



Corporate Advisory

SIMPSON GRIERSON

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Heightened compliance and disclosure measures for the financial sector

A number of significant changes are about to be made to the regime that regulates financial advisers in New Zealand. As discussed in a recent FYI, the Securities Markets Amendment Act 2006 (**Amendment Act**) has introduced new disclosure requirements for investment advisers and brokers which come into effect on 29 February 2008.

The Financial Service Providers (Registration and Dispute Resolution) Bill (**FSP Bill**) and Financial Advisers Bill (**FA Bill**) build on the principles introduced by the Amendment Act and develop a more comprehensive system to regulate financial advisers. They are expected to be passed into law by mid-2008.

In this, our final instalment on the impending changes to financial services law, we review the FSP Bill and FA Bill and highlight some areas where uncertainty may arise in ensuring compliance with the proposed reforms.

Financial Service Providers (Registration and Dispute Resolution) Bill

Broadly speaking, the FSP Bill establishes a registration system for financial service providers and an industry-based dispute resolution service.

Registration

Anyone who carries on the business of providing a "financial service" or a "financial adviser service" will be required to register under the FSP Bill. A "financial service" is defined widely to include (among other things):

- accepting deposits;
- borrowing and lending money;
- managing money or securities on another person's behalf;
- dealing in derivative and FX transactions;
- participating in securities issues as an issuer, trustee, promoter or manager (including the activities of a public issuer); or

“Anyone who carries on the business of providing a "financial service" or a "financial adviser service" will be required to register under the FSP Bill.”

- providing any other financial service that is prescribed for the purposes of New Zealand complying with Financial Action Task Force Recommendations or similar international obligations.

The definition of a "financial adviser service" is considered below in relation to the FA Bill.

Under the FSP Bill a financial service provider is prohibited from providing a financial service unless that person is registered.

The main conditions for registration are that:

- the applicant and any controlling owner, directors and senior managers are not bankrupt, subject to management banning orders, or convicted of certain offences; and
- the applicant is a member of an approved dispute resolution scheme (**ADRS**).

Accordingly, the vast majority of those wishing to be registered should not have any difficulty in qualifying for registration, once the ADRSs are set up. That said, there will inevitably be costs associated with initial registration and the ongoing monitoring of registration that will need to be absorbed. It is to be expected that these costs will be passed on to the consumer.

The FSP Bill will create the office of Registrar of Financial Service Providers and Financial Advisers, who will oversee the registration system. The register will be publicly searchable and will include details of the financial services provider, the chosen dispute resolution scheme and any Approved Professional Body (APB) of which the provider is a member.

Dispute Resolution

Currently there is no industry-wide dispute resolution scheme to address consumer complaints and concerns in the financial services industry. The FSP Bill looks to address this issue by creating a dispute resolution system.

The key features of the system are that:

- the relevant Minister may approve schemes that meet certain criteria; and
- financial service providers must be a member of an approved dispute resolution scheme if they provide financial services to natural persons and small businesses (i.e. no more than 19 full time employees).

The system will be funded by the industry which, again, represents additional costs for financial service providers to absorb.

A default dispute resolution scheme (the **Reserve Scheme**) will also be established, to provide a fall-back scheme if insufficient ADRSs are available. The obligation to be a member of an ADRS will not apply until the Reserve Scheme is established. The Reserve Scheme will be capable of resolving disputes relating to all types of providers and financial services. This scheme will be funded by a levy on its members.

It will be interesting to monitor any submissions in this area, particularly from parties who may not generally be considered financial advisers such as some public issuers. These parties will obviously be keen to limit any levies that may be charged by the Reserve Scheme.

Financial Advisers Bill

The FA Bill imposes statutory conduct and disclosure obligations on financial advisers and establishes a co-

regulatory regime for financial advisers in conjunction with the Securities Commission and APBs.

The FA Bill will prohibit a person from performing a "financial adviser service" unless they are a member of an APB, registered under the FSP Bill and not otherwise disqualified under the FSP Bill. This signals a real shake-up of the industry in that the provision of financial advice will be prohibited unless the adviser is appropriately licensed.

One of the FA Bill's key provisions relates to the definition of a "financial adviser service". This term is defined widely to include the provision, in the course of business, of advice relating to the financial implications of a financial decision. It also includes any dealing in money as a result of or in anticipation of a financial decision.

A financial decision includes any decision related to saving, investing or making a financial provision for the future. Financial advice does not, however, include the provision of information where it is not accompanied by some recommendation, opinion or guidance.

Notably the FA Bill's coverage is significantly wider than the Amendment Act's, as the latter only applies to investment advice provided in relation to securities. Financial intermediaries will need to be careful to recognise when their employees may fall into the new regime.

The APBs, which will be appointed on the recommendation of the Securities Commission, will be charged with the day-to-day regulation of financial advisers. The FA Bill prescribes certain criteria an APB must meet, and types of rules that an APB must have, in order to be appointed.

The FA Bill requires a financial adviser, before performing a financial adviser service for a member of the public, to make prescribed disclosures. The form and content of these disclosures are very similar to those prescribed by the Amendment Act, with a number of additional requirements. The FA Bill requires disclosure in an upfront disclosure statement which includes details of:

- the adviser's qualifications, experience, APB and ADRS;
- criminal convictions of certain types, bankruptcy, management bans or expulsion from professional bodies;
- fees;
- the potential for conflicts of interest, including commissions or other benefits received in connection with providing the financial advice;
- types of securities on which the adviser provides

“This signals a real shake-up of the industry in that the provision of financial advice will be prohibited unless the adviser is appropriately licensed.”

advice;

- procedures for handling money or other property; and
- professional indemnity insurance held.

The FA Bill also introduces certain "conduct obligations" for all financial advisers. The FA Bill's conduct obligations include:

- to act with integrity;
- to exercise reasonable care, diligence and skill;
- not to do anything that is misleading or deceptive;
- not to recommend or receive money for an acquisition of securities if the offer for subscription is illegal; and
- to abide by certain money handling and trust accounting requirements.

The Securities Commission will be responsible for monitoring the disclosure and conduct obligations.

The FA Bill contains detailed enforcement and remedy provisions for non-compliance with disclosure obligations or conduct obligations. Disclosure orders, management bans, pecuniary penalties of up to \$1 million and compensatory orders are all within the armoury of remedies for failures to comply with the requirements.

Timing

The FSP Bill had its first reading in December 2007 and the FA Bill had its first reading on 19 February 2008. Both Bills were referred to the Finance and Expenditure Select Committee and are intended to be considered contemporaneously. Both Bills are expected to be passed by mid 2008 with the register in place by 2010 and the full regime in force by 2012.

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