NZ Society of Actuaries Conference 2008

The impact of legislation on the provision of financial products and advice

or

What is the Government doing to the finance sector? Help or hindrance?

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INSTITUTE OF FINANCIAL ADVISERS®

Agenda

- Public Finance Act – guarantees
- Financial Providers (Registration and Dispute Resolution) Act
- Financial Advisers Act
- Taxation
- Anti-money laundering
- Impact of financial crisis on financial adviser sector

Public Finance Act guarantee

- Able to be used without Parliamentary approval – just Minister of Finance
- Traditional Government tool to use in a crisis
- Driven by international events and loss of confidence driven by fear and panic
- Concerns at potential flight from NZ banks to Australian banks that were guaranteed – similar to Ireland

Guarantee Issues

- Inequalities in application between institutions – banks of varying size, non-banks
- Two year time period = difficult to exit
- Impact on managed funds that are not guaranteed, e.g. – frozen mortgage-backed unit trusts
- What will the longer term impact be on managed funds?

Financial Providers (Registration and Dispute Resolution) Act

- Requires all financial providers to be registered
  - Product providers, e.g.
    - Deposit taking and funds transfer
    - Funds management
    - Providing credit under a credit contract
    - Derivatives and futures
    - Insurance
  - Financial Adviser Service
    - Firms providing adviser service rather than individual advisers
- “Proper person” test – not disqualified

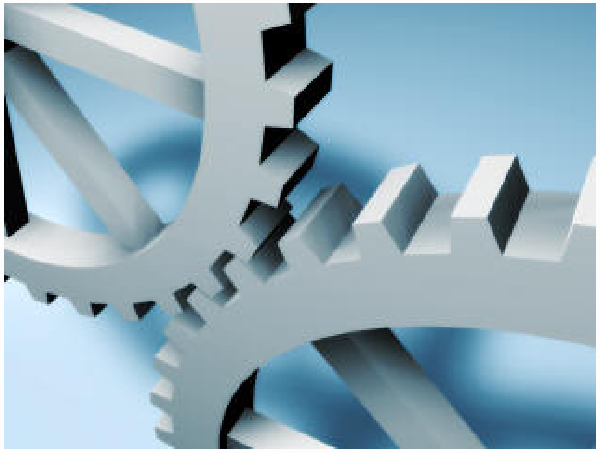
Dispute Resolution

- Every financial service provider must be a member of a dispute resolution service
- Either:
  - An approved service, or
  - The reserve scheme
- Existing schemes:
  - Banking ombudsman
  - ISO ombudsman

May not represent your mediation

Issues

- Multiple schemes have disadvantages;
  - Consumer confusion over where to go
  - Complaints often involve both an adviser and a product provider – who may belong to different schemes
  - Cost of multiple schemes – base fixed overheads of contact centre, web site, record keeping etc.
- Advisers concerned about costs:
  - Annual membership fee - $800 pa in Australia for an individual adviser (less per adviser as firm size grows)
  - Cost per complaint around $3,000 = incentive to settle rather than fight



Financial Advisers Act

- Purpose: Encourage public confidence
- Tiered approach
  - Two Categories
  - QFEs
- Detail yet to be developed
  - Code of practice
  - Competencies
- Introduction will need to be phased in over a period of years – March 2010 key date
- Discipline with teeth – ability to prevent someone continuing in practice

Exclusions

- Lawyers, Chartered Accountants, tax agents, real estate agents, registered valuers
  - to the extent that the financial advice they provide is "in the course of his or her professional practice" and is "**a necessary incident**"
- Issuers and trustees
- Advice given without charge in the course of a service offered by a non-profit organisation (e.g. Citizens Advice, budget advice services)
- Employers providing assistance to an employee with the implementation of a financial product made available through the employee's workplace (e.g. KiwiSaver)
- Teacher, lecturer, or journalist giving advice in the course of that occupation
- Plus several others

Categories

Category 1:	Category 2:
• Securities, e.g. equities, bonds, PIEs • Superannuation KiwiSaver • Investment real estate • Futures contracts	• Call accounts • Bank term deposits • Consumer Credit, mortgages • Life Insurance • Health insurance • General insurance

+ Financial Planning Service

Regulation of advisers

Category 1:

- Firm registered as financial service provider
- "Care, diligence and skill"
- Must be "authorised" - $$$
- Listed on Register
- Comply with Code - meet practice standards
- Comply with "terms of authorisation"
  e.g. areas of competency
- Comprehensive disclosure
- Member dispute resolution service

Category 2:

- Firm registered as financial service provider
- "Care, diligence and skill"
- Do **not** need to be "authorised"
- **Not** listed on register
- **Not** required to comply with Code but – "care" test will be similar
- No specified competency requirements – but must have relevant skills
- Disclosure that **not** authorised
- Member dispute resolution service

Qualified Financial Entities

- Registered as financial service provider
- Meets specific “terms and conditions”
- Takes responsibility for actions of employees and agents who are financial advisers => compliance processes and competency of advisers
- Disclosure statement is QFE’s not advisers and is not comprehensive
- Employees (but not agents) providing advice on Category 1 products where QFE is the **issuer** may be included
  - Appears to give advantage to QFEs by not requiring competency to same level as other Category 1 advisers – unless this was made a condition of gaining QFE status
  - Current definition of “issuer” is narrow, so many products (e.g. KiwiSaver) would not meet “issuer” test – probable amendment before law takes effect
- Category 1 products where QFE is not the issuer – advisers will still need to be individually authorised

Issues

- Category 1 – supposed to be "complex" and "high risk" – but includes Cash PIEs and Bonus Bonds, Term Deposits for NBDTs (e.g. Building Societies)
- Category 2 – supposed to be "simple" – but includes all debt; trauma, income protection and disability insurance which are complex
- There will be "**classes**" of "**authorised**" advisers – but these have yet to be defined and will have a big impact on competency requirements
  - Competency will be based upon unit-standards-based National Qualifications, but these are still being developed
  - So, competency testing of Category 1 advisers will need to be phased in
  - Initial "authorisation" will be **registration rather than full** "**authorisation**"

Likely impact

Category 1:

- Financial planners, investment advisers
- Personal risk insurance advisers – for any policy with an investment element issued after 31 December 2008
- Sharebrokers
- Bank wealth management advisers
- Real estate investment advisers (other than real estate agents)
- Foreign exchange, futures, hedging

Category 2:

- Most bank staff – bank accounts, TDs, loans, insurance
- Bank staff advising on their own managed funds – if have QFE status
- NBDT staff – provided have QFE status
- Personal risk insurance advisers – provided do not advise on investments or superannuation
- General insurance brokers
- Mortgage brokers
- Hire purchase lenders

Likely impact – how many advisers?

Sector	Advisers	Category 1
Financial planners, insurance advisers	8-10,000	5,000
General insurance (house/car/business)		
Brokers	2,400	
Staff	500-1,000	
Mortgage brokers	2,500	
Banks	17,000	?
Non-bank deposit takers	900-1,900	?
Stockbrokers	550	550
Consumer credit lenders	500-2,000	
Totals	32-37,500	

Potential market responses

- Existing Category 1 advisers decide to **retire or leave the industry** rather than meet new requirements
  - This is already happening – perhaps also influenced by financial market conditions
  - Sell their businesses – but impact on price if there are more sellers?
- Personal risk insurance advisers decide to **restrict their areas of advice** to be Category 2 only
  - Cease advising on KiwiSaver and investments
  - Sell this aspect of their business – but impact on prices?
  - Do nothing about gaining formal qualifications in the belief that they are exempt from competency requirements
- **QFEs (e.g. banks) restructure staff responsibilities** to restrict the number of staff advising on Category 1 products
- **Banks seek to become QFEs** and increase the number of managed funds where they are the "issuer" so do not need to have staff individually "authorised"
- **Building Societies** become banks (already happening)
- Insurance firms seek to **expand their "tied" agency forces** and seek to become QFEs including these Category 2 advisers

Taxation

"I don't like it either way—with or without!"

- **PIE**
  - Significant tax incentive for 33% and 39% taxpayers
  - Removal of risk of taxation of capital gains on NZ (and many Australian) shares held through a PIE
  - Some gains from annual tax rather than provisional tax of PIEs
- New lower Personal income tax rates not aligned with PIE tax rates
- Life insurance taxation
  - **Annuities**, excluded from the review
- Family trusts and tax of beneficiary income but there may be **advantages of holding investments directly in PIEs**

Anti-Money Laundering

- Anti-money laundering and countering financing of terrorism – draft Bill released for consultation September 2008
  - Detail to be included in regulations – drafts yet to be released
- 3 levels of "**due diligence**" – standard, enhanced, simplified
  - Mostly about customer identification
  - Reporting suspicious transactions
  - Keeping transaction records
- Bill expected to go to Parliament April 2009 – timing matches Financial Action Task Force visit

Financial Crisis

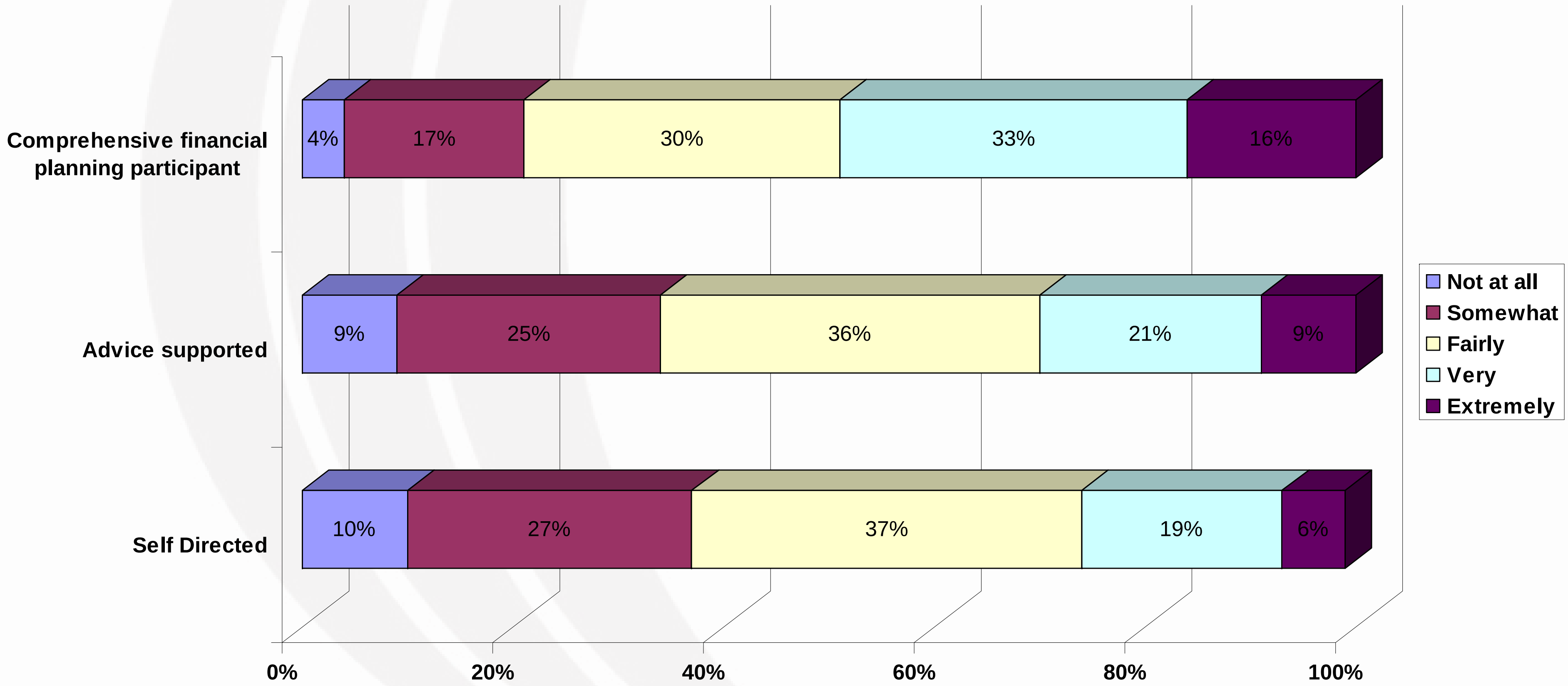
- Sub-prime debt + housing price bubble + leveraged investment + guarantee insurance = bad debts + inability of insurers to pay guarantees = financial institution collapse = lack of trust = funding crisis + inability to value financial instruments= crisis of confidence (who can you trust?) = share market falls + flight to security = guarantees of banks + government intervention + bail outs
- Financial crisis => Recession = economic problems = fiscal stimulus by government = deficits = growth in public debt = future problems
- Managed funds – caught up in crisis of confidence, valuation problems, client redemptions, liquidity issues, funds frozen = further lack of confidence

US Survey data on financial planning and client confidence

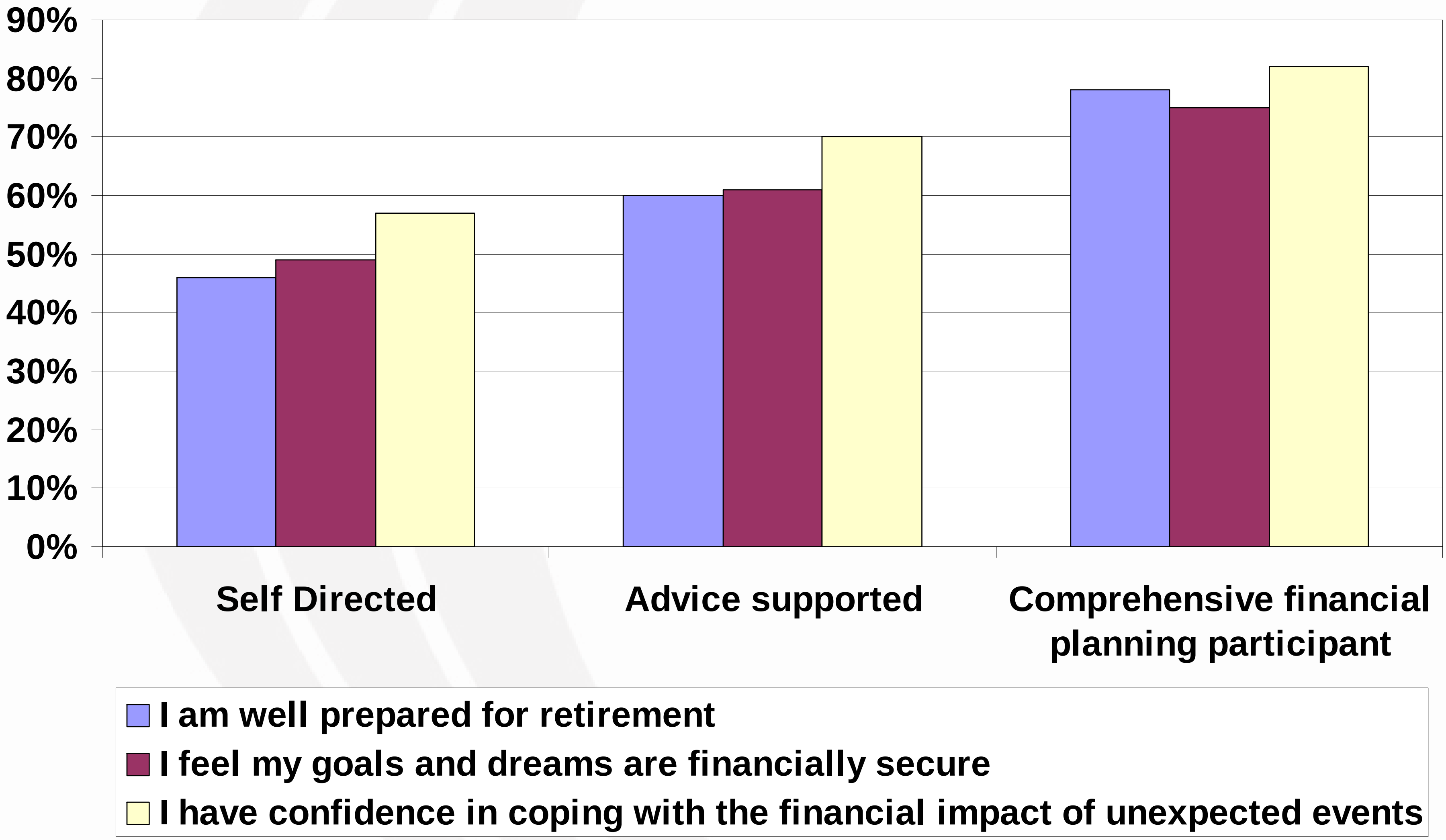
- Financial Planning Association (US) – membership organisation for CFP professionals
  - Consumer study June/July 2008
  - Confidence in financial future
  - Analysed results based upon level of support:
    - **Comprehensive financial planning participant**
    - **Advice supported**
    - **Self directed**
  - **www.fpanet.org/docs/assets/Report_Final.pdf**
- CFP Standards Board – certifier of CFP professionals
  - Survey of CFP professionals October 2008
  - Views on current economic situation
  - **www.CFP.net/downloads/CFP_Board_Pulse_Survey_2008-10.pdf**

FPA Survey results

How confident are you in your financial future?



Questions on financial situation



CFP Standards Board Survey

- Have you seen an increase in calls from potential clients?
  - Significant increase 27%
  - Moderate increase 39%
- What actions are your clients taking?
  - Standing firm with existing strategies 78%
  - Reviewing financial goals 48%
  - Reviewing asset allocation 57%
  - Rebalancing portfolio 34%
  - Moving to lower risk positions 45%
  - Taking advantage of investment opportunities 40%
- How do you view media coverage of economic uncertainties?
  - Exaggerates situation 72%

Dow-Jones Industrials 105 Years

Discussion and questions

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