

## FINANCIAL LAW >>UPDATE

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The Financial Service Providers (Pre-Implementation Adjustments) Bill contains a range of technical changes to the new financial services regime. For those operating in the industry, the Bill presents the last opportunity to influence the governing framework for the new regime before it takes effect at the end of 2010.

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### **Financial Service Providers (Pre-Implementation Adjustments) Bill introduced**

The next twist in the tale of financial adviser reform was formally unveiled in Parliament on 8 December. The new Bill contains a range of amendments to the Financial Advisers Act 2008 (FAA) and the Financial Service Providers (Registration and Dispute Resolution) Act 2008 (FSPA), focusing on a range of technical and practical workability aspects and responds to a number of concerns raised by the industry over the past year. This special edition of *Financial Law Update* outlines the key changes contained in the Bill.

#### **Changes to the QFE model**

The most substantial changes proposed under the Bill—as well as the most highly anticipated—are changes the QFE model.

The changes to the QFE model include the following:

- Introducing the concept of a ‘nominated representative’. A nominated representative is an individual nominated to provide financial adviser services in respect of the nominating QFE. A nominated representative of a QFE will be able to give financial advice or make an investment transaction in relation to a Category 2 product without needing to be registered or authorised. Currently only employees and agents can do this.

- Employees and nominated representatives of a QFE will also be allowed to give financial advice or make an investment transaction in relation to a Category 1 product issued or promoted by the QFE without needing to be registered or authorised. Currently relief is only available in relation to Category 1 products for employees of a QFE, and then only in respect of products issued by the QFE.
  - Exempting nominated representatives of a QFE from the requirement to join an approved dispute resolution scheme in order to provide financial services in the course of the business of the QFE, in the nominated representative's capacity as such.
  - Extending the exemption from personal statutory liability for contravening a 'financial adviser obligation' from employees of a QFE to include any nominated representative of the QFE, unless the person is also an authorised financial adviser.
- Second, at a policy level, these changes risk undermining the Securities Commission's stated desire for regulatory neutrality, or at least create that perception. Expanding the relief from liability under the FAA for nominated representatives runs counter to the objective of individual adviser responsibility. As a consequence we expect the hoops that a QFE will need to jump through in order to utilise the widened scope of the status will be significant.

### **Reclassification of some products**

The Bill reclassifies bonus bonds and call building society shares as Category 2 products, and expressly confirms that term life insurance policies are Category 2 products. The rationale for this is that these products are simple and already well understood, and therefore do not need the additional restrictions which apply to Category 1 products.

As part of this change the Bill will incorporate definitions of 'call building society share' and 'term life insurance policy' which essentially match the definitions used in the Securities Act and Securities Regulations. The Bill will also insert definitions of 'life insurance policy' and 'call debt security'. Previously these terms were defined by reference to external sources. Again, the new definitions essentially match the definitions used in the Securities Act and Securities Regulations, but we welcome the approach of containing concepts within the FAA itself.

Of course, the big issue highlighted in the financial adviser Code Committee consultation rounds is that the sales process for a term life insurance policy will often extend to activities that amount to a 'financial planning service' under the FAA, meaning the adviser will still need to be authorised, even if the outcome of the process is only ever going to be a Category 2 product. So whilst the new definitional approach assists in providing

We welcome these changes for the flexibility they provide. The changes address a couple of the most significant limitations in the workability of the QFE model. For that reason, the changes have the potential to make the QFE model significantly more appealing for many of those involved in the industry.

We do, however, have two reservations with the extension to the QFE model:

- First, it is still unclear whether or not it is intended that an individual can be nominated by more than one QFE. Whilst allowing this would further enhance the scope of QFE application, we foresee major complications ahead with the roll out of such a model. For those contemplating QFE status who were seeking this flexibility, be careful with what you wish for.

some relief, the relief provided is by no means absolute. And despite pleas from some quarters, KiwiSaver remains a Category 1 product.

### **Transitional period**

The Bill will specifically allow the Code of professional conduct for financial advisers to include transitional mechanisms. This is potentially a very significant development. Including transitional provisions in the Code may well relieve the bottleneck looming for training and assessment as advisers scramble to obtain authorisation.

The Bill will also insert sections allowing the Securities Commission to authorise persons as authorised financial advisers without conducting criminal record checks during the period between the commencement of the sections dealing with applications for authorised financial adviser status and the commencement of the FAA 'proper'. The FAA will now also have a limited transitional provision for entities applying for QFE status before the FAA commences relating to the requirement to provide a list of nominated representatives with their application. Both are practical changes that should help with the smooth introduction of the FAA.

### **Exclusions from performing a 'financial adviser service'**

The Bill adds an additional exclusion from the concept of providing a 'financial adviser service' for ratings provided by an approved rating agency. It's easy to see why this exclusion has been considered necessary.

The Bill also expands several of the existing exclusions, including an extension to the limited exclusion relating to products offered through the workplace, to specifically cover an employee of an excluded person. These exclusions are welcomed as providing practical meaning to concepts already in place.

The exclusion for companies providing advice or conducting an investment transaction on behalf of a related company has also been clarified so that it is now clear that in order to be exempt the service must be provided in the course of the company's business.

### **Other changes**

The Bill includes a number of other more minor changes to the FAA. These include the following:

- Confirming that (amongst other things) statements made at a meeting of members of an issuer, a company's annual report, a notice of meeting of shareholders, and a statement made by a listed issuer to the relevant exchange in compliance with listing rules, will not constitute financial advice. Why this relief has not been extended to annual reports issued to unitholders by unit trust managers, and to members by superannuation and KiwiSaver trustees, is a mystery. Surely the same principles apply?
- Widening the prohibition on using the term 'sharebroker'.
- Tweaking the fines for failing to maintain registration and/or QFE status where required, and for performing a financial adviser service where the person knew or ought to know that registration and/or QFE status had lapsed, to ensure that the employer is subject to the larger fine.

### **Changes to the Financial Service Providers (Registration and Dispute Resolution) Act**

The Bill changes the territorial scope of the FSPA to include 'licensed providers' and persons required to be registered or licensed by the FAA, in each case irrespective of whether the person is in or outside New Zealand.

The change itself isn't significant, but it does reinforce our view that the FAA will apply to persons providing financial adviser services from offshore to persons in New Zealand. If this weren't the case, then there would be no need to have amended the FSPA to cover off the position of persons required by the FAA to be registered or licensed. The practicalities of the loose approach taken to defining the territorial scope of both the FSPA and the FAA remain a major concern for us, and leaves offshore providers of financial services to New Zealanders in a grey area. A pragmatic approach will be required, with a high risk of inadvertent breach.

Other changes to the FSPA are more technical in nature. They include the following:

- Removing a superannuation scheme from the definition of 'person'. The effect of including superannuation schemes in that definition would have been that both the scheme and its trustee(s) would have needed to register. This would have created significant practical difficulties, and from a legal perspective was curious, as a superannuation scheme itself does not have a separate legal existence.
- Expanding the list of persons who are not regarded as 'financial service providers' to include a nominated representative of a QFE while acting in that capacity.
- Widened exclusions from the FSPA's application for employers providing financial services to enable employees to obtain rights or benefits under a registered superannuation scheme or KiwiSaver scheme that the employer (and other employers) participates in for the benefit of their employees. This additional relief is a fantastic win for Workplace Savings NZ in particular, helping to ensure the new rules do not come as a death blow for employer-

sponsored savings arrangements in New Zealand.

### **More to come?**

It seems clear that there are more changes to come. In particular, Simon Power has said that the Government is working through potential changes to the way that investment transactions are regulated. As our main December [Financial Law Update](#) mentioned, a number of practical difficulties have been identified with the way the regime in its current form will impact on entities conducting investment transactions, and this remains perhaps the last twist in the scope of the new rules that has yet to play out.

We expect that any further changes will either be incorporated into the Bill at the select committee stage or by way of a supplementary order paper. The one certainty we have is that there are more changes to come.

### **Be ready to submit**

Simon Power, in announcing the Bill, encouraged financial advisers and consumers to remain actively involved in the development of the Bill through the select committee process. The signal that the Government retains an open mind to considering further enhancements to the regime is encouraging.

While there is unlikely to be much (if any) appetite for policy changes at this stage, we expect that any suggested amendments to correct technical issues or to improve the practical workability of the FAA and FSPA will be carefully considered by officials.

We would encourage all those affected by the reforms to think again about how the new regime will affect their operations, and submit on any practical issues they identify. This is likely to be the last opportunity to have your say on the legislation itself before the new regime takes effect.

Of course, while these reforms are working their way through the system, progress with the Code of professional conduct for financial advisers marches on. Submissions on the main substantive aspects of competency, knowledge and skills, ethical behaviour and client care have now closed. However, further consultation on continuing professional training is expected to take place over January, with a draft of the Code itself expected to be available for consultation by

March 2010. The extent to which the Code Committee's thinking will be influenced by the Capital Markets Development Taskforce final report 'Capital Markets Matter' released on 16 December 2009 remains to be seen, and the first quarter of 2010 looks like it will be pivotal in shaping the future operating environment for delivering financial adviser services in New Zealand.

### Start a conversation...

Members of our financial markets team will be available over the Christmas break to help with any urgent issues, and we have a team returning to the office from Monday 5 January.

If you would like further information about the Bill, or would like our assistance in preparing a submission or on any other financial services issue, please contact [Catriona Grover](#) on (04) 498 0816, [David Ireland](#) on (04) 498 0840, [Maria Taylor](#) on (09) 914 7290, or [Nick Summerfield](#) on (04) 498 0876, or email the team at [financiallawupdate@kensingtonswan.com](mailto:financiallawupdate@kensingtonswan.com).

