

28 March 2008

Clerk of the Committee
Finance and Expenditure Committee
Select Committee Office
Parliament Buildings
WELLINGTON

FINANCIAL ADVISERS BILL

Introduction

- 1 This submission on the Financial Advisers Bill (“Bill”) is made by the Legislation Advisory Committee (“LAC”).
- 2 The LAC was established to provide advice to Government on good legislative practice, legislative proposals, and public law issues. The LAC produces and updates the LAC Guidelines adopted by Cabinet as appropriate benchmarks for legislation.
- 3 The LAC does not seek to appear before the Committee in support of this submission.

Lack of Clarity

- 4 The LAC reiterates the concerns expressed in its submission to the Committee on the Financial Service Providers (Registration and Disputes Resolution) Bill (“Financial Service Providers Bill”) that the separate introduction and passage of individual components of a large suite of bills to regulate the finance industry is likely to result in inconsistency between the bills and a lack of cohesion. There

are cross-references in both the Bill and the Financial Service Providers Bill to each other, which makes comprehension of these two Bills more difficult than it should be.

- 5 The LAC believes that there is merit in combining the Bill and the Financial Service Providers Bill, and indeed the future bills regulating the finance industry, as parts of a single bill to avoid the need for constant reference from one to the other. Consistency would be better assured by this method. We submit that serious consideration should be given to that mode of proceeding.
- 6 Clause 25 of the Bill provides that a financial adviser “must act with integrity” when performing a financial adviser service. If a person breaches any financial adviser obligation, this may result in serious penalties, yet there is no explanation of what it means to “act with integrity” in the context of the regulatory regime. In addition to specific conduct obligations, financial advisers must also exercise care, diligence and skill, and must not engage in misleading or deceptive conduct. It is difficult to see what acting with integrity adds to these obligations. The LAC considers that this lack of clarity is unsatisfactory. The Bill should either include a clear definition of what it means to “act with integrity”, or clause 25 should be deleted from the Bill.
- 7 Clause 50 provides that every Approved Professional Body (“APB”) must maintain a list of its current members containing specified details in respect of its members. No context is provided for this requirement. For example, the clause does not state the purpose of the list or who can access the information in it. This should be clarified.
- 8 Clause 53 sets out the matters that must be included in an APB's rules. Paragraph (m) requires that an APB must have rules in relation to a disciplinary matter against a member of an APB, including rules establishing a body to deal with disciplinary matters and how the body should operate. However, the Bill does not set out any requirements in respect of the nature of such a disciplinary body or the penalties it can impose. Although the Bill seeks to establish a co-regulatory regime, the LAC considers that matters such as the discipline of APBs are key elements of the regulatory regime that should be provided for in statute. The LAC

submits that the Bill should provide further guidance for APBs on disciplinary matters.

Overlap with Existing Law

- 9 Clause 27 of the Bill provides that a financial adviser must not engage in conduct in relation to the performance of a financial adviser service that is misleading or deceptive or likely to mislead or deceive. Clause 28 is a similar provision relating to advertisements. It is unclear how these relate to the provisions of the Fair Trading Act 1986, although clause 135 states that a person cannot be found liable in a Fair Trading Act proceeding for conduct regulated by the Financial Advisers Act if that person would not be liable for that conduct under the Financial Advisers Act. The Bill does not specify which agency should take the lead if the conduct at issue is a potential breach of more than one piece of legislation. In practice, it seems that prosecutions are unlikely to be brought by both the Securities Commission and the Commerce Commission for the same conduct.
- 10 The RIS states that there may be some overlap with the Fair Trading Act and the Consumer Guarantees Act 1993, and that the Commissions will work together to ensure the objectives of both Acts are met. The LAC submits that it would be simpler for the Bill to specify which type of investigation is to take priority if there is a potential breach of more than one Act for the same conduct.

No Requirement to Create APBs

- 11 The Bill provides a process for the establishment of APBs, but will not actually create any new APBs upon its enactment. The LAC is concerned that there is no requirement for any body to establish itself as an APB, even though APBs will have a key role in the regulatory regime.
- 12 The RIS states that to address the fact that there are no APBs, officials will work with industry to extend the existing capabilities of existing bodies, or to promote the set up of an appropriate body in the transition period of the regulatory framework, which may extend through to 2010. In the LAC's view, consideration should be given to providing for a default APB in the Bill if none are established within a set period of time.

Inadequate Guidance on Exercise of Remedial Powers

- 13 The Bill contains a complex menu of enforcement powers, civil remedies and criminal offences, with no guidance on the circumstances in which the Securities Commission should use its own enforcement powers or seek particular remedies from the Court.

Enforcement powers

- 14 Both the Securities Commission and the Court have powers to make a number of enforcement orders if satisfied that a person has contravened a financial advisers' obligation or exemption. The Securities Commission may make the following orders itself after following the procedural requirements set out in clause 73:
- (a) A prohibition order to restrict the making of any statement or distributing of any document by the person to prevent a contravention or further contravention of a financial advisers' obligation or exemption (clauses 67-68);
 - (b) A corrective order to direct the person in contravention to publish corrective statements (clauses 67-68);
 - (c) A disclosure order in order to secure compliance with the relevant disclosure obligation or exemption (clauses 69-70); and/or
 - (d) A temporary banning order (clauses 71-72).
- 15 Similarly, the Court may make the following enforcement orders upon application by the Securities Commission or any other person:
- (a) An injunction restraining a person from engaging in conduct that constitutes or would constitute a breach of a provision of the Act (clauses 77-79);
 - (b) A corrective order to direct the person in contravention to publish corrective statements (clauses 80-81); and/or

- (c) A disclosure order to secure compliance with the relevant disclosure obligation or exemption (clauses 82-83).

16 It is unclear when the Securities Commission should exercise its own powers to make corrective or disclosure orders and when it should apply to the Court for such orders, as the provisions are essentially the same (compare clauses 67-70 with clauses 80-83). It appears that, in practice, the Court process may only be used by third parties if the Securities Commission has declined to act. The circumstances in which the Securities Commission should exercise its own powers instead of applying to the Court for orders should be clarified.

Civil remedies

17 The Bill provides that the Court may make the following orders against a financial adviser:

- (a) On application by the Securities Commission, a declaration of contravention where a person has contravened a financial advisers' obligation or exemption (clauses 85-87);
- (b) On application by the Securities Commission, a pecuniary penalty order payable to the Crown where a person has contravened a financial advisers' obligation or exemption to a maximum of \$1 million (clauses 85-89);
- (c) On application by the Securities Commission or any other person, a compensatory order for payment of any sum the Court thinks just to compensate a person who has suffered or is likely to suffer loss or damage because of the contravention of a financial advisers' obligation or exemption (clauses 91-92);
- (d) On application by an "entitled person", a civil remedy order for payment to an entitled person (irrespective of whether any loss has been suffered) to a maximum of \$100,000 for an individual and \$300,000 for a body corporate (clauses 93-95);

- (e) An order banning the financial adviser from performing services for up to 10 years if a pecuniary penalty order has been made against the person or the person has been convicted of certain other offences (clauses 99-102); and/or
- (f) Orders preserving assets to satisfy claims against the financial adviser (clauses 103-105).

- 18 It is difficult to see why it is necessary for the Bill to include the civil remedy orders provided for in clause 93 in addition to pecuniary and compensation orders. Clause 95 states that the Court may make a civil remedy order of one kind against a person even though the Court has made another civil remedy order of a different kind against the person for the same conduct. It is not clear whether this clause is referring only to the civil remedy orders provided for in clause 93 or to any of the orders available under subpart 3 of the Bill. Presumably the latter interpretation was intended, but this needs to be clarified. Careful consideration should be given to the types of orders that are available for the same conduct. It would seem unfair for example for a compensation order and a civil remedy order under clause 93 to be made in respect of the same conduct. The Bill should provide further guidance on the circumstances in which multiple orders may be appropriate.
- 19 The LAC is also concerned that the \$1 million maximum pecuniary penalty is significantly higher than the fines payable if a person is convicted of any of the offences under the Act. This seems somewhat oppressive given that the standard of proof required for civil proceedings is the balance of probabilities (clause 97), rather than the usual criminal standard of proof beyond reasonable doubt.

Criminal offences

- 20 In addition to the civil remedies provided for above, there are a number of criminal offence provisions in the Bill for breaches of particular financial advisers' obligations.
- 21 The maximum penalty for almost all of the offence provisions is \$100,000 for an individual, and \$300,000 for a body corporate. The main exception is clause 111, which relates to the offence of deceptive, misleading, or confusing advertisement.

For this offence, the fine is \$300,000 for a person and, if the offence is a continuing one, a further fine not exceeding \$10,000 for every day or part of a day during which the offence is continued.

- 22 Clause 129 of the Bill provides that a person cannot be ordered to pay a pecuniary penalty and be liable for a fine under the offence provisions of the Act for the same conduct. It does appear that a person can be convicted of an offence and be the subject of other civil orders however. It is not clear when the Securities Commission should apply to the Court for a pecuniary penalty, and when it should bring a prosecution for an offence. There is significant overlap between the various civil remedies and the offence provisions, which the LAC considers to be unprincipled. In any particular case where there appears to be a breach of a financial advisers' obligation, the Securities Commission must choose which enforcement option to follow, and in the case of civil remedies, what order to seek from the Court. The Bill does not specify when a criminal prosecution is appropriate and when a civil remedy should be preferred. The LAC considers that the Bill should provide guidance on how the Securities Commission should exercise its powers with respect to its choice of remedies.

Inappropriate Delegation of Legislative Power

- 23 Clause 130(j) of the Bill provides that the Governor-General may, by Order-in-Council made on the recommendation of the Minister, make regulations "exempting (on terms and conditions, if any) any person or class or (sic) persons, any class of transactions, or any class of financial adviser service from any compliance with any financial advisers' disclosure obligation or obligations or any other requirement of the Act". Such an exemption by regulation would effectively alter the coverage of an Act of Parliament, and yet the Bill does not state any criteria for the making of such regulations.
- 24 Further, clause 136 provides the Securities Commission with the power to grant exemptions "in its discretion and on the terms and conditions (if any) that it thinks fit" by notice in the *Gazette*. The Commission may grant exemptions from compliance with any financial advisers' disclosure obligations, and may also exempt any person from the requirement to be a member of an APB. The

Commission must notify its reasons for granting an exemption, unless it is satisfied that it is proper not to do so on the ground of commercial confidentiality. Again, no criteria for granting an exemption are specified. It is also difficult to see why the Commission should be able to grant such exemptions, particularly in relation to membership of an APB, as this is one of the cornerstones of the regulatory regime established by the Bill.

- 25 The LAC has real concerns with provisions enabling delegated authority to exempt persons from the scope of legislation. However, if such powers are considered necessary, the circumstances in which they may be exercised should be properly circumscribed in the enabling legislation itself.

Conclusion

- 26 To ensure that the legislation is accessible and coherent, the LAC considers that the Bill and the Financial Service Providers Bill should be incorporated into one bill.
- 27 Clauses 25, 50 and 53 of the Bill require further clarification. So too does the relationship between the Bill and the Fair Trading Act, particularly regarding the priority for the investigation of activities that may breach overlapping provisions in these Acts.
- 28 The Bill should provide guidance on how the Securities Commission may exercise its powers in deciding which remedies to pursue when it considers that there has been a breach of any financial advisers' obligation. Consideration should be given to whether it is appropriate to have civil penalties that are higher than the penalties for breaches of offences.
- 29 The powers to create exemptions from the provisions of the Act should be removed. If not, the circumstances in which those powers may be exercised should be clearly articulated.