

JULY 2010

In late June, the Government passed the Financial Advisers Amendment Act 2010 which made significant changes to the current Financial Advisers Act 2008.

While the amendments were being considered by the Select Committee, the Commerce Minister signalled that the Act will be implemented over the next 12 months, coming fully into force on 1 July 2011. This effectively gives financial advisers a further six month extension from the previous implementation date of December 2010 to be ready as authorised financial advisers (AFAs) by 30 June 2011.

For most financial advisers operating within the financial advisory industry, the amendments would not affect the continuing position that they are required to be AFAs once the Act becomes fully enforced.

For other professionals like lawyers and chartered accountants, the amendments may mean that the Act will no longer apply to them. However, the New Zealand Institute of Chartered Accountants (NZICA), which regulates chartered accountants, now requires its members to abide by its new financial advisory engagement standard from 1 July 2010.

For AFAs, following the finalisation of the legislative amendments, the AFA code and the revised Adviser Business Statement (ABS) are the next significant documents that will be finalised as a priority. Knowledge of the code and completion of the ABS are one of the prerequisites to gaining AFA status.

This update will cover the following matters:

- Certain amendments to the legislation that are of note;
- The revised draft AFA code recently released by the Code Committee on 2 July 2010;
- The adviser business statement and the draft guide issued by the Commission on 2 June 2010; and
- The New Zealand Institute of Chartered Accountant's (NZICA) Financial Advisory Engagements Standard which takes effect from 1 July 2010.

We will then conclude the update with the timing of events running up to 1 July 2011 and some points on what financial advisers can do now to ensure they are fully operational and compliant from that date.

LEGISLATION AMENDMENTS

FINANCIAL ADVISER SERVICE REDEFINED

Only financial adviser services provided to a client are caught within the adviser regulations. These services are the giving of financial advice, providing an investment planning service or providing a discretionary investment management service.

The new definition of investment planning service (previously called financial planning service) means a service which the adviser "designs, or offers to design, a plan for an individual that is based on, or purports to be based on, an analysis of the individual's current and future overall financial situation (which must include his or her investment needs) and identification of the individual's investment goals and includes one or more recommendations or opinions on how to realise those goals (or one or more of them)".

As a result of the narrowing of the definition, the Commission has withdrawn its previous guidance on financial planning services.

RETAIL AND WHOLESALE CLIENTS

A client can fall into either one of two client categories – retail client or wholesale client. Different (minimal) obligations apply to services provided to wholesale clients.

Services provided to a retail client can be provided either on a personalised basis or on a class basis.

A personalised service is one where it is given to, or in respect of, a named client or a client who is otherwise readily identifiable by the financial adviser and either:

- the financial adviser has taken into account the client's particular financial situation or goals (or any one or more of them) in providing the service; or

- a client would, in the circumstances in which the service is provided, reasonably expect the financial adviser to take into account the client's particular financial situation or goals (or any one or more of them).

If the service provided is not a personalised service, then it is a class service.

ENTITY CAN PROVIDE FINANCIAL ADVISER SERVICE

In our previous update, we mentioned that there are three types of financial advisers, being: registered financial advisers; authorised financial advisers; and QFE financial advisers. The amendments now give registered entities the ability to provide financial adviser services to wholesale clients and class-based services to retail clients. This means employees or contractors of registered entities can perform these services without needing to be registered or authorised. It is important to note that the entity is subject to the generic conduct obligations that would apply to an AFA and a registered financial adviser as well as any other obligations that may be imposed by regulations.

CATEGORY 2 PRODUCTS EXTENDED

Registered financial advisers can only provide personalised financial advice and discretionary investment management services to retail clients on Category 2 products. Units in term and cash portfolio investment entities and all contracts of insurance (except investment-linked contracts of insurance) are now classed as Category 2 products.

The amended Act also allows registered financial advisers to provide class-based services to retail clients and financial adviser services to wholesale clients.

The extended Category 2 products combined with the new 'narrower' definition of investment planning service means that many risk advisers do not need to be authorised. According to the Act, a risk adviser who continues to choose to become an AFA will not automatically get authorised unless regulations are in place to give the Commissioner the ability to provide such an authorisation. These advisers will need to wait until the regulations are finalised before determining whether they can be authorised or not.

INCIDENTAL SERVICE AND OCCUPATIONAL EXEMPTIONS

The 'necessary incident' exemption has been replaced by an incidental service exemption – in general, a financial adviser service that is provided only as an incidental part of another non-financial service business is excluded from the Act.

Lawyers, incorporated law firms and chartered accountants (amongst others) are also excluded from the Act provided the financial adviser service is within the ordinary course of business of that kind. It is understood that both the New Zealand Law Society and NZICA are considering how this will apply in practice.

With the removal of the 'necessary incident' exemption, NZICA noted that "far fewer members will be required to follow the new regime, although members may want to be registered in order to differentiate the services they offer". Chartered accountants who are not intending to be AFAs will need to rely on the NZICA financial advisory engagement standard for guidance and clarity. See below for further comments on the standard.

A trustee of a family trust is exempted under an exemption which covers 'a principal officer of any entity providing a financial adviser service in the person's capacity as a principal officer'. Note, chartered accountants acting as trustees of a family trust may still be required to observe the NZICA financial advisory engagement standard.

BROKERS

Financial advisers and entities that provide only broking services are subject to a different regime within the Act. These rules are mainly disclosure and conduct obligations when providing the broking service. Brokers must still be registered with the Companies Office.

AFA DRAFT CODE – JULY VERSION

As a result of the legislative amendments, the revised AFA draft code was released for public consultation early in July. The principles outlined in the draft standards have not substantially changed from the earlier version (released back in March). Some amendments have been made to the

guidance provisions within each standard to provide more clarity. A few standards, including the 'dob-in' requirement where the adviser has an obligation to report another adviser to the Commission for non-compliance with the code or legislation, have been removed on the basis that these have been legislatively included within the amended Act. With regards to the 'dob-in' requirement, this has now changed to be on a voluntary basis only.

On the topic of independence, an AFA cannot call themselves 'independent' if they receive a benefit from a person other than the client unless it is 'remote or insignificant'. In response to our submission seeking further clarity on what 'remote or insignificant' means, the Committee responded that "it was considered best to leave it to the AFA to decide what is 'remote or insignificant' in the context in which the AFA operates, without being prescriptive in this regard. However, the onus will be on the AFA to justify reliance on that 'de-minimus' exception."

ADVISER BUSINESS STATEMENT

As part of their application for authorisation, AFAs must complete their Adviser Business Statement (ABS). The ABS need not be submitted to the Commission during the application process, however, the Commission notes that "you are expected to be able to explain it to the Commission or provide supporting documentation, if requested".

Last month, the Commission released the ABS guide, in draft, to assist AFAs in setting out a framework for completing their ABS. The final version of the guide will be circulated later this year once the revised disclosure regulations and the code for AFAs are finalised.

There are two parts to the ABS. The first part requires the AFA to detail their adviser business outlining their role, remuneration and reward, business relationships, products and services and clients. The second part requires the AFA to detail their compliance processes covering ethical behaviour, disclosure, the provision of advice or service, client complaints, record keeping and continuing professional training.

The requirement to maintain the ABS is likely to be set by the Commission within the terms and conditions of becoming an AFA. If breached, the Commission's powers include suspending or cancelling the financial adviser's authorisation.

NZICA'S FINANCIAL ADVISORY ENGAGEMENT STANDARD

In its website and the recent NZICA Journal (July 2010), the NZICA states that this standard (FAES) applies for most members who provide financial advice to clients, establishing mandatory requirements and covering all aspects of the provision of advice, from engagement acceptance to communication and, if applicable, implementation of advice.

The FAES applies to all members undertaking engagements to provide financial advice, whether or not they hold a certificate of public practice, whatever their membership status and whether or not they are AFAs. It is quite separate to any obligations or exemptions under the Financial Advisers Act. It is worth noting here that, unlike the Act, the FAES makes no distinction between providing financial advice to a retail and a wholesale client – that is, the same standard is applied regardless.

The FAES is a standard that members will be judged against should a complaint be made about financial advice or financial service that they provide to clients.

NZICA emphasise that members must only undertake professional work in which they have the competence necessary to perform the work to the technical and professional standards expected. In providing financial advice, it is left to be said whether NZICA will look towards the AFAs training requirements as a benchmark for setting the competency level.

TIMING

It is understood that financial advisers have until 31 March 2011 to be registered and apply for authorisation. However, all other financial service providers (for example, issuers, broker entities and banks) must continue to register with

