefit of an exemption notice is generally specific to the exemption, I recommend that regulations be promulgated enabling the Commission to charge for processing an application for exemption. I further recommend that the fees for processing an application for exemption from the FAA be based on the fees charged for exemptions under the Securities Act but with appropriate amendments to accommodate the different professions of, and qualifications held by, staff in the licensing and supervision area compared to the Securities Act area. Similarly, I recommend that the costs recoverable by the Commission in respect of an application for exemption from the FAA be based on the model used for exemptions from the Securities Act.
- 103 Finally, I note that there is a review underway at present assessing the fees of the Commission across the board. This review is likely to re-examine the FAA exemption fees as a part of this process. However, it is important that fees be put in place now to ensure that the Commission can charge for any work undertaken for exemptions and can publicise the charges for potential applicants ahead of the regime coming into force. My officials will report to me in due course on whether any adjustments to these fees are required.

CONSULTATION

- 104 In relation to the above proposals, MED conducted targeted consultation with stakeholders likely to be affected between August and October this year. Submitters were supportive of the proposals.
- 105 One submitter did argue that, rather than *excluding* retailers arranging credit under the assignment model, regulations should be used to *require* all retailers arranging credit at point of sale to belong to a DRS. However, Parliament decided in July this year that this type of activity should be excluded from the regime. The proposal in this paper is to fix a technical anomaly. A decision to expand the scope of the FSPA would require a full policy process and would best be considered as a part of the review of consumer law, which is currently underway.
- 106 The following government agencies have been consulted: the Ministry of Consumer Affairs, the Companies Office, Treasury, the Ministry of Justice, the Reserve Bank and the Securities Commission. All concerns raised have now been addressed in the proposals in this paper.
- 107 The Department of the Prime Minister and Cabinet and Parliamentary Counsel Office have been informed.

FISCAL IMPLICATIONS

- 108 The proposal to set fees for the consideration of exemptions by the Commission may have some fiscal implications. At present no estimates of the likely total cost of these activities is available, as the number of applications for exemption is not known at this time.

HUMAN RIGHTS

- 109 There are no human rights implications arising from the proposals in this paper.

LEGISLATIVE IMPLICATIONS

- 110 The proposals in this paper will require the promulgation of regulations under the FAA and the FSPA.

REGULATORY IMPACT ANALYSIS

Regulatory Impact Analysis Requirements

- 111 The Regulatory Impact Analysis ("RIA") requirements apply to the following proposals in this paper:
- a The definition of "land investment product";
 - b The proposed exemptions from the FSPA and the FAA;
 - c The exemption fees regulations; and
 - d The disclosure exemption for telephone advice.
- 112 A Regulatory Impact Statement ("RIS") has been prepared for each of these proposals. The four RISs are attached to the end of this paper.
- 113 No RIS has been prepared for the definitions of "investment-linked contracts of insurance", "call credit union share" or "cash or term portfolio investment entity", as these definitions are technical and substantially re-enact the current law to provide clarity.

Quality of the Impact Analysis

- 114 The Regulatory Impact Analysis Review Panel ("RIARP") assessed the four RISs attached to this paper. With regards to the RIS on the definition of "land investment product" RIARP has provided the following statement:

The Deputy Secretary, Economic Strategy Branch, Ministry of Economic Development and the Regulatory Impact Analysis Review Panel have reviewed the Regulatory Impact Statement (RIS) prepared by the Ministry of Economic Development and associated supporting material, and considers that the information and analysis summarised in the RIS partially meets the criteria necessary for Ministers to fairly compare the available policy options and take informed decisions on the proposals in this paper.

- 115 With regards to the RISs relating to exemptions from the FAA and FSPA, the exemption for telephone advice on category 2 products and Commission fees for exemption consideration, RIARP has provided the following comment:

The Deputy Secretary, Economic Strategy Branch, Ministry of Economic Development and the Regulatory Impact Analysis Review Panel have reviewed the Regulatory Impact Statement (RIS) prepared by the Ministry of Economic Development and associated supporting material. And they consider that the information and analysis summarised in the RISs meet the criteria necessary for Ministers to fairly compare the available policy options and take informed decisions on the proposals in this paper

Consistency with Government Statement on Regulation

- 116 I have considered the analysis and advice of my officials, as summarised in the attached Regulatory Impact Statement and I am satisfied that, aside from the risks, uncertainties and caveats already noted in this Cabinet paper, the regulatory proposals recommended in this paper:

- Are required in the public interest;
- Will deliver the highest net benefits of the practical options available; and
- Are consistent with our commitments in the Government Statement on Regulation.

PUBLICITY

- 117 Subject to Cabinet approval, I will issue a press statement confirming Cabinet's decision in relation to the proposed regulations.
- 118 MED will post a copy of this paper on its website.

PART TWO – PROMULGATION OF DISCLOSURE REGULATIONS

DISCLOSURE REGULATIONS

- 119 In February this year, the Cabinet Economic Growth and Infrastructure Committee ("EGI") agreed to prescribe disclosure requirements for financial advisers under the Financial Advisers Act 2008 (EGI (10) 14 refers). The Financial Advisers (Disclosure) Regulations 2010 give effect to this policy with the following recommended modifications, which are reflected in the attached regulations.

- 120 First, EGI agreed that authorised financial advisers ("AFAs") be required to disclose details of any circumstance in which the adviser was adjudicated bankrupt within the past five years. To ensure full and accurate disclosure, I also recommend that AFAs be required to disclose details of any instance in which they have been admitted to the no asset procedure under Part 5 of the Insolvency Act 2006. Similarly, I also recommend that AFAs be required to disclose if they have been expelled or prohibited from a relevant professional body within the past five years. I believe that this is also a matter relevant to the consumer's assessment of whether or not to engage a financial adviser.
- 121 Second, EGI agreed to prescribe specific format requirements for the disclosure statements of AFAs and registered (but not authorised) financial advisers. These requirements included that the disclosure statements be set out under headings set by regulation and be no longer than two A4 pages. During the drafting of the regulations and after consultation with targeted stakeholders, officials became aware that these format restrictions would be overly restrictive and may not allow advisers to make disclosure in a professional way that would be most meaningful to the consumer.
- 122 To address this, I recommend a slightly different format for the disclosure statements of AFAs and registered (but not authorised) financial advisers ("RFAs"). For AFAs, I recommend that AFAs be required to fill out a primary disclosure statement. This statement is set by regulation. It has been designed so that it can be provided to the client at the earliest point in the relationship between financial adviser and consumer. The statement is heavily prescribed and the binding instructions on how to fill it out keep the statement short and concise. For all remaining information which AFAs are required to disclose, but which is not included in the primary disclosure statement, AFAs will be obliged to provide this information in secondary disclosure statements. These statements will not be subject to prescriptive format requirements allowing the AFA to provide them in a form that is most useful to the consumer. For RFAs, I recommend that RFAs be required to complete a similar form to the AFA's primary disclosure statement.
- 123 Third, I recommend that regulations stipulate the form in which qualifying financial entities ("QFEs") must make disclosure. I recommend that, in general, QFEs be able to make disclosure in any form they choose. This will enable them to provide information in a flexible way that suits their circumstances.
- 124 However, I also recommend that QFEs be required to make available to customers on request a disclosure statement in a form detailed in the regulations. The form (but not the content) will be the same as is required for AFAs' secondary disclosure statements (Clause 6(1)(a-d) of the disclosure regulations). This will ensure that customers can have access to information on QFEs that is understandable and broadly comparable between QFEs. They should also have to make disclosure in a form that is consistent with the relevant purpose statement under section 3(2)(b)(i) of the FAA, namely:

ensuring that clients can make informed decisions about whether to use the financial adviser... and... whether to follow a financial adviser's advice.

- 125 Finally, I recommend that AFAs be required to disclose whether they have any criminal convictions and whether they have been expelled or barred from a professional body within the last five years. I consider this information important for consumers to be able to decide whether to start a relationship with an adviser and whether to follow the adviser's recommendations.

CONSULTATION – DISCLOSURE REGULATIONS

- 126 In relation to disclosure, MED conducted a targeted consultation from July to September this year which included numerous industry and adviser firms directly affected by my recommendations.
- 127 The following government agencies have been consulted: The Ministry of Consumer Affairs, the Companies Office, Treasury, the Ministry of Justice, the Reserve Bank and the Securities Commission. No concerns have been raised.
- 128 The Department of the Prime Minister and Cabinet has been informed.

TIMING AND 28-DAY RULE – DISCLOSURE REGULATIONS

- 129 The attached regulations are to come into force on 1 July 2011. This is to provide advisers and adviser firms with sufficient time to develop their disclosure statements and compliance systems in order to comply with the regulations.

COMPLIANCE – DISCLOSURE REGULATIONS

- 130 The attached regulations comply with the following:
- i The principles of the Treaty of Waitangi;
 - ii The rights and freedoms contained in the New Zealand Bill of Rights Act 1990, or the Human Rights Act 1993;
 - iii The principles and guidelines set out in the Privacy Act 1993;
 - iv Relevant international standards and obligations; and
 - v The *LAC Guidelines: Guidelines on Process and Content of Legislation*, a publication by the Legislation Advisory Committee.
- 131 Under section 154(5) of the FAA 2008 I must be satisfied of the following matters before recommending the attached regulations:
- i that the exemption is consistent with the purposes of the Act; and
 - ii that the costs of compliance with the provision or provisions to which the exemption relates would be unreasonable or not justified by the benefit of compliance; and
 - iii that the extent of the exemption is not broader than what is reasonably necessary to address the matters that gave rise to the exemption.
- 132 I am satisfied of these matters. Under section 154(4) of the Act I am also required to consult with the Securities Commission. This requirement has been met.

REGULATIONS REVIEW COMMITTEE – DISCLOSURE REGULATIONS

- 133 There are no grounds for the regulations review committee to draw the regulations to the attention of the House under Standing Order 310.

CERTIFICATION BY PARLIAMENTARY COUNSEL – DISCLOSURE REGULATIONS

- 134 The Parliamentary Counsel Office has certified the regulations as being in order for submission to Cabinet

REGULATORY IMPACT ANALYSIS – DISCLOSURE REGULATIONS

- 135 Regulatory Impact Statements were submitted at the time that approval of the policy relating to these Regulations was sought from the Cabinet Economic Growth and Infrastructure Committee.

PUBLICITY – DISCLOSURE REGULATIONS

- 136 MED will post a copy of this paper on its website.
- 137 The Regulations will be published in the Gazette on the Thursday following Executive Council approval. I will issue a press release when the regulations are gazetted.

RECOMMENDATIONS

138 It is recommended that the Committee

Definitions

- 1 **Agree** that the definition of 'land investment product' be focussed on complex land investment schemes rather than relatively simple land investments;
- 2 **Agree** that a credit union share subject to the statutory 60 day withholding period be categorised as a category 2 product;
- 3 **Agree** that an investment linked contract be a contract aimed at generating a return as opposed to a contract aimed at mitigating the risk of an event occurring;
- 4 **Agree** that "a unit in a cash or term portfolio investment entity" be defined to cover portfolio investment entities that:
 - 4.1 are invested entirely in category 2 term or call securities; and
 - 4.2 are issued by the same business as these underlying securities.

Exemptions

Financial Service Providers (Registration and Dispute Resolution) Act 2008

- 5 **Note** that regulations granting exemptions from the obligation to belong to a dispute resolution scheme must not be recommended unless:
 - 5.1 The exemption is consistent with the purposes of the Financial Service Providers Act 2008 ("FSPA"); and
 - 5.2 The costs of compliance with the obligation would be unreasonable or not justified by the benefits of compliance.
- 6 **Agree** that providers of low value non-cash payment facilities, be exempted from the obligation to be a member of a dispute resolution scheme;
- 7 **Note** that regulations exempting a person or service from the application of the entire FSPA must not be recommended unless:
 - 7.1 The Minister of Commerce has had regard to New Zealand's obligations under the FATF Recommendations; and
 - 7.2 The Minister of Commerce is satisfied that the costs of compliance with the obligation would be unreasonable or not justified by the benefits of compliance.
- 8 **Agree** to exempt from the FSPA:
 - 8.1 providers of gift cards and loyalty schemes that are incidental to retailing be exempted from the FSPA entirely;

- 8.2 retailers, when this obligation is only derived from the fact that they provide credit under a credit contract that is assigned to a financial service provider by the end of the next working day;
 - 8.3 directors of promoters of securities, insofar as this obligation is only due to their position as directors of a promoter of securities;
 - 8.4 individual trustees of superannuation boards of trustees, provided the board is registered as an unincorporated body;
 - 8.5 The New Zealand Police; and
 - 8.6 financial services between related companies.
- 9 **Note** that in most instances angel investors are unlikely to be caught by the FAA but that some activities within angel investor networks could be caught;
- 10 **Agree** that any natural person who is a member of an angel network or group be exempted from registering on the Register of Financial Service Providers if the angel network or group:
- 10.1 Is registered as a financial service provider; and
 - 10.2 Maintains a register of all natural persons who are members of that angel network or group; and
 - 10.3 Makes the register available to the Registrar of Financial Service Providers whenever reasonably requested.
- 11 **Agree** that an angel network or group be defined as any incorporated or unincorporated body:
- 11.1 that is established with the purpose of establishing a forum for investors to pool resources with the objective of providing capital for start-up companies; and
 - 11.2 that does not directly provide capital for such companies.
- 12 **Agree** that the members of Lloyd's be exempted from the FSPA, provided the only financial service they provide is acting as a Lloyd's underwriter;
- 13 **Agree** that temporary transitional regulations be promulgated to enable Lloyd's to register before the Insurance (Prudential Supervision) Act 2010 comes into force in September 2013;
- 14 **Agree** that sole trader financial advisers not be required to register their legal entity, provided:
- 14.1 the legal entity is a member of a dispute resolution scheme; and
 - 14.2 the financial adviser identifies the legal entity in his/her application to register under the FSPA.

Financial Advisers Act 2008

- 15 **Agree** for regulations to be drafted exempting from the disclosure obligation persons giving advice on category 2 products provided they disclose verbally:
- 15.1 the fact that the adviser is a registered financial adviser, AFA or QFE;
 - 15.2 the fact that the adviser has a dispute resolution procedure available to the consumer, should the consumer have a complaint;
 - 15.3 the fact that the adviser will provide a written disclosure statement to the customer upon request; and
 - 15.4 in the case of an AFA or QFE, any other matters required to be disclosed under the terms and conditions imposed by the Commission.
- 16 **Agree** that it be permitted that this verbal disclosure be automated in some way;

Financial Advisers Act 2008 and Financial Service Providers Act 2008

- 17 **Agree** that regulations be promulgated exempting the Board of Trustees of the National Provident Fund from the FAA and the FSPA;
- 18 **Agree** that regulations be promulgated exempting Annuitas from the FAA and FSPA in respect of services provided to the Board of the National Provident Fund and other Crown organisations;

Fees

- 19 **Note** that my officials are undertaking a detailed review of the Securities Commission's fees at present and will report to me on FAA exemption fees as a part of this process.
- 20 **Note** that the Securities Commission needs to have fees set as soon as possible so that it can process applications for exemptions before the regime is fully implemented.
- 21 **Agree** that regulations be promulgated enabling the Commission to charge for processing an application for exemption from the FAA.
- 22 **Agree** that the fees for processing an application for exemption from the FAA be based on the fees charged for applications for exemption from the Securities Act 1978.
- 23 **Agree** that the costs recoverable by the Commission in respect of an application for exemption from the FAA be based on the model used for exemptions from the Securities Act 1978.

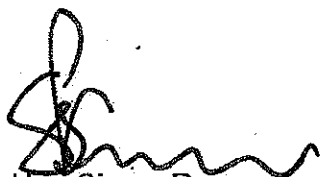
Disclosure

- 24 **Note** that on 12 February 2010 the Cabinet Economic Growth and Infrastructure Committee agreed to require advisers to make disclosure of certain information before providing financial adviser services (EGI (10) 14 refers).

- 25 **Note** that the attached Financial Advisers (Disclosure) Regulations 2010 give effect to the decision referred to in paragraph 1 above.
- 26 **Note** that section 154 of the FAA requires that I consult with the Securities Commission and the advice of the Minister of Commerce that these requirements have been met.
- 27 **Agree** that authorised financial advisers ("AFAs") be required to disclose details of any instance in which they have been admitted to the 'no asset procedure' under the Insolvency Act 2006 within the last 5 years.
- 28 **Agree** that AFAs be required to disclose if they have been expelled or prohibited from a relevant professional body within the last 5 years.
- 29 **Note** that Cabinet previously agreed that AFAs' disclosure statements not be longer than 2 A4 pages, using a reasonable font size (EGI (10) 14 refers).
- 30 **Rescind** this decision.
- 31 **Agree** that instead AFAs be required to provide:
 - 31.1 a primary disclosure statement of prescribed format; and
 - 31.2 a secondary disclosure statement or statementsas described in the Financial Advisers (Disclosure) Regulations 2010.
- 32 **Agree** that financial advisers, other than qualifying financial entities ("QFEs") and AFAs, be required to make disclosure in accordance with schedule 3 of the attached Financial Advisers (Disclosure) Regulations 2010.
- 33 **Agree** that QFEs be able to make disclosure in any form, provided:
 - 33.1 the QFE makes available to customers a written disclosure statement in accordance with proposed Regulation 8(5) of the attached Financial Advisers (Disclosure) Regulations 2010 when requested by a customer.
- 34 **Agree** that AFAs be required to disclose whether they have been expelled or barred from a professional organisation within the last five years and whether they have any criminal convictions or have had other adverse findings against them by a court or disciplinary tribunal.
- 35 **Authorise** the submission to the Executive Council of the Financial Advisers (Disclosure) Regulations 2010.

Publicity

- 36 **Agree** for this Cabinet paper to be posted on the website of the Ministry of Economic Development, with any necessary withholdings.



Hon Simon Power
Minister of Commerce

Date signed: 13/10/10

Regulatory Impact Statements

This section contains four Regulatory Impact Statements, covering:

- 1 The definition of the "land investment product";
- 2 A number of exemptions from the Financial Advisers Act 2008 and the Financial Service Providers (Registration and Dispute Resolution) Act 2008;
- 3 An exemption from the disclosure obligation; and
- 4 Fees to be charged by the Securities Commission for the consideration of exemption applications.

Regulatory Impact Statement #1

DEFINITION OF 'LAND INVESTMENT PRODUCT' UNDER THE FINANCIAL ADVISERS ACT 2008

AGENCY DISCLOSURE STATEMENT

This Regulatory Impact Statement has been prepared by the Ministry of Economic Development.

It provides an analysis of options for the definition of 'land investment product' to be provided by regulations under the Financial Advisers Act 2008.

The analysis undertaken involved an assessment of the nature of the Blue Chip property scheme, being a prominent example of a land investment product, and consultation with stakeholders involved in property investment to identify key costs and benefits of different approaches. Regulations are needed to avoid regulatory uncertainty in the market place that would result from no definition being set. However, detailed information on the costs and benefits of one of the options is difficult to obtain. The resulting high level of uncertainty around one of the options is a key factor influencing the recommendation in this paper.

One key risk of the recommendation is that if the definition is drafted too widely, it could inadvertently capture a wider range of activities than is intended, leading to additional compliance costs. Similarly, if the exemption is drafted too narrowly it could allow promoters of land investment products to avoid the definition through by structuring the product around it.

It is possible that the Government would demand a particularly strong case before agreeing to one of the options in this paper, although this is not the preferred option.

Jivan Grewal, Acting Manager, Corporate Law and Governance

P.P. J. Grewal

Signature of person]

12 October 2010

STATUS QUO AND PROBLEM DEFINITION

The Financial Advisers Act 2008 ("FAA") regulates the provision of advice on the acquisition or disposal of "financial products". Any person who provides such advice in the ordinary course of business will be subject to a licensing and supervision regime administered by the Securities Commission (the "Commission"), unless the advice is incidental to the provision of another service.

One financial product in the FAA is the "land investment product" ("LIP"). The definition of this product must be set by regulations. If it is not set by regulations there will be little basis on which the term can be interpreted by industry, the regulator and the Courts. This would lead to significant uncertainty. Setting a definition for the LIP is the proximate problem to be resolved.

The more fundamental problem is to create an appropriate definition. The central objective of including the LIP in the FAA was to ensure that property schemes that are set up in such a way that they are not securities, such as some of Blue Chip's products, are still subject to the FAA.⁴

There is also arguably a case for casting a wider net and capturing advice on a wider range of property investments. New Zealanders invest heavily in land and there is a risk that excluding the acquisition of most types of interest in land from the regime will leave a significant gap. This could result in substandard advice in relation to land investments.

A wide net would also minimise the chance that a land investment scheme like Blue Chip could avoid the definition. Blue Chip was a complex land investment scheme that was structured in such a way that its products were not securities and consequently avoided regulation as such. When Blue Chip collapsed, around 3000 investors lost a total of approximately \$80 million. As these products were not securities, advice on them would not be caught by the FAA unless they are within the LIP definition.

However, it should also be noted that most advice on land is provided by real estate agents, who are subject to a separate regulatory regime and are exempt from the FAA.

Timing constraints

Financial advisers must be registered on the register of financial service providers by 31 March 2011 and must be fully compliant by 1 July 2011. Therefore, a policy decision must be obtained in the near future so that market participants and the Commission are aware of the scope of the FAA. Similarly, regulations should be promulgated as soon as possible after policy decisions are made in order to provide certainty to the market.

⁴ This was clearly the intention of the Commerce Select Committee, as noted in the commentary to the Financial Service Providers (Pre-Implementation Adjustments) Bill, which created the concept of the LIP.

OBJECTIVES

The first objective is to ensure that a definition for the LIP is provided by regulations to ensure that there is regulatory certainty.

The second objective is to ensure that advice on schemes with characteristics like securities are caught by the FAA. The Securities Act 1978 excludes some types of investments in land, making it possible for securities-like products to be developed that avoid regulation as securities. Key features of these products that give rise to similar issues as investment in securities include exposure of the investor to the risk that the promoter of the investment could become insolvent, for example through a rental guarantee from the scheme's promoter.

Products promoted by Blue Chip are prominent examples of this type of scheme.

Thirdly, the LIP definition should catch other advice on acquiring or disposing of interests in land, where the benefits of regulation would outweigh the costs.

REGULATORY IMPACT ANALYSIS

There are two feasible options:

- 1 To define the LIP widely, catching most investments in land.
- 2 To define the LIP narrowly, focussing on land investments that are similar to securities (like Blue Chip).

Leaving the LIP undefined is not a feasible option, as this would result in extreme uncertainty in the market as to the interpretation of the term and, consequently, as to the obligations of persons advising on the sale or acquisition of interests in land.

Option One – a wide definition (not preferred).

This option would involve a broad definition that would capture advice on the majority of investments in land and, consequently, a wide range of persons providing advice on land.

Impacts - benefits

Investments in real estate are popular in New Zealand and it is arguable that there is therefore a case for the FAA to catch such advice. Arguably investors investing in land are just as vulnerable to information asymmetries and risks as are investors investing in securities, which are caught under the FAA.

Therefore, one key benefit of this option would be that consumers and investors would be afforded the protections of the FAA when receiving advice on a wide range of property investments, to the advantage of consumers and investors.

However, a large percentage of advice on land is provided by real estate agents. Although problems were identified by stakeholders with the conduct of many real estate agents, they are subject to regulation under the Real Estate Agents Act 2008 and are exempt from the FAA when providing advice that is in the ordinary course of a real estate agent's business. Accordingly, problems with real estate agents are more appropriately dealt with through their own regime.

Furthermore, although there is a relatively sound *theoretical* argument for the broad inclusion of land under the FAA on the grounds that this will improve advice on land investments, the only available evidence of a problem to be addressed is anecdotal. Officials have not been able to obtain evidence that a widespread problem exists.

Finally, the Code of Professional Conduct, to which financial advisers dealing in LIPs would be held, does not currently contain educational or competence requirements specific to land investments. Although advisers would still be held to general ethical and procedural standards, the benefits would be muted by the absence of specific competence standards.

It is therefore unclear how significant the beneficial effects of a wide definition would be.

Nonetheless, this option would still have the advantage of minimising the risk that unethical advisers and sales people could legally avoid the coverage of the FAA.

Impacts – costs

A wide definition of the LIP will result in a greater range of sales people and advisers being caught by the regime. This will impose compliance costs on a range of individuals throughout the economy. Such people will have to either cease providing advice on LIPs or else become authorised financial advisers. The cost of authorisation is approximately \$1150 with annual costs of approximately \$570. In addition, training could be necessary in order to qualify for authorisation, costing hundreds of dollars per person.

A wide definition could potentially catch a wide range of professions, for many of which there is no clear problem to be solved. Examples include architects, engineers and builders. As it is unclear exactly who might be caught by a wide definition, it is not possible at this time to quantify the costs that would be imposed. However, given the range of professions that could be caught, the costs could well be significant.

Any compliance costs imposed on industry would ultimately be passed on to consumers and investors.

Decision

This option is not preferred because the benefits are uncertain and the costs, while also uncertain, are likely to be high.

Option Two – a narrow definition (preferred)

Under this option, basic investments in land would be excluded from the LIP definition. Instead, the definition would be targeted at more complex schemes for investing in land, such as many products promoted by the firm Blue Chip.

The detailed approach to drafting would need to be discussed with Parliamentary Counsel but the definition would capture products where the value of the investment depends to a high degree on factors not directly tied to the value of the land (ie: on factors besides rental income and capital appreciation). In particular, relevant schemes expose investors to the risk that the promoter of the scheme could become insolvent.

Impacts - benefits

The primary benefit of this approach is that it would make it more difficult for sales people and advisers to avoid the coverage of the FAA by structuring a complex investment in land in such a way that it is not a security.

This would improve outcomes for investors, as sales people and advisers dealing in complex land investment products would be subject to the ethical standards and enforcement procedures in place under the FAA. This would improve outcomes for investors consulting regulated advisers. It would also reduce incidences of unethical and misleading sales practices, as the Commission would be able to take enforcement action at an early stage against the adviser if the adviser were not authorised under the FAA.

As noted above under **Option one**, real estate agents are not generally subject to the FAA and there are no land-specific standards in the Code of Professional Conduct.

Furthermore, again, the benefits of this approach are not easy to quantify, as it is unknown exactly how many of these products exist at present.

Impacts – costs

Under this option, the costs of authorisation (detailed above) would still be imposed on applicable advisers. However, this group would be far narrower than under **Option one**.

The primary cost of this option is that the regulatory protections afforded to investors and consumers will only apply in respect of a narrower group of land investment schemes relative to **Option one**.

Decision

This option is preferred, as it does not bring the uncertain benefits and uncertain – but probably high – costs of **Option one**.

Given the uncertain trade off created by a wide definition, a narrow definition is preferable to ensure that undue compliance costs are not created for uncertain benefit.

Under this approach the core purpose of the LIP is maintained – ensuring that the FAA will apply to complex Blue Chip-like investment schemes.

CONSULTATION

Targeted consultation took the form of preliminary discussions with a number of industry bodies such as the New Zealand Mortgage Brokers Association and the New Zealand Bankers Association. Following this, draft proposals were sent to a number of law firms, industry bodies representing a variety of classes of financial adviser and property investor organisations.

The proposals were also sent to the Commission, Ministry of Justice, Ministry of Consumer Affairs, the Companies Office, Treasury and the Reserve Bank have been consulted.

The preferred option in this paper has taken into account the views revealed during this targeted consultation and views conveyed to officials during the consideration of the Financial Service Providers (Pre-Implementation Adjustments) Bill.

Key feedback

All respondents agreed with the basic premise that complex schemes such as Blue Chip should be caught by the LIP definition.

Broadly speaking, submitters agreed that the best approach would be to restrict the definition to complex investment schemes with characteristics like those outlined above in the **Objectives** section.

However, numerous stakeholders also drew our attention to wider issues around advice on investments in land including anecdotal evidence that problems in this area do exist. They also suggested that due to the popularity of property investment in New Zealand it would be preferable for the FAA to catch property investment more broadly. However, these stakeholders also recognised the uncertain range of persons who would be caught by a wide definition of the LIP and recognised the resulting uncertain, but potentially high, costs that this would cause. They therefore acknowledged that a more detailed policy process would be wise before trying to design a wide definition for the LIP.

Submitters also supplied proposals for how to approach the drafting of the definition, which will be discussed with Parliamentary Counsel.

CONCLUSIONS AND RECOMMENDATIONS

As noted above, the preferred option is **Option one** – a narrow definition focussed on complex property investment schemes such as Blue Chip. This is preferred, as it will catch high risk complex products, without the uncertain impacts of a wider definition.

Nonetheless, officials agree that there is a theoretical argument that advice on investments in land should be subject to a similar level of regulation as advice on investments in securities and other financial products. Therefore, we recommend that a comprehensive policy process be conducted to determine more precisely the costs and benefits of broader regulation with a view to revising the FAA's application to land investments in the future if this proves warranted.

This could form part of the five year review (see below) but, as changes would probably only require amendments to regulations and not to the primary legislation, it would be desirable for this process to be completed by the end of 2011. This review process would enable standards specific to advice on investments in land to be developed and incorporated into the Code of Professional Conduct before the promulgation of regulations widening the definition, if this is decided to be necessary.

Furthermore, one key risk of the recommendation is that if the definition is drafted too widely, it could inadvertently capture a wider range of activities than is intended, leading to additional compliance costs. Similarly, if the exemption is drafted too narrowly it could allow promoters of land investment products to avoid the definition through by structuring the product around it.

In order to mitigate this risk, careful drafting will be necessary in consultation Parliamentary Counsel and key stakeholders.

IMPLEMENTATION

The primary implementation risk relates to timing. The obligation to register as a financial adviser applies from 31 March 2011, with full compliance with the FAA required from 1 July 2011. In order to allow the market to work to comply in time for these deadlines, regulations defining the LIP need to be promulgated as soon as possible.

In order to mitigate this risk, officials will liaise with industry and work with PCO to ensure that a definition is developed in a timely manner.

It will also be important to liaise with the Commission, which will, as regulator, be charged with enforcing compliance with the FAA. This will be important to ensure that the market has clear information on the scope of regulation.

MONITORING, EVALUATION AND REVIEW

The Ministry is required to review the FAA within five years of commencement (section 161 of the Act). The Ministry is developing an evaluation plan. This is likely to involve the identification and recording of base data for the period in which the FAA commences to be compared against data at the end of the relevant period. The data will be qualitative and quantitative and will be gathered from surveys, interviews with relevant stakeholders, statistical information, international comparisons and other observable market and industry outcomes.

As noted above, officials also recommend that a comprehensive policy process be completed by the end of 2011 to assess whether the definition of the LIP works in practice. The key points to consider are whether:

- the definition should be wider in order to prevent products that should be caught evading the regime through careful structuring;
- whether any land investments are caught inadvertently that should not be subject to adviser regulation; and
- whether advice on land investments more broadly should be subject to the FAA.

Regulatory Impact Statement #2**EXEMPTIONS FROM THE FINANCIAL SERVICE PROVIDERS ACT AND THE FINANCIAL ADVISERS ACT****AGENCY DISCLOSURE STATEMENT**

This Regulatory Impact Statement has been prepared by the Ministry of Economic Development.

It provides an analysis of options for addressing a number of potential exemptions from the Financial Advisers Act 2008 and the Financial Service Providers (Registration and Dispute Resolution) Act 2008.

The analysis undertaken has essentially been a cost-benefit analysis of a number of potential exemptions from provisions in the Financial Advisers Act 2008 and the Financial Service Providers (Registration and Dispute Resolution) Act 2008. In some instances it is unclear exactly how certain provisions in the Acts might be interpreted. In these situations, officials have erred on the side of providing certainty to industry rather than relying on the Courts to interpret the legislation in the manner hoped for.

None of the policy options in this paper are likely to have effects that the Government has said will require a particularly strong case before considering.

Jivan Grewal, Manager, Corporate Law and Governance

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[Signature of person]

12 October 2010

STATUS QUO AND PROBLEM DEFINITION

Stakeholder submissions have brought a number of situations in which the costs of compliance with the Financial Service Providers (Registration and Dispute Resolution) Act 2008 (the "FSPA") and with the Financial Advisers Act 2008 (the "FAA") are perhaps not justified by the benefits of compliance. This is caused by the scope of the two Acts being slightly wider than intended, primarily on technical grounds. Specifically, stakeholders have suggested that the following exemptions should be considered:

- 1) An exemption from the obligation to belong to a dispute resolution scheme ("DRS") under the FSPA for providers of low value non-cash payment facilities;
- 2) Complete exemptions from the FSPA (being exemptions from both the obligation to register and the obligation to be a member of a DRS) :
 - i. Gift cards and loyalty schemes that are incidental to retailing
 - ii. Credit arranged by retailers at point of sale;
 - iii. Directors of promoters of securities;
 - iv. Individual trustees of superannuation schemes;
 - v. The New Zealand Police;
 - vi. Lloyd's underwriters; and
 - vii. Financial services between related companies;
- 3) Exemptions from the FSPA and the FAA:
 - i. Angel investors;
 - ii. the Board of Trustees of the National Provident Fund and Annuitas;
- 4) Exemptions from the FAA only:
 - i. Workplace advice from related companies;
 - ii. Financial adviser sole traders.

The details of each situation are described in greater detail below under the Regulatory Impact Analysis section of this paper.

Without government intervention, it is highly likely that unjustified compliance costs will be incurred by a range of businesses.

BACKGROUND

The FAA and the FSPA were passed in 2008 to improve confidence in New Zealand's financial markets. Both Acts were amended in July 2010 in order to simplify compliance and address a number of technical issues in the legislation.

The FSPA requires all persons in the business of providing financial services to register with the Registrar of Financial Service Providers (run by the Companies Office) and, if they offer services to retail clients, to belong to a DRS. The register will be publicly searchable.

The FAA imposes obligations on financial advisers, including the obligation to be registered under the FSPA and to belong to a DRS. All advisers are subject to minimum statutory standards of conduct and competence. Advisers who deal in complex "category 1" products⁵ must be authorised by the Securities Commission (the "Commission") and are subject to a Code of Professional Conduct. There is also a limited entity authorisation model mainly intended for product providers.

OBJECTIVES

The central objective is to ensure that the scope of the FAA and the FSPA does not extend too wide, creating unnecessary compliance costs.

The FAA and the FSPA both contain a basic framework for assessing potential exemptions.

FSPA exemption framework

The FSPA contains a relatively explicit framework for assessing potential exemptions.

Exemptions from the obligation to be a member of a DRS must be consistent with the purposes of the Act and can only be granted if the cost of complying with the obligation to be a DRS member would be unreasonable or not justified by the benefits of compliance.

The relevant purpose of the Act is:

to promote confidence in financial service providers by improving consumers' access to redress from providers through schemes to resolve disputes. The schemes are intended to be accessible, independent, fair, accountable, efficient, and effective.

With regards to complete exemptions from the FSPA, in addition to making an assessment of the costs and benefits of compliance, the Minister of Commerce must have regard to New Zealand's obligations under the FATF Recommendations, which are intended to facilitate enforcement of anti-money laundering laws.⁶

FAA exemption framework

Similarly, the FAA contains a basic framework for assessing potential exemptions.

Section 154(5) states that the Minister of Commerce must not recommend an exemption unless:

- a. the exemption is consistent with the purposes of the Act; and

⁵ Relatively complex products are category 1, being most types of securities, futures contracts, "land investment products" and "investment-linked contracts of insurance". Category 2 products are relatively simple and well understood, including consumer credit contracts, bank term deposits and basic insurance.

⁶ The Financial Action Task Force (FATF) is an inter-governmental body whose purpose is the development and promotion of national and international policies to combat money laundering and terrorist financing.

- b. the costs of compliance with the provision or provisions to which the exemption relates would be unreasonable or not justified by the benefit of compliance; and
- c. the extent of the exemption is not broader than what is reasonably necessary to address the matters that gave rise to the exemption.

The basic frameworks in the FSPA and the FAA provide a sound basis for assessing potential exemptions.

REGULATORY IMPACT ANALYSIS – PART ONE – EXEMPTIONS FROM THE DISPUTE RESOLUTION REQUIREMENTS OF THE FSPA

There are two main costs to consider with regards to dispute resolution:

- Membership costs approximately \$1000 per year at current market rates; and
- Members will be exposed to the risk of complaints, the investigations of which they must fund at a cost of up to \$3000 per complaint. There is a risk that the no-charge nature of complaints could encourage unethical consumers to lodge spurious complaints for under \$3000 in the hope of a settlement.⁷

Low value non-cash payment facilities

Problem outline

The FSPA captures persons that are “in the business” of providing defined financial services. The definition of “financial service” in the FSPA is very wide, as is the definition of being “in the business”. As a result, a number of services are potentially caught by the FSPA that do not require the full level of regulation that this Act imposes. This is potentially the case for low value non-cash payment facilities, such as billing services like providers of taxi cabs and services such as Snapper cards. These services are potentially caught by section 5 (f) and (g) of the FSPA – operating a money or value transfer service and issuing and managing a means of payment.

The costs of compliance with the dispute resolution requirements are likely to be unduly onerous on providers of low value non-cash payment facilities.

Option One – do not exempt (not preferred)

The main benefit of this option is that consumers would have access to a DRS when they use low value non-cash payment facilities. However, this benefit is minor, as the services considered here are generally well understood by consumers and are of low value. As a consequence, consumers are less likely to have disputes than in the case of more sophisticated transactions and where a dispute does occur, they have access to the Disputes Tribunal.

In contrast, the costs of DRS membership are comparatively high. Although the registration obligation will still apply, the fees and risks associated with DRS membership, as noted above are still present.

The low benefits and comparatively high costs of this option mean that this option is not preferred.

⁷ It is worth noting that dispute resolution schemes generally refuse to process spurious or vexatious complaints. It is unclear at this time how effective this filtering process will be in practice.

Option Two – exempt (preferred)

The main benefit of this option is that providers of low value non-cash payment facilities would not have to pay for membership to a DRS (unless they offer other financial services).

The primary cost is that consumers would not have access to a DRS in respect of these services. However, as alluded to above, the benefit of DRS access in this situation is not substantial.

This option is preferred as the costs to businesses of compliance with the FSPA by providers of low value non-cash payment facilities would outweigh benefits to consumers.

REGULATORY IMPACT ANALYSIS – PART TWO – COMPLETE FSPA EXEMPTIONS

The cost of registration is approximately \$350 plus \$60 per year to maintain registration.

Furthermore, if a financial service provider provides financial services to retail clients it must belong to a DRS, incurring the costs outlined in the previous Part. Purely wholesale providers are not subject to this obligation and may register without being members of a DRS.

Means of payment that are incidental to retailing – gift cards and loyalty schemes

Problem outline

As noted above, the wide definitions in the FSPA could lead to certain types of business being inappropriately caught by the FSPA. This could occur when a conventional retailing business provides a means of payment such as gift cards and loyalty schemes. Although these services are incidental to retailing, they are potentially caught by section 5 (f) and (g) of the FSPA – operating a money or value transfer service and issuing and managing a means of payment.

If gift cards and loyalty schemes are captured by the FSPA, this will impose significant compliance costs on industry.

Option One – do not exempt (not preferred)

This option is not preferred, as it confers few benefits.

There would be some benefit in having such businesses belong to aDRS, as this would increase consumers' access to redress. However, given the low value of the transactions and consumers' general access to the Disputes Tribunal, these benefits are not significant.

Furthermore, the obligation to register could lead retailers to stop providing these services, reducing consumer choice.

There is also little benefit in having such businesses on a public register.

Ultimately, this option is not preferred because the minor benefits to consumers are outweighed by the significant costs to the relevant businesses.

Option Two – provide an exemption (preferred)

There is no reason for such businesses to register for FATF purposes, as the 2003 FATF document *The FATF 40 Recommendations* states:

When a financial activity is carried out by a person or entity on an occasional or very limited basis (having regard to quantitative and absolute criteria) such that there is little risk of money laundering activity occurring, a country may decide that the application of anti-money laundering measures is not necessary, either fully or partially.

This would cover an appropriately drafted exemption.

This option is preferred, as it does not impinge on New Zealand's FATF obligations and the minor benefits to consumers of having such businesses comply with the FSPA, as noted above, are outweighed by the significant costs to businesses.

Credit arranged by retailers at point of sale

Problem outline

Under the FSPA, a person who is in the business of providing credit under a credit contract must register and be a member of a DRS if he/she/it provides credit to retail clients.

In the area of retailing, there are two models under which financiers provide credit to customers making purchases:

1. The direct credit model, under which a financier assesses the customer's credit worthiness and, if satisfied, pays the retailer for the product before collecting the debt from the customer; and
2. The assignment credit model, under which the above happens but the credit is technically provided for a very short time by the retailer before this is assigned to a financier to collect. It is still the financier that assesses the credit worthiness of the customer.

Option One – do not exempt (not preferred)

In terms of consumer interests, there is little benefit in relevant retailers belonging to a DRS, as the retailer does not make the decision to extend credit and does not collect the debt. There would be little, if any, scope to complain to a DRS about the financial services provided, very briefly, by the retailer.

There is also little value in having retailers that arrange credit under one model listed on the Register of Financial Service Providers but not retailers that arrange under the other model. From a practical perspective the two models are identical.

In contrast, the costs of compliance (outlined above under **Objectives**) are material. Therefore this option is not preferred.

Option Two – exempt (preferred)

An exemption for retailers that promptly assign credit contracts to a financier should not undermine New Zealand's compliance with the FATF obligations. This is because the decision to extend credit to the customer is still made by the financier, which will have to be a registered financial service provider and will still have to comply with the obligations imposed under the Anti Money Laundering and Countering Financing of Terrorism Act 2009.

This option is preferred as it does not threaten New Zealand's FATF obligations and the costs of compliance with the FSPA would outweigh the negligible benefits.

Directors of promoters of securities

Problem outline

With the exception of financial advisers, registration is generally expected to occur at the entity level under the FSPA. Under this Act, a person who participates in an offer of securities to the public as a promoter under the Securities Act must register. The definition of a promoter in the Securities Act (which is defined to include all directors of a promoter that is a body corporate) means that not only do companies that are promoters of securities have to register, but their individual directors each have to register also.

Option One – do not exempt (not preferred)

There would be negligible benefit in requiring directors of promoters of securities to register individually. Regulators and the public will not have their access to information materially reduced, as the firm will still need to be registered and will need to list its directors on the Companies Register.

Similarly, there is no threat to consumers' access to redress, as the firm will still have to be registered and be a member of a DRS if it provides financial services to retail clients. There is no benefit in having the individual directors belong to a scheme as well.

These benefits are outweighed by the costs of compliance (outlined above under **Objectives**) so this option is not preferred.

Option Two – exempt (preferred)

As the company will still have to register as a financial service provider, it will still be readily identifiable. Furthermore, its directors will still have to pass the checks carried out by the Registrar of Financial Service Providers in order for the company to register. Therefore, exempting directors of promoters from the obligation to register does not threaten New Zealand's compliance with the FATF recommendations.

This option is preferred as it does not threaten New Zealand's FATF obligations and the costs of compliance with the FSPA would outweigh the negligible benefits.

Individual trustees of superannuation schemes

Problem outline

As noted above, registration under the FSPA is generally expected to occur at the entity level. With respect to superannuation trustees, however, many are in fact individuals acting on an unincorporated board of trustees.

Requiring individual trustees of superannuation schemes to register is likely to impose unnecessary compliance costs.

Option One – do not exempt (not preferred)

There are only very small benefits to having all individual trustees register in addition to the board itself. Consumers' access to redress would not be improved, as the board itself would still have to be a member of a DRS.

Furthermore, although there could be some small benefit in being able to see the individual members of the board, the regulators and the public would still be able to find information on the board itself.

These benefits are outweighed by the costs of compliance (outlined above under **Objectives**) so this option is not preferred.

Option Two – exempt (preferred)

If the board of trustees itself is registered as an unincorporated body, which is permitted under the FSPA, then FATF obligations are not undermined by an exemption for the individual members of the board. The board is identified and the members of the board, as senior managers, would still be subject to the checks required under the FSPA.

This option is preferred as it does not threaten New Zealand's FATF obligations and the costs of compliance with the FSPA would outweigh the negligible benefits.

The New Zealand Police

The New Zealand Police (the "Police") provide insurance and superannuation to its employees and will therefore have to register under the FSPA. Although the Police is a statutory creature, it is not within the exemptions in section 7(b) and (d) of the FSPA that exclude government departments and Crown Entities from the regime.

An exemption should be considered to remove unnecessary compliance costs.

Option One – do not exempt (not preferred)

There are negligible benefits to this option. As the Police are a government agency, they pose little money laundering risk and do not need to be specially identified for anti-money laundering purposes.

Similarly, there are no material benefits to consumers of requiring registration by the Police, as users of Police insurance and superannuation have recourse to the Ombudsman.

The costs of this option are the costs of registration and membership of a dispute resolution service. These costs would accrue to the Police.

As there are costs to this option with no real benefits, this option is not preferred.

Option Two – exempt (preferred)

The benefits of this option are the costs of **Option One** are avoided.

There are no material costs to this option, as it brings no anti-money laundering or consumer protection benefits.

Therefore, this option is preferred.

Lloyd's underwriters

Problem outline

Rather than underwriting insurance in its own right, Lloyd's operates and regulates a market in which its members select risks to underwrite in their own names. Lloyd's coordinates brokers seeking insurance underwriters with Lloyd's members and also imposes prudential regulation of its members. This is a unique structure that does not fit comfortably into general regulatory frameworks. As a consequence, the members of Lloyd's have special provisions in United Kingdom and under New Zealand's Insurance (Prudential Supervision) Act 2010.

Under Lloyd's arrangement each of its members would, at present, need to register under the FSPA as an underwriter of insurance. This is highly onerous, as Lloyd's has over 2000 members. All of these members effectively operate under the same organisation but due its unique legal structure each would have to register and be a member of a DRS.

Option One – do not exempt (not preferred)

There are no significant benefits to consumers of this option. Lloyd's will be a member of an approved DRS, ensuring that consumers retain access to redress under the FSPA model.

There is also little benefit in terms of public access to information. Rather than being preoccupied with which particular member might underwrite their insurance, the significant point for buyers of insurance is that the underwriter is a member of Lloyd's. Status as a member provides significant reassurance to clients in the form of the regulation of members, including prudential overlays to protect against the risk of failure by an individual member.

Furthermore, finding an insurance underwriter is always done through the Lloyd's structure so there should be no confusion among clients as to where they should go to find an underwriter.

Therefore, although there will be a slight reduction in public access to information, this is not substantial.

These minor benefits of having all members register individually are outweighed by the costs of compliance, as outlined above. Multiplied over more than 2000 members, this amounts to over \$2.7 million.

Option Two – exempt (preferred)

With regards to FATF compliance, Lloyd's maintains an up-to-date list of its members, enabling rapid identification if required by New Zealand regulators. Furthermore, senior managers of Lloyd's members are checked against the criteria set by the Financial Services Authority in the United Kingdom.⁸ These are stricter criteria than those imposed under the FSPA, meaning there is little benefit in requiring individual members to register from a FATF perspective.

This option is preferred as it does not threaten New Zealand's FATF obligations and the costs of compliance with the FSPA would outweigh the negligible benefits.

Financial services between related companies

Problem outline

The FSPA applies to any person that provides financial services to another person. This includes services provided between related companies.

Many businesses choose to operate as groups of related companies. These related companies can then "provide a financial service" for each other but these services are effectively activities within the same business. Therefore, requiring companies that only provide financial services to related companies is likely to be unduly onerous.

Option One – do not exempt (not preferred)

There would be negligible benefit in having such companies register. Access to information by the public and the regulators would not be affected, as the only relevant services being provided would be inside the group. Any external services would require registration of the provider.

Similarly, there is little benefit in prohibiting certain people from the management of such companies, as the only services being provided are within the group, which will have its own internal governance arrangements.

Finally, there are no consumer implications, as the only relevant services are provided solely within the group. Any external services would require registration of the provider and would attract the obligation to belong to a DRS if the recipients of the services are retail clients.

Although there are no benefits, there are material costs of compliance (outlined above) so this option is not preferred.

Option Two – exempt (preferred)

Services provided between related companies are not a money laundering risk in and of themselves, as they are simply a way for businesses to structure themselves

⁸ See *The Fit and Proper Test for Approved Persons* by the Financial Services Authority.

efficiently. Money laundering risks would only be created if a company provided financial services to other persons outside of its corporate group. In this situation, the company would have to register, as normal. Therefore, an exemption for services provided between related companies would not undermine compliance with FATF obligations.

This option is preferred as it does not threaten New Zealand's FATF obligations and the costs of compliance with the FSPA would outweigh the negligible benefits.

REGULATORY IMPACT ANALYSIS – PART THREE – EXEMPTIONS FROM THE FAA AND THE FSPA

In addition to the compliance costs outlined above in respect of FSPA compliance, complying with the FAA imposes the following compliance costs:

- Financial advisers who deal in category 1 products must be individually authorised by the Commission at an up-front cost of approximately \$1150 plus \$570 per year; or
- Where the limited entity authorisation model is used, the cost is approximately \$4900 upon authorisation plus \$4600 per year.

Angel investors

Problem outline

Angel investors are generally wealthy individuals who use their own funds to help provide capital for businesses in the early stages of development. Many angel investors are organised into angel groups or networks so that they can better share research and pool their investment capital. The advice provided between angels could cause such angels to require registration as wholesale financial advisers under the FSPA.

As a wholesale service, financial advice provided within angel investor groups are subject to a lighter handed regime under the FAA. However, angels would still be required to register as financial service providers. The Commerce Select Committee considered this issue during the passage of the amendments to the FAA passed in May 2010 and it was considered that the issue may be best addressed through a specific exemption.

Option One – do not exempt (not preferred)

Under this option, no exemption would be granted from either the FAA or the FSPA. This would require many angel investors to register as financial service providers.

The most obvious cost of this option is that angels would have to pay the registration fee of around \$350 plus \$60 per year to maintain registration. However, this cost might not be of concern in the case of angels, who are typically wealthy individuals.

The principal costs of this option are that derived from the aversion of many angels to being named on a public register. This could lead to decreased angel investor activity and reduced provision of venture capital to early stage businesses in New Zealand.

These costs would accrue to entrepreneurs – who would have reduced access to capital, to angel investors themselves – who would have reduced investment opportunities, and to the economy as a whole – which would suffer from reduced innovation and entrepreneurial activity.

The main benefit of this approach is that information on angel investors would be available on the Register of Financial Service Providers. The public and regulators could make use of this information.

Option Two – completely exempt (not preferred)

Under this option, angel investors would be completely exempted from both the FAA and the FSPA.

The main benefit of this option is that it would avoid the negative outcomes outlined in **Option One**, above.

One cost of this approach is that angels would cease to be subject to the minimum conduct standards in the FAA that apply to all financial advisers, namely to exercise due care, skill and diligence.

The main cost of this option is that this would greatly reduce access to information on persons providing certain types of wholesale financial advice. This would complicate efforts to enforce anti-money laundering requirements and the wholesale financial adviser requirements. It could potentially also damage New Zealand's compliance with the FATF requirements.

This option is not preferred, as the benefits can still be obtained through a more limited exemption such as **Option Three**, without the costs caused by reduced information.

Option Three – exempt from the registration obligation only (preferred)

Under this option, angels would only be exempted from under the FSPA insofar as they belong to a registered angel investor organisation and insofar as they are only required to register because of the angel advisory activities (ie: they do not provide another financial service such as retail financial advice or insurance underwriting).

The main benefit of this option is that it would avoid the negative outcomes outlined in **Option One**, above.

Furthermore, the costs associated with **Option Two** related to lack of information are mitigated by this option. If the angel group itself is registered as an unincorporated body, which is permitted under the FSPA, then FATF obligations are not undermined. A condition of the exemption could be that the angel group keep an up-to-date list of its members. This would enable rapid identification of individuals if required. The senior managers of the organisation would still be subject to the checks required under the FSPA, again ensuring FATF compliance.

Furthermore, in contrast to **Option Two**, as an “exempt provider”, the basic conduct standards in the FAA would still apply.

This option is preferred, as it does not impinge on New Zealand's compliance with its FATF obligations and because the benefits to entrepreneurs, angels and the economy generally outweigh the costs of a minor reduction in information accessibility.

Annuitas and the Board of Trustees of the National Provident Fund

Problem outline

Crown organisations are exempted from the FAA and FSPA completely. The Board of Trustees of the National Provident Fund (the "**Board**") is a statutory body corporate, but is not a Crown organisation.

Annuitas Management Limited ("**Annuitas**") is a joint venture between the Board and the Government Superannuation Fund Authority (the "**GSFA**") and is similarly not exempt. Neither the GSFA nor the Board have employees of their own. Their functions are staffed by Annuitas.

Although Crown organisations are exempt from the FSPA and the FAA, neither the Board nor Annuitas is a Crown entity. However, these entities effectively function as Crown entities, meaning requiring compliance with the FAA and FSPA is an unnecessary compliance burden.

Option One – do not exempt (not preferred)

The Board's superannuation schemes are closed to new members and, under the National Provident Fund Restructuring Act 1990, the Crown guarantees the payment of benefits under the remaining schemes. Therefore there are negligible benefits provided to consumers if the Board complies with the two Acts.

Nor are there particular advantages to the government, including regulators, under this option. This is because there is no anti-money laundering benefit to having these entities registered as financial service providers, as they are already readily identifiable by their nature.

Furthermore, the Minister of Finance appoints the members of the Board, making the checks carried out on senior managers before registration unnecessary.

The cost of this option is that the Board and Annuitas will have to register as financial service providers and will be subject to enforcement under the FAA by the Commission. As wholesale providers, the only monetary cost would be the cost of registration, being about \$350.

Although these compliance costs are not large, they are not justified by the minimal benefits of compliance.

Option Two – exempt (preferred)

Under this option, the Board would be exempted completely from the FSPA and the FAA. Annuitas would be exempt from the FSPA and the FAA in respect of its services to the Board and other Crown organisations (being the only relevant services it provides).

The main benefit under this option is that the costs in **Option One** would be avoided for the Board and for Annuitas.

There are negligible costs to this option. As noted under **Option One**, these entities provide very constrained services and the Government guarantees the schemes the Board administers so there are negligible costs to consumers.

There are no FATF implications under this option, as these entities are already readily identifiable and the appointments to the Board are made by the Minister of Finance, removing the benefits of the checks carried out on senior managers before registration.

This option is preferred, as the costs of compliance outweigh the negligible benefits to regulating these entities, which effectively act like Crown organisations.

PART FOUR – EXEMPTIONS FROM THE FAA ONLY

The costs of compliance with the FAA are outlined at the start of Part Three

Workplace advice from related companies

Under the FAA financial advice is exempt from regulation when it is provided by an employer to an employee in respect of financial products made available through the workplace ("**workplace products**"). This primarily concerns workplace superannuation schemes.

However, many businesses are structured as groups of companies and it may be the case that one company in the group is best placed to advise the employees of all members of the group on workplace products.

The FAA also exempts agents of employers providing advice to employees on workplace products. This is likely to exclude subsidiaries advising the employees of their holding company but might not allow different configurations to make use of the exemption.

Option One – do not exempt (not preferred)

Under this option advice on workplace products would only be exempt from the FAA if provided by the relevant employees' employer.

The only real benefit of this option is that it could result in more employees receiving financial advice from external advisers due to limitations on advice from their employer and its group.

The cost of this option is that employers would have to employ a financial adviser to advise on workplace products. It is likely that, instead, many workplaces would simply cease to provide any advice on their products.

Furthermore, employees working for a company in a group might not be able to receive advice on their workplace savings and similar services from the entity in the group best placed to provide the advice.

This option is not preferred as it creates an artificial distinction between businesses that operate as single companies and businesses that operate in groups of companies. In the former case, employees are likely to have reduced access to workplace superannuation and similar financial products.

Option Two – exempt (preferred)

Under this option advice on financial products made available through the workplace would be exempted from the FAA when provided by a related company of the recipient's employer.

The benefit of this approach is that employees' access to advice on workplace products would be increased. Also, advice on these products could be provided more effectively and cheaply under this option, as the entity able to deliver the advice in the most efficient manner in a business group would be able to provide all the financial advice to the group's employees.

This option is also consistent with the general principle in the FAA that employees are able to receive advice from the business they work for on provided workplace products without the advice being subject to the FAA.

The cost of this approach is that employees might receive less advice from external advisers subject to the FAA. However, external advisers will still be available for employees to consult if they choose, mitigating this cost.

This option is preferred as the benefits outweigh the costs and because it is consistent with the existing general approach in the FAA.

Sole traders' companies

Under the FAA, natural persons who advise retail clients must be registered under the FSPA as individuals. In the majority of cases, their employer or principal will also have to register. Only the employer or principal needs to be a member of a DRS.

Generally speaking this model is appropriate, as it ensures that the public has information about qualified individual advisers and about companies providing financial adviser services. This information must also be available to regulators for enforcement purposes, in particular for enforcement of the anti-money laundering regime.

However, in the case of sole traders operating through a company – being individual advisers that are the sole director and shareholder of their company – registration of both the individual adviser and the company could be unduly onerous. This is because in the case of sole traders the company only has one adviser working for it – the sole trader. Therefore the checks carried out on directors and senior managers of the company that are required for registration will already have been carried out on the adviser when he/she registered in his/her individual capacity. Furthermore, the cost of registration of both the individual adviser and the company will be entirely carried by the single adviser.

Option One – do not exempt (not preferred)

Under this option, the adviser and the company will have to register.

The benefit of this approach is that it is consistent; all financial advisers will be registered and all companies providing financial adviser services will be registered, providing clear information to the public and regulators.

The cost of this approach is that sole traders will have to carry the cost of registration twice – once for the company and once for individual registration. This could have the effect of making the sole trader model less competitive and reducing the viability of small scale advisory businesses.

This option is not preferred as its benefits can be retained through lower-cost means.

Option Two – exempt the adviser from registration (not preferred)

Under this option, each sole trader would have to register his/her company but would not have to register individually.

The benefit of this option is that it would prevent sole traders from having to pay for registration twice, reducing compliance costs.

The cost of this option is that it would allow financial advisers that have been debarred by the Commission to continue to carry out business by registering a company and operating through it as a sole trader. Neither the public nor regulators would be able to see clearly whether the adviser working through the company was permitted to carry on this business.

This option is not preferred, as it would open a significant loophole in the supervision framework.

Option Three – exempt the company from registration, with conditions (preferred)

Under this option sole traders would have to register as individuals but would not have to register their companies. Instead, they would be required to identify their company when they register individually. The register has the ability to allow individual advisers to identify their company.

The benefit of this approach is that it reduces the compliance costs of sole traders while retaining the benefits of registration of both individual advisers and their companies. As the information required to be disclosed upon registration is publicly searchable, consumers would still be able to access information about legitimate adviser businesses and regulators would be able to identify entities providing relevant services.

The only cost to this option is that sole trader advisers will need to complete a slightly more complicated registration process in order to avail themselves of the exemption. This could lead to errors. However, this cost can be mitigated through the Register's "help text", which enables regulators to guide people through the registration process step by step.

This option is preferred, as it combines the benefits of the other two options with no material costs.

CONSULTATION

Targeted consultation took the form of preliminary discussions with stakeholders relevant to each proposed exemption, particularly law firms, industry bodies and dispute resolution schemes. The proposals were also sent to the Commission, Ministry of Justice, Ministry of Consumer Affairs, the Companies Office, Treasury and the Reserve Bank have been consulted.

The preferred option in this paper has taken into account the views revealed during this targeted consultation and views conveyed to officials during the consideration of the Financial Service Providers (Pre-Implementation Adjustments) Bill.

Key feedback

Stakeholders were supportive of our proposals. The main response was that care should be taken in drafting the exemptions to avoid unintended consequences and to maximise consistency with other regimes, such as the anti-money laundering regime, where appropriate.

CONCLUSIONS AND RECOMMENDATIONS

In order to remove unnecessary compliance costs, the following exemptions are proposed:

- 1) An exemption from the obligation to belong to a DRS under the FSPA for providers of low value non-cash payment facilities;
- 2) Complete exemptions from the FSPA:
 - i. Gift cards and loyalty schemes that are incidental to retailing
 - ii. Credit arranged by retailers at point of sale;
 - iii. Directors of promoters of securities;
 - iv. Individual trustees of superannuation schemes;
 - v. New Zealand Police;
 - vi. Lloyd's underwriters;
 - vii. Financial services between related companies.
- 3) Exemptions from the FSPA and the FAA:
 - i. Angel investors; and
 - ii. The Board of Trustees of the National Provident Fund and Annuitas.
- 4) Exemptions from the FAA:
 - i. The registration obligation for the companies of sole traders; and

- ii. Financial adviser services provided to employees by related companies in relation to financial products provided through the workplace.

IMPLEMENTATION

The primary implementation risk relates to timing. The obligation to register as a financial service provider applies from 1 December 2010 (except for financial adviser, who have until 31 March 2011). In order to allow the market to see in advance what its obligations will be policy decisions are needed in October. Furthermore, exemption regulations for the FSPA must be promulgated before 1 December. If necessary, exemptions from the FAA could be promulgated in early 2011.

The secondary risk is that the exemptions are drafted too widely or in such a way that they do not line up with relevant regimes.

In order to mitigate these risks, officials will liaise with industry and work with PCO to ensure that a satisfactory definition is developed in a timely manner.

MONITORING, EVALUATION AND REVIEW

The Ministry is required to review the FAA within five years of commencement (section 161 of the Act). The Ministry is developing an evaluation plan. This is likely to involve the identification and recording of base data for the period in which the FAA commences to be compared against data at the end of the relevant period. The data will be qualitative and quantitative and will be gathered from surveys, interviews with relevant stakeholders, statistical information, international comparisons and other observable market and industry outcomes.

Upon completion of the review, the Ministry will prepare a report to the Minister of Commerce who will table the report to the House of Representatives.

Regulatory Impact Statement #3

THE APPLICATION OF THE DISCLOSURE OBLIGATION UNDER THE FINANCIAL ADVISERS ACT 2008 TO THE PROVISION OF FINANCIAL ADVICE OVER THE TELEPHONE

AGENCY DISCLOSURE STATEMENT

This Regulatory Impact Statement has been prepared by the Ministry of Economic Development.

It provides an analysis of options to address impracticalities of disclosure obligations under the Financial Advisers Act 2008 in respect of telephone advice on category 2 products.

The analysis in this paper is a cost-benefit analysis using information obtained during the Select Committee submissions on the Financial Service Providers (Pre-Implementation Adjustments) Bill in the first half of 2010. It also drew on information provided by stakeholders during a targeted consultation in July and August 2010.

The key uncertainty in this analysis is derived from the fact that the disclosure obligation under consideration has not been in force, so information on the costs of compliance can only be estimated.

The options in this paper are not likely to have effects the Government has said would require particularly strong justification.

Jivan Grewal, Manager, Corporate Law and Governance

Signature of person]

pp J. Grewal

12 October 2010

STATUS QUO AND PROBLEM DEFINITION

The Financial Advisers Act 2008 ("FAA") regulates the provision of financial advisory services in New Zealand with a view to promoting the sound and efficient delivery of financial adviser services as well as promoting the professionalism and integrity of financial advisers (section 3, FAA). The FAA is expected to come into force in July 2011.

As one way of achieving its statutory purpose, the FAA requires advisers to make prescribed disclosure in order to ensure that clients can make informed decisions about whether to use a financial adviser and whether to follow a financial adviser's advice (section 3(2)(b)(i)). Specifically, a financial adviser who provides a personalised financial advisory service to a retail client is required to make disclosure as detailed in the regulations before they provide the service or as soon as practicable thereafter (section 22(1)).

Cabinet has agreed to the prescribed information which financial advisers must disclose (EGI (10) 14] refers). Regulations giving effect to this policy are due to be completed in October this year.

During the drafting of the regulations, concern has been raised that advisory services provided over the phone in respect of category 2⁹ products might require customised disclosure obligations, as disclosure generally must be in writing.

Whilst section 22 contemplates that disclosure statements need only be provided before giving advice where it is practical to do so, disclosure must still eventually be provided in writing. In the case of telephone advice on category 2 products this might not be appropriate.

The FAA contains a regulation making power that permits exemptions to be made subject to appropriate conditions. This is available to address the problem if the Minister is satisfied of the statutory criteria for making the exemption.

OBJECTIVES

The Ministry's objective in addressing the problem is to recommend a solution that removes compliance costs which are unreasonable or which are not justified by the benefit of compliance whilst still promoting the purposes of the FAA and the purposes of disclosure.

REGULATORY IMPACT ANALYSIS

In order to recommend the passing of regulations addressing this issue, the Minister must be satisfied that the costs of compliance with the FAA are unreasonable or not justified by the benefit of compliance. Part A contains the Ministry's assessment of this point.

⁹ Relatively complex products are category 1, being most types of securities, futures contracts, "land investment products" and "investment-linked contracts of insurance". Category 2 products are relatively simple and well understood, including consumer credit contracts, bank term deposits and basic insurance.

Part B provides the Ministry's assessment of the options available to address the issue as well as the Ministry's preferred option.

Part C provides the Ministry's assessment of the remaining statutory prerequisites for passing regulations in this area – that the regulations are consistent with the purposes of the FAA and that the proposed exemption is not broader than what is reasonably necessary to address the matters that give rise to the exemption.

Part A: Costs and Benefits of Compliance with the Status Quo

The Ministry considers that the cost of compliance with the disclosure obligation is likely to be significant when advice is provided over the telephone in relation to category 2 products. At the same time, the Ministry considers that benefit of compliance is likely to be limited. Accordingly, the Ministry is satisfied that the cost of compliance is not justified by the benefit of compliance.

Cost of Compliance

The Act is not yet in force so there is no data available on the cost of compliance with the disclosure obligation. However, stakeholders were able to provide general estimates of costs, as many advisers are already required to make some disclosure under different regimes.

The principal cost is that the provision of financial advice will be delayed if certainty is not provided. Specifically, numerous firms and advisers have informed the Ministry that without greater clarity in the disclosure obligation, they will feel compelled to refrain from giving financial advice until they have established that the recipient of the advice has received a written disclosure statement from them. This is difficult to put a monetary value on such delays. At the very least, however, this policy outcome would appear inconsistent with the Act's objective of promoting the efficient delivery of financial adviser services (refer section 3(1) of the FAA).

A further cost is that advisers would be required to take down the name and contact details of any person who seeks financial advice over the phone or in any situation where there is a chance that financial advice may be provided during the phone conversation. This is a significant cost in the insurance industry where insurance providers often receive calls from members of the public seeking information about the products that they offer. The majority of the conversation would not be considered to be financial advice (and therefore not attract the disclosure obligation) because it would be the provision of information only. However, in many cases, financial advice may be provided, for example, "I recommend you purchase this insurance product because it is the most competitively priced product in the market." Alternatively, financial advice may be provided inadvertently, such as through an implied recommendation. Some insurance providers have advised the Ministry that in order to manage their legislative compliance risk, they intend to require their telephone call centre staff to refrain from commencing any conversation until it has been established that the member of the public has received written disclosure.

In many cases, the member of the public may not wish to receive the disclosure statement and receiving the statement may actually be a cost to them. The most compelling example that was provided to the Ministry was in the case of insurance where a member of the public who wishes to call four or five insurance providers to obtain quotes on their products. While providing these quotes it is possible that the adviser could give implied advice inadvertently. That member of the public could also find themselves receiving four or five disclosure statements from those providers.

Similarly, it may be that the person wishing to find the information about the insurance product does not wish to have any further relationship with the insurance provider and does not wish to provide their contact details to them. As such, the provision of that information in order to receive the information they are looking for would be a cost in itself.

Benefit of Compliance

The primary benefit of compliance with the current obligation is that it ensures a consistent process is followed no matter the medium in which financial advice is provided. This benefit appears to be limited. So long as the content of the disclosure statement remains consistent across mediums and the consumer is still provided with the necessary information to make a decision about whether or not to engage a financial adviser and whether or not to follow the adviser's advice, the manner in which the information is delivered is of secondary importance.

Part B: Options

Option One - Retaining the Status Quo

This is not the Ministry's preferred option because the Ministry considers that the likely expected benefits of doing so (consistency of disclosure across mediums of financial advice provision) are outweighed by the costs (delayed advice and unwanted disclosure) as discussed above under **Costs and Benefits of Compliance with the Status Quo**.

Option Two – An Exemption where the advice does not result in the sale of a financial product

Numerous submitters suggested that an exemption from the disclosure obligation should apply where the advice does not result in the sale of the financial product. This would directly address the situation in which consumers call multiple product providers to seek quotes and do not wish to have any further relationship with the product provider. It also reflects the fact that the category 2 disclosure provides little benefit to the consumer where the advice does not result in the sale. At this stage, the category 2 disclosure is generally limited to providing information about how to hold the adviser to account rather than whether or not to follow the adviser's advice. There may be very little to hold the adviser to account for if the consumer does not purchase the financial product. This point was noted by numerous submitters.

However, at the same time, numerous submitters expressed concern about the uncertainty of having an exemption based on whether or not a sale occurs. Two stakeholders noted that in a situation where a member of the public rings for a quote, the product provider will have no way of knowing if their advice results in a sale after the phone call has ended. As noted by many submitters, this could be addressed by making the exemption only apply if a sale does not occur during the phone call. This would provide certainty. However, the Ministry is concerned that it may also encourage regulatory arbitrage. It also ignores the fact that sales of insurance products occur over the internet – the disclosure regime could easily be undermined if telephone advisers encouraged their clients to purchase the product over the internet in order to reduce compliance costs.

Furthermore, the Financial Service Providers (Pre-Implementation Adjustments) Act 2010 amended the FAA to add regulation making powers which contemplate additional disclosure requirements for category two advisers, including disclosure of fees and remuneration. Should this occur, this would mean that the category two disclosure would become increasingly significant and provide information relevant to whether or not to engage the adviser and whether or not to follow the adviser's advice. A complete exemption for the situation in which the adviser's advice does not result in a sale would undermine the ability of the disclosure regime to meaningfully require this disclosure should this be government policy at some point in the future.

Option Three – An Exemption where limited verbal disclosure is provided before giving advice (Ministry's preferred option)

Some submitters suggested that limited verbal disclosure could be made as a condition of an exemption. A particular benefit of this option is that it would require advisers to make disclosure of some of the most important information for consumers.

There are costs associated with this approach. Two submitters noted that any exemption which extended the length of a phone call would be very expensive. One provided useful information about its call centre staff. The call centre staff roster is designed so that all staff are busy at all times. This means that any requirement for oral disclosure would mean that the submitter would have to hire more people. The submitter estimated that it would cost them \$1.9 million per year if the exemption required that all of the information in the regulations was required to be disclosed orally.

The Ministry acknowledges this cost and recommends that the verbal disclosure should be very limited and only cover a few, essential items of information. In particular, the verbal disclosure should not amount to much more than disclosure of

- (1) the fact that the adviser is a registered or authorised financial adviser or a qualifying financial entity;
- (2) the fact that the adviser has a dispute resolution procedure available to the consumer, should the consumer have a complaint; and
- (3) the adviser will provide a written disclosure statement to the customer upon request.

Various submitters also noted that verbal disclosure may not be useful to the consumer if it is too long. The Ministry agrees and considers that this lends further weight to the position that the verbal disclosure should be limited to the three matters described above. One submitter provided results of its own research which found that customers will only tolerate a pre-recorded message of one minute or less. Given that many firms already disclose other pre-recorded information over the phone (including information required by the law or information about the firm), This submitter recommended that the limited verbal disclosure be less than 30 seconds. The Ministry has estimated that it should take no longer than 20 seconds to verbally disclose the information above.

One submitter also noted that from a compliance perspective, it would not be able put the obligation on their adviser to determine whether or not a customer has already received disclosure, so all advisers would make disclosure each time a new person calls. Whilst the Ministry does not wish to dictate the manner in which advisers and their firms comply with the obligation, the Ministry proposes that this exemption permit disclosure to be made through an automated mechanism. For example, the Ministry considers that the limited verbal disclosure should be able to be made by having a brief recorded message that the customer receives at the beginning of the phone call.

Option Four – An Exemption for Product Providers

A further option is for an exemption to be provided only for financial product providers. This would directly address the situation where a member of the public rings product providers to obtain quotes but does not wish to have any further relationship with the provider. One submitter suggested that any proposed exemption should only apply to product providers.

This is not the Ministry's preferred option because it may create distortions and it does not account for the unnecessary compliance costs for any situation in which advice is provided by a non-product provider.

Option Five – An Exemption for Advice in relation to products that have a cooling off period

A further option proposed was for an exemption to apply to advice provided in relation to products that have a cooling off period and only so long as the written disclosure statement is provided to the client before the expiration of the cooling off period. This would ensure that the consumer receives full disclosure before they make a binding decision. A submitter noted that this option also addresses the situation where a consumer decides to purchase a product without receiving further advice from the original adviser.

This option did not receive support from the majority of submitters, although some submitters did suggest that a cooling off period would be a useful condition in combination with other conditions for an exemption. However, it was also submitted that a cooling-off period would be unworkable because credit products cannot be subject to such a constraint. Arguably an exemption of this type would also be inconsistent with the approach of the FAA of "as soon as practicable thereafter."

Finally, a submitter noted that a cooling period requirement would be unduly restrictive because many insurance products do not have a cooling off period but do not impose exit costs, so the consumer is still free to exit the product without incurring significant costs. For example, many insurance products can be cancelled with a pro rata refund of premium which has the same effect as a cooling off period. In those situations, the exemption should also apply.

Part C: Remaining Statutory Prerequisites

Section 154 also requires the Minister of Commerce to be satisfied of the following matters before recommending the regulations:

- That the exemption is consistent with the purposes of the Act;
- That the extent of the exemption is not broader than what is reasonably necessary to address the matters that gave rise to the exemption;
- The Ministry considers that its preferred option is consistent with the purposes of the Act. By reducing the compliance costs associated with the disclosure obligation, and in particular, the cost of delaying the provision of financial advice, the Ministry's preferred option is consistent with the FAA's objective of promoting the sound and efficient delivery of financial adviser services. The Ministry also considers that by requiring verbal disclosure of limited key information, the preferred option is also consistent with the FAA's further objective of encouraging public confidence in the professionalism and integrity of financial advisers; and
- The Ministry also considers that the preferred option is not broader than what is reasonably necessary to address the matters that give rise to the exemption. As discussed above, the Ministry preferred option is carefully qualified so that it also requires disclosure of key information relevant to achieving the purpose of the disclosure requirement.

CONSULTATION

The Ministry conducted targeted consultation on these matters in July and August this year. Those consulted included:

- members of the Financial Advisers Disclosure Working Group which advised on the development of the 2009 Discussion Document proposing financial adviser disclosure policy;
- those who submitted on the 2009 Disclosure Discussion Document; and
- key stakeholders who may voluntarily become authorised financial advisers and therefore be required to make authorised financial adviser disclosure.

The Ministry notes that a few stakeholders submitted that any exemption should apply to all products and advice rather than being specific to a particular financial product or adviser. However, numerous other stakeholders submitted that the complexity and costs of compliance are different depending upon the financial advice in question. Further, the Ministry considers that the benefits of compliance are different depending upon the advice in question, which is apparent in proposed disclosure requirements which have different disclosure depending upon the type of adviser.

Finally, nearly all stakeholders consulted on the matter submitted that some form of exemption is necessary. However, one stakeholder submitted that an exemption should be a last resort and that it felt there would be little to gain by granting exemptions yet potentially a significant reduction in the protection afforded to consumers. A further submitter stated that they would prefer the exemption to be made by the Securities Commission through terms and conditions of authorisation.

CONCLUSIONS AND RECOMMENDATIONS

The Ministry recommends that advice in relation to category two financial products be exempt from the disclosure obligation so long as the verbal disclosure is made stating:

- (1) the fact that the adviser is a registered or authorised financial adviser or a qualifying financial entity;
- (2) the fact that the adviser has a dispute resolution procedure available to the consumer, should the consumer have a complaint; and
- (3) the adviser will provide a written disclosure statement to the customer upon request.

This disclosure would not have to be made by the adviser personally; pre-recorded messages would be sufficient.

IMPLEMENTATION

It is currently envisaged that the regime introduced by the FAA will be fully brought into force by July 2011. The Register of Financial Service Providers (the "Register") was opened to applicants from mid August 2010.

These proposals will be implemented through regulations which we expect may be promulgated by mid November 2010.

The key implementation risk is that the regulations are delayed. This would mean that advisers would be forced to comply with the existing disclosure obligation presenting significant compliance costs.

MONITORING, EVALUATION AND REVIEW

The Ministry is required to review the FAA within five years of commencement (section 161 of the Act). The Ministry is developing an evaluation plan. This is likely to involve the identification and recording of base data for the period in which the FAA commences to be compared against data at the end of the relevant period. The data will be qualitative and quantitative and will be gathered from surveys, interviews with relevant stakeholders, statistical information, international comparisons and other observable market and industry outcomes.

Upon completion of the review, the Ministry will prepare a report to the Minister of Commerce who will table the report to the House of Representatives.

Regulatory Impact Statement #4

FEES FOR THE EXERCISE OF SECURITIES COMMISSION'S EXEMPTION POWERS

AGENCY DISCLOSURE STATEMENT

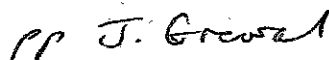
This Regulatory Impact Statement has been prepared by the Ministry of Economic Development

It provides an analysis of options establish fees for the exercise of the Securities Commission (the "Commission") exemption powers under the Financial Advisers Act 2008 (the "FAA").

The development of proposals relating to the establishment of a fee for the exercise of the Securities Commission's power to exempt persons from the FAA has been broadly premised on existing fees in relation to similar powers exercised by the Commission under the Securities Act. This is premised on the assumption that the basic costs involved with considering, processing and finalising applications for exemptions under either legislation are the same. Given that formal applications for exemptions have yet to be received, it is not possible to determine with certainty at this stage, whether this will, in fact, be the case.

The preferred option imposes fees on applicants seeking an exemption from the Commission. This will impose additional costs on businesses. However, the purpose of the exemption would be to reduce the overall compliance costs that such businesses would face under the regime. The preferred options do not otherwise impose additional costs on businesses, impair private property rights, market competition, or the incentives on businesses to innovate and invest, or override fundamental common law principles (as referenced in Chapter 3 of the Legislation Advisory Committee Guidelines).

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Signature of person]

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Status quo and Problem Definition

Section 148 of the FAA provides that the Commission may exempt any person, service or transaction from compliance with the FAA, regulations, the Code of Conduct for Authorised Financial Advisers (the "Code") or any obligation to register under the FSPA by virtue of being a financial adviser or broker. In granting any exemption, the Commission must be satisfied that the cost of compliance would be unreasonable or would otherwise not be justified by the benefit of such compliance. The Commission must also be satisfied that the granting of any such exemption would not prejudice the protection of the New Zealand public. Further, where the Commission is seeking to grant an exemption from the Code in respect of matters relating to competence, the Commission must be satisfied that the applicant has qualifications that are comparable to those in the Code.

The Commission will incur costs in considering, processing and finalising applications for exemptions. If fees regulations are not promulgated, the costs to the Commission cannot be recovered from applicants and will need to be funded from an alternative source. In the event that the status quo is maintained, the Crown will need to fund the costs that will be incurred by these agencies in granting exemptions under the FAA. This would mean that taxpayers are effectively cross-subsidising a commercial activity, namely whether or not specific persons or groups of persons should be brought within the FAA. Subsidising risk-management for such persons and not others may lead to inefficiencies. The opportunity cost of this subsidy is forgone public services or higher public debt.

OBJECTIVES

The objective of the proposal is to fund the costs of establishing and administering the new regime in accordance with Treasury's Guidelines for Setting Charges in the Public Sector and the Auditor General's Guidelines on Costing and Charging for Public Sector Goods and Services. Broadly the relevant objectives identified in these guidelines include:

- a. minimising the cost associated with providing the service;
- b. reducing reliance on funding from general taxation;
- c. dealing equitably with the taxpayer, those who benefit from the output, and/or those whose actions give rise to it; and
- d. ensuring that any fee does no more than recover costs of providing the relevant service.

Without sufficient funding, there is a risk that the FAA will not be appropriately administered, which could result in a number of businesses being inappropriately caught by the regime.

REGULATORY IMPACT ANALYSIS

There are three options to address the problem, including:

1. Not enabling the Securities Commission to charge fees for processing an exemption;

2. Set a standard fee chargeable by the Commission for considering any exemption; and
3. Set an hourly rate to be charged by the Commission when considering any exemption.

Option One – No Fees (Status Quo)

This option will involve retaining the status quo. The impact of the status quo would be that the Commission will not have the authority to charge a fee for the consideration of any application for exemption.

Benefits

The primary benefit of this option is that firms and individuals seeking an exemption will not incur a fee in seeking an application. Thus, the direct costs of seeking an exemption will be minimised.

There are no significant benefits for consumers with this option.

Costs

This option will limit the Commission's ability to prioritise exemption work over other Commission functions. The Commission is charged with undertaking a range of functions under the FAA. This is funded predominantly through fees and levies to be imposed on persons being supervised by the Commission. Accordingly, without any specific additional funding for undertaking work relating to exemptions, The Commission's capacity to undertake exemption work will be limited.

This will impact on both applicants (who may find that their applications take significantly longer to address) and the Commission (who may come under increasing pressure to deliver exemptions in shorter timeframes).

If Crown funding is sought to assist with the exemption work, this will have the effect of making the New Zealand tax-payer fund benefits that may only accrue to specific persons or class of persons.

Option Two – Fixed Fee

An alternative option is to set a standard fee that will be payable by applicants seeking an exemption. The standard rate will be payable by all applicants.

Benefits

This option will ensure that the Commission is properly funded to undertake any necessary exemption work. Accordingly, the Commission will be likely to be able to process such exemptions more expeditiously, which will ensure that industry will be able to place greater reliance on applications being processed within a set time.

A further benefit of this option is that applicants will know with certainty about the costs associated with an application for exemption.

Costs

The most significant cost of this option is that the fee payable would not be reflective of the service provided by the Commission. Applicants who submit applications that take less time to process will end up subsidising the costs of the more complex exemptions. This may produce particularly inequitable results where the simple applications are rejected at the end of the process. This outcome would not be in line with the Treasury's Guidelines for Setting Charges in the Public Sector and the Auditor General's Guidelines on Costing and Charging for Public Sector Goods and Services.

The total monetary cost of this option is unknown, as it will depend on the number of exemption applications received by the Commission.

There is also a risk that if the fee is set too low the Commission will not be able to recover its costs, resulting in under funding and problems similar to those above in **Option one**

The costs of the exemption are also likely to be passed on by financial advisers to their clients in the form of higher fees.

Option Three – Set Application Fee for Cost-Recovery (Preferred Option)

The preferred option is to allow the Commission to charge according to a structure that recovers the costs of considering and (if applicable) granting an exemption.

Approximate information on the costs of considering and processing exemptions is available by referring to the costs of the Commission's exemption regime under the Securities Act 1978. Securities Act exemptions cost on average \$5,000 to consider, although this varies from around \$1,500 to \$25,000. The total number of exemptions is approximately 60 per year, with a total cost of approximately \$300,000 per year.

The costs are broken down into the following:

- a The cost of logging an exemption application: \$112.50; and
- b The cost of one hour of work by a member of the Commission: \$225; and
- c The cost of one hour of work by an officer or employee of the Commission who holds a qualification in accountancy, business, commerce, economics, or law: \$163.

There are also variable costs of publishing a new exemption and of consulting experts to assist with the processing of an application. These costs vary from application to application.

In order to recover these costs the most appropriate model for fees is the model used under the Securities Act, being an hourly rate for work undertaken on processing an exemption. There would also be a minimal set fee for receiving an application. Finally, the Commission would be able to recover publication costs and the cost of consulting relevant experts, where required. This is consistent with the approach taken under the Securities Act.

Benefits

The benefit of this approach is that it ensures that the costs of processing an exemption is borne by the person to whom the benefit of the exemption relates. Accordingly, simpler exemptions that take less time to process will be cheaper. As such, any flow through of costs to consumers is may be lower than setting a standard fee, depending on the nature of the service.

Costs

This approach will result in higher costs for those applications that may deal with more complex issues.

The total monetary cost of this approach is unknown, as this will depend on the number of applications for exemptions received and the complexity of the applications.

CONSULTATION

Targeted consultation took the form of preliminary discussions with a number of industry bodies such as the New Zealand Mortgage Brokers Association and the New Zealand Bankers Association. Following this, draft proposals were sent to a number of law firms, industry bodies representing a variety of classes of financial adviser and property investor organisations. The proposals were also sent to the Securities Commission, Ministry of Justice, Ministry of Consumer Affairs, the Companies Office, Treasury and the Reserve Bank have been consulted.

The preferred option in this paper has taken into account the views revealed during this targeted consultation and views conveyed to officials during the consideration of the Financial Service Providers (Pre-Implementation Adjustments) Bill.

Respondents were supportive of the approach.

One stakeholder noted that it would be preferable for exemptions with wide relevance across the economy to be funded publicly. Officials at the Ministry of Economic Development, Ministry of Consumer Affairs and the Securities Commission are currently preparing a framework for allocating exemption applications between the three agencies. In designing this framework, officials will consider whether exemption applications with high policy content and/or wide effects should be considered by officials at the Ministry of Economic Development, rather than by the Securities Commission.

CONCLUSIONS AND RECOMMENDATIONS

For the reasons set out above, it is recommended that the preferred option be adopted. Namely that the Commission be permitted to charge an hourly rate for work undertaken on processing an exemption with a minimal set fee for receiving an application. This will ensure that the Commission charges on a cost-recovery basis.

The specific fees should be the same as those charged for exemptions from the Securities Act 1978:

d fee of \$112.50 for an application; and

- e a fee calculated at the following hourly rates in respect of any of those applications:
 - i for work carried out by a member of the Commission, an hourly rate of \$225; and
 - ii for work carried out by an officer or employee of the Commission who holds a qualification in accountancy, business, commerce, economics, or law, an hourly rate of \$163.

The Commission should also be able to recover from applicants costs incurred by the Commission in:

- f printing or publishing the necessary exemption notices; and
- g the obtaining of expert advice or expert assistance in respect of an application.

This structure results in cost-recovery by the Commission.

The higher rate charged for the time of Commission members compared to the time of officers and employees of the Commission is justified, as these persons occupy more senior positions in the Commission and have more demands on their time.

The only amendment to the above fees is that the list of relevant qualifications held by officers and employees will need to be expanded slightly to account for the different professions and areas of expertise in the financial advisers area compared to the Securities Act area.

IMPLEMENTATION

The primary implementation risk relates to timing. The obligation to register as a financial adviser applies from 31 March 2011, with full compliance with the FAA required from 1 July 2011. In order to allow the market to work to comply in time for these deadlines, fees regulations need to be promulgated as soon as possible.

In order to mitigate this risk, officials will liaise with PCO to ensure timely delivery.

MONITORING, EVALUATION AND REVIEW

The Ministry is required to review the FAA within five years of commencement (section 161 of the Act). The Ministry is developing an evaluation plan. This is likely to involve the identification and recording of base data for the period in which the FAA commences to be compared against data at the end of the relevant period. The data will be qualitative and quantitative and will be gathered from surveys, interviews with relevant stakeholders, statistical information, international comparisons and other observable market and industry outcomes.

Upon completion of the review, the Ministry will prepare a report to the Minister of Commerce who will table the report to the House of Representatives.