Regulatory Impact Statement

Regulatory Reporting Requirements for Authorised Financial Advisers

Incorporating the Regulatory Reporting Guide and AFA Information Return

July 2014

FINANCIAL MARKETS AUTHORITY

TE MANA TATAI HOKOHOKO - NEW ZEALAND

Financial Markets Authority
Website: www.fma.govt.nz

Auckland Office
Level 5, Ernst & Young Building
2 Takutai Square, Britomart
PO Box 106 672
AUCKLAND 1143

Wellington Office
Level 2
1 Grey Street
PO Box 1179
WELLINGTON 6140

July 2014

Contents

Executive Summary

This Regulatory Impact Statement addresses FMA's decision to publish the first Regulatory Reporting Guide (RRG) for Authorised Financial Advisers (AFAs), including the Information Return that is the first reporting requirement under the RRG.

Considering the regulatory and financial impacts, this document provides an analysis of options that were considered in determining the final policy proposal. Each option was assessed based on:

- feedback received from two public consultations
- a desire to minimise likely search and build costs for industry
- other impacts, costs and benefits.

After careful consideration of both regulatory and non-regulatory impacts, FMA decided:

- to proceed with publishing the RRG, taking into account feedback following the consultations
- that the Information Return is to be completed online.

This means that AFAs will complete their first Information Return relating to their business activities for the period 1 July 2013 to 30 June 2014. AFAs will be required to submit the completed Information Return online by 30 September 2014.

Thereafter for each subsequent year AFAs will need to complete an Information Return for the 12 month period ending 30 June each year and submit it by 30 September of the same year.

Section 1: Introduction

Background

How FMA monitors AFAs

One of the functions of FMA is "*to monitor, and conduct inquiries and investigations into any matter relating to, financial markets or the activities of financial markets participants or of other persons engaged in conduct relating to those markets*".

Accordingly, we select AFAs for monitoring reviews in one or more of the following ways:

- random selection
- risk-based – based on the nature, scale and extent of the AFA's business
- targeted - based on information received
- part of a theme, e.g. researching a particular service, or exploration of a potential industry problem.

Monitoring activities include a mix of desk-based research (investigating complaints, public information and reviewing documents, e.g. Adviser Business Statement's (ABS's), and professional development plans), phone discussions and office visits with AFAs. Our monitoring reviews may also include mystery shopping.

Our risk-based approach to supervision

FMA takes a risk-based approach to its supervision of market participants. As a conduct regulator we are not seeking to eliminate all risk from the financial advice sector. Rather, we seek to optimise use of our limited resources by focusing on those risks that are most likely to adversely impact our objectives and responsibilities. In this way, we believe we can make the greatest difference to New Zealand financial markets, particularly the provision of financial adviser services.

Our risk-based supervision framework is therefore intended to help ensure we:

- meet our statutory objectives by identifying and acting on, as early as possible, 'high risk' conduct within the financial advice sector
- allocate resources effectively by focusing on those 'high risk' practices
- maintain a consistent and robust approach to monitoring financial advisers.

Standard term and conditions for AFAs

All AFAs must comply with the terms and conditions of authorisation which include:

- the Standard Conditions subject to any modifications that FMA considers appropriate
- terms and conditions specific to the AFA.

The Standard Conditions include requirements for the AFA to maintain an ABS, provide an annual confirmation and to notify FMA of significant matters.

The Financial Advisers Act 2008 (Act) allows us to vary the Standard Conditions relating to reporting requirements from time to time during the period of an authorisation of each AFA. We consider the publication of the first RRG to be a variation of Standard Condition 2 and therefore we followed the approval and consultation process set out in the Act. The RRG will form part of the Standard Conditions and will be incorporated into the authorisations of all AFAs.

Current Challenge

FMA does not currently collect regulatory information from AFAs. This limits our ability to develop the necessary intelligence capability and to implement effective risk-based monitoring of this sector.

AFAs are currently required to have, and maintain an ABS, and each AFA must ensure their ABS accurately reflects their business and compliance arrangements. However use of the ABS for intelligence purposes is limited because:

- updated ABSs are not routinely collected and retained by FMA
- ABSs are not required to be submitted in electronic form, making it time consuming and an inefficient use of resources to manually extract information from these documents for analysis.
- The ABS does not contain all the relevant information required for developing our risk-based monitoring approach.

FMA considers that by collecting this information it will enable us to further develop our risk-based approach for monitoring the AFA sector. Therefore to address this, the Information Return was designed as a tool to collect current information concerning each AFA's business model, operations and process in electronic form.

Who is impacted?

Impacted stakeholders include:

- AFAs
- Advisory firms
- QFEs
- Professional Bodies
- Best practice consulting firms
- AFAs' clients

Objectives
The objective of regulatory reporting is to use information collected to inform our risk-based approach to monitoring AFAs. The information will help to prioritise our work and focus our thematic reviews. We will compare data collected from AFAs and may aggregate information about the industry. We will use this to inform our policy work, and communicate trends, risks and other information that may be useful to the industry or general public.

Accordingly, the Information Return will be one of our key tools that will provide us with more accessible and comprehensive information to help us better understand the profiles and business of individual AFAs, and the AFA market as a whole.

Section 2: Options and Impact Analysis

Option 1: Status Quo

Description
Status Quo involves not implementing Regulatory Reporting at this time. This would mean that we would not have sufficient up-to-date data to ensure effective identification of high risk practices. This could potentially give rise to the real possibility of misallocating resources to aspects that may not be of high risk.

Impact analysis
If we were to rely on the ABS as our main source of information on which to base a risk-based approach, then we would need to re-allocate existing front-line monitoring staff to the procurement and assessment of 1,903 individual non-electronic ABS documents (as at 30 April 2014).

An ABS takes around 3 hours to review and assess.

1,903 ABS documents	5,709 hours to review and assess = 714 days
4.5 FTE (assume 160 days per FTE)	= 720 days

This means that 4.5 FTE monitoring resourcing would be re-directed from front-line monitoring visits.

This is a high cost option with low benefit, as the ABS includes both expected and suggested information that cannot give FMA comparable data to develop a reliable risk evaluation methodology.

Option 2: Comprehensive AFA Information Return

Description
This option included the release of a comprehensive Information Return – up to 72 questions. This version of

the Information Return involved an extensive information capture designed to help identify areas of 'high risk' in AFA business practices.

Impact analysis
Feedback from the first consultation revealed the compliance costs of this option would be high and market participants are not readily able to provide the information required, e.g. they do not have IT systems in place to enable them to provide the information easily. In fact, feedback received was explicit in that AFAs anticipated significant system and process changes would be required. One submitter indicated the collection of data would be labour intensive, and estimated it could conservatively take up to 80 hours of dedicated time. Another submitter noted the costs could be significant, but those costs could not be quantified until the final version of the Information Return was known.

Option 3: (Preferred Option) Shorter version of Option 2

This option would involve publishing FMA's first RRG for AFAs, with the first reporting requirement being an Information Return based on revised questions amended to reflect the feedback from the consultations. The Information Return would seek information covering topics such as:

- About the AFA
- Clients
- Products
- Investments
- Compliance
- Mortgages
- Insurance
- KiwiSaver
- Client money and property

This option is similar to Option 2 but has significantly fewer questions. In many cases, best estimates can be provided for questions that have not been asked before and where the AFA was not aware of the need to collect data during the period to answer those questions. It is expected that in subsequent years, Information Returns will provide more accurate answers to these questions. Additionally, AFAs only need to answer the relevant questions depending on the financial adviser services they provide. To make it even easier, the majority of the questions only require readily available information.

Thereafter, AFAs will complete an Information Return annually for each subsequent year and submit it to FMA by 30 September online via our website.

Impact Analysis
FMA considered the views of the participants' through both consultation sessions. We are mindful that AFAs are not unduly overburdened as an unintended consequence of regulatory choices. As a result, we have significantly revised the Information Return's set of questions with a view to minimising compliance costs for AFAs while also balancing the regulatory need for up-to-date information.

This revised Information Return can be summarised below:

1. It is significantly shorter (number of questions reduced to 40 from 72(see Option 2).
2. Requires less quantifiable information from AFAs.
3. Involves lower build and search costs for AFAs, therefore it is expected that AFAs will spend considerably less time (less than half the initially estimated time for completing the Information Return as outlined in Option 2) to extract the information necessary to answer each question.

As a result, AFAs will not be required to make significant system and process changes in order to gather the information required to complete the first Information Return, which allows AFAs to provide best estimates in many instances.

From our perspective, the impact of obtaining relevant and structured information around business practices and operations is significant in assisting to develop risk-based approaches to monitoring AFAs.

This option impacts AFAs, all advisory firms including Qualified Financial Entities (QFEs). Professional bodies and best practice consulting firms are impacted to the extend they support AFAs to meet their compliance obligations.

Section 3: Consultations

Consultations

FMA undertook two consultations.

First Consultation
On 16 September 2013, we published our *Consultation Paper: Regulatory Reporting Guide for Authorised Financial Advisers,* to advise the industry we wanted their feedback on the proposed RRG for AFAs and the questions to be asked in the Information Return.

The final date for submissions was Friday 11 October 2013.

FMA received 38 written submissions from groups including industry groups and associations, qualified financial entities, registered banks and individual AFAs. We also received four submissions on a confidential basis.

Second Consultation
On 20 March 2014, we undertook a second consultation.

The final date for submissions was Wednesday 9 April 2014.

FMA received 18 written submissions from the groups as detailed in the first consultation. We also received one submission on a confidential basis.

We invited and encouraged all stakeholders to make submissions on the RRG, Information Return, and ‘test drive the online demonstration system (first consultation).

The submissions were of a high quality, detailed and constructive. Submitters addressed most of the consultation questions and provided further helpful information on the individual questions contained in the Information Return.

At the conclusion of both consultations, we carefully considered all submissions and feedback received. We also met with various industry representatives to discuss the RRG and Information Return.

We are grateful to everyone who submitted feedback throughout this process.

Key themes from the submissions

Overall, submitters were supportive of the requirement for an RRG and Information Return. Most, submitters agreed with the requirement for periodic regulatory reporting by AFAs.

Other key themes highlighted by submitters included:

a) The Information Return did not sufficiently take into account of AFAs operating in certain business models. For example, AFAs working for Qualified Financial Entities (QFEs). Some AFAs could find it confusing as to whether to answer certain questions in the Information Return at the adviser business level or QFE level.

b) There appeared to be significant overlap and duplication of information requested between the Information Return and an AFA's ABS, the QFE Adviser Business Statement and the QFE Report.

c) FMA's rationale for asking certain questions contained in the Information Return was not well understood. Submitters considered some of proposed questions were intrusive and beyond the scope and function of FMA.

d) FMA should ensure the information requested was necessary and the compliance burden on individual AFAs is not disproportionate to those benefits.

e) Some AFAs are likely to incur significant costs in relation to completing the Information Return. These costs include monetary costs in establishing systems to collect the information and the opportunity costs of collecting the information and completing the Information Return.

f) In the first consultation, there were concerns regarding the timing for completion of the Information Return. For instance, an AFA would be required to complete and submit the Information Return prior to the IRD return date and, as a result, some financial information may not be available. It was also not always clear what period or date the information required from AFAs related to.

What we did

1. In light of the feedback received from the first consultation paper and various meetings with industry representatives, we undertook a comprehensive review of the RRG and Information Return and its approach to regulatory reporting for AFAs. As a result, we produced a revised RRG and Information Return which is shorter, more efficient and better aligned to achieving our regulatory reporting objectives.
2. Detailed questions that focused on such areas as income and remuneration, Discretionary Investment Management Services (DIMS), portfolio quality and continuous personal development hours have either been removed or significantly scaled back in the Information Return. We added questions focusing on areas such as United Kingdom and Australian pension transfers, mortgages,

insurance and KiwiSaver, as it was identified from feedback that the Information Return did not sufficiently cover the entire range of products offered by AFAs.

3. The Information Return has been re-designed so AFAs who do not advise clients or who are employed by QFEs, or who only provide certain products and services, will only be required to answer the questions that are relevant to their situation.
4. We reviewed the ABS requirement and the Information Return. Where possible, FMA removed questions from the Information Return that overlapped or duplicated information already contained in an AFA's ABS. However, we were unable to completely eliminate overlapping or duplication of information between the ABS and the Information Return. This is because we do not hold a copy of each AFA's most recent ABS, and would therefore need to request a copy of each AFA's most recent ABS to acquire that particular information. Further, the information contained in each AFA's ABS is not in a form that can easily be extracted or analysed by FMA. However, the cost to the AFA in providing information readily available to them in the ABS is minimal.

We considered the questions contained in the Information Return to ensure there is a clear rationale for asking each question and it could be understood. We identified key risk issues that would help us more effectively and efficiently allocate our resources and focus monitoring and surveillance activity to areas of highest potential risk. We also isolated some key knowledge points or areas that will help us better understand the profiles and businesses of individual AFAs and the AFA profession as a whole.

Section 4: Conclusion & Preferred Option

The introduction of the RRG provides an opportunity for us to implement a more effective risk-based approach to monitoring AFAs.

Neither Option 1 nor Option 2 will meet that objective without imposing unreasonable burden on either AFAs or the FMA.

The preferred option was Option 3 - for FMA to proceed to publish our first RRG for AFAs with a scaled back version of questions for the Information Return. This will provide sufficient information to inform our risk-based approach to monitoring AFAs which will:

- help us better understand the profiles and business of individual AFAs, and the AFA market as a whole
- help us to prioritise our work and focus our thematic reviews
- inform our policy work
- allow us to more effectively and efficiently allocate our resources and focus monitoring and surveillance activity to areas of highest potential risk
- ensure our resources are best directed to help achieve the objectives of the Financial Advisers Act.

Option 3 will assist FMA to meet our overarching objective, which is to promote and facilitate the development of fair, efficient and transparent financial markets.

Section 5: Appendix

Defining types of financial advisers

Financial advisers are people who give advice about investing and other financial services and products as part of their job or business. They include financial planners, mortgage and insurance brokers and people working for insurance companies, banks and building societies that provide advice about money, financial products and investing.

There are different types of financial adviser:

Registered financial adviser (RFA)

RFAs are individuals who can give advice or provide discretionary investment management services for products such as insurance, mortgages and bank term deposits. They can also provide class services and services to wholesale clients.

Authorised Financial Advisers (AFAs)

AFAs can advise and provide the same services as an RFA, but can also provide services in relation on more complex investment products, and can provide an investment planning service. To become authorised, AFAs need to first register on the Financial Service Providers Register. They also need to be authorised by the Financial Markets Authority and meet eligibility requirements, including minimum competence requirements and good character. They must develop an Adviser Business Statement (ABS) before applying for authorisation.

Qualifying Financial Entity (QFE) Advisers

A QFE adviser, for example, bank staff, can advise on the same products as RFAs and investment products like KiwiSaver or managed funds – but they can only advise on the products provided by their company.

FMA

FINANCIAL MARKETS AUTHORITY

TE MANA TATAI HOKOHOKO - NEW ZEALAND