FEBRUARY 2023

Regulatory Impact Statement:

Regulatory reporting requirements for licensed financial advice providers

This document is for financial advice providers, financial advisers, and other interested parties. It discusses the regulatory reporting requirements as required by Standard Condition 3 for licensed financial advice providers.

FMA
FINANCIAL MARKETS AUTHORITY
TE MANA TĀTAI HOKOHOKO

Contents

Background

Document purpose

This Regulatory Impact Statement (RIS) discusses the decision of the Financial Markets Authority – Te Mana Tātai Hokohoko (FMA) on the regulatory return requirements for all classes of licensed Financial Advice Providers (FAPs). FAPs will complete a regulatory return annually for the period 1 July to 30 June and submit it to the FMA by 30 September online via our website. The first regulatory returns will be due by 30 September 2024, for the period 1 July 2023 to 30 June 2024.

Background

The Financial Services Legislation Amendment Act 2019 amended the Financial Markets Conduct Act 2013 (FMC Act) to introduce a new regulatory regime for financial advice. When the new regime came into force on 15 March 2021, providing a financial advice service to retail clients required a FAP licence under the FMC Act. There are two phases to FAP licensing: transitional and full. FAPs operating under a transitional have up to 16 March 2023 to obtain a full licence.

From 17 March 2023, FAPs, as well as any financial advisers, nominated representatives and authorised bodies under another FAP's licence, can only provide regulated financial advice to retail clients if they have been granted a full FAP licence.

Risk-based monitoring

FAP licensees are subject to ongoing monitoring by the FMA. We take a risk-based approach to this monitoring.

This approach is intended to help ensure we:

- meet our statutory objectives by identifying and acting on conduct that has a high risk of causing harm.
- allocate resources effectively by focusing on those high-risk practices.
- maintain a consistent and robust approach to monitoring FAPs.

Our oversight of FAPs through monitoring is one of the activities we conduct to support fair outcomes for consumers of financial advice services.

Monitoring Financial Advice Providers

Our ability to effectively monitor the licensed population and emerging risks in the sector relies on the quality and depth of information available to us. This may be obtained through public complaints, referrals from other agencies, licensing applications, information collected under licence conditions or through our statutory powers.

Using the information available to us, we select licensed FAPs for monitoring in one or more of the following ways:

- Random selection
- Based on themes within the sector
- Based on risk with regards to the nature, scale, and activities of the FAP
- Targeted based on information such as complaints or notification of changes to the licensed business[1] received from the FAP or other parties

Monitoring activity includes a mix of desk-based activity (investigating complaints and public information, and reviewing documents), virtual meetings (video conferencing) and on-site visits to the FAP's office location.[2]

FAP licensing and standard conditions

We can impose conditions on licences under the FMC Act by written notice to the applicant or licensee (see section 403 of the FMC Act). Licensees have an obligation to comply with those conditions under section 402(3).

Full FAP licence holders are required to comply with seven standard licence conditions, as well as any additional specific conditions added to the licence, as well as other statutory duties and obligations that apply to financial advice services.

In 2020, we consulted on the proposed standard licence conditions for all classes of FAPs. This included Standard Condition 3 – Regulatory Returns, which requires the FAP to provide us with information help us to monitor their ongoing capability to effectively perform the financial advice service in accordance with the applicable eligibility criteria and other requirements in the FMC Act, including updated information on the nature, size and complexity of the FAP service. Reporting requirements under the (repealed) Financial Advisers Act 2008 no longer apply.[3]

We have now considered and decided what information we require FAPs to provide in their regulatory returns. This information will inform our risk-based monitoring approach and is necessary to effectively monitor full FAP licence holders.

Regulatory returns

This RIS explains our decisions on the regulatory reporting requirements that all full FAP licence holders must comply with.

The regulatory returns require reporting of factual business information, such as business volumes and service types, numbers of customers, complaints information and arrangements as a licensed FAP, which may have changed since a licence was granted. This will help us to understand the profile of a FAP's business and to focus our resources appropriately.

In the 2020 consultation on the FAP licence standard conditions, stakeholders indicated they were generally supportive of Standard Condition 3; however, some submitters noted they could not comment without knowing what information would be required.

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[1] Standard Condition 7 for Full FAP Licences; Sections 412 of the FMC Act; Regulation 191 of the Financial Markets Conduct Regulations.

[2] The FMA published an information sheet that explains how we carry out our monitoring activities for FAPs.

[3] FA Act s 45(1); s 77

In late 2021, we carried out staged consultation with each of the three classes of FAPs on the proposed questions to give effect to Standard Condition 3.

We have revised the question set to present a lighter version of the original information proposed, based on industry feedback (which is summarised in this RIS) and our objectives for the returns.

Our decision has been made after carefully considering the impacts that each option would have on the objectives for regulatory reporting. This document sets out our considerations in relation to each option against these objectives, and each FAP licence class.

Objectives and relevant stakeholders

Objectives

Primary objective

Regulatory reporting informs our risk-based approach to monitoring licensed FAPs. This means data collected from FAPs helps determine who and what to monitor, with respect to ongoing capability to effectively perform the financial advice service. This enables us to promote the following statutory purposes of the FMC Act, which we used as the objectives against which to measure the possible options for the regulatory returns requirements:

- Promoting the confident and informed participation of businesses, investors, and consumers in the financial markets.
- Promoting and facilitating the development of fair, efficient and transparent financial markets.
- Ensuring the availability and quality of financial advice services.
- Avoiding unnecessary compliance costs.

What we mean by 'risk-based'

Risk-based means we focus our monitoring on areas of greatest harm to consumers, financial markets, and risks to the statutory purposes of the FMC Act.

Information collected on the profile and business activities of licensed FAPs allow us to understand the risks to these statutory objectives and improves our ability to reduce harm, adapt and respond quickly, and ensure effective and efficient use of our resources.

Sector-wide trends and information

The regulatory returns may also provide us with the ability to produce sector-wide views of trends, risks or other information about the licensed population. We will report this publicly in an aggregated form, and use it to inform other activities such as policy, intervention design and strategy setting. Regulatory reporting also assists us in carrying out thematic reviews, and publishing information and guidance for the financial advice sector.

Relevant stakeholders

The regulatory returns will require FAP licence holders to comply with all reporting requirements, including Standard Condition 3. This will impact individuals and entities that hold or intend to apply for a FAP licence. In considering the options, we also considered the interests of other stakeholders, including:

- Authorised bodies, who provide a financial advice service covered by a FAP licence
- Financial advisers and nominated representatives, who are engaged by a FAP to provide advice on its behalf

- Professional bodies, aggregator groups, and other compliance support providers who provide services and support to the financial advice sector
- Dispute Resolution Service (DRS) providers
- Consumers of regulated financial advice

Problem definition, options, and impact analysis

Problem definition

Without issuing a regulatory return, we are limited to relying on public complaints, referrals, and other information that FAPs are required to provide the FMA. This will be inadequate to provide comprehensive and up-to-date information about whether (and to what extent) licensed FAPs are fulfilling their obligations, and will limit our understanding of conduct risks with respect to financial advice services. We would be unable to appropriately target our risk-based monitoring due to limited data. In turn, we believe this would greatly increase the potential risks to consumers of regulated financial advice and ultimately lead to poor customer outcomes.

Options

We considered three options in relation to the problem identified:

- **Option 1**: Do not issue the regulatory return (i.e. status quo)
- **Option 2**: Comprehensive regulatory return
- **Option 3 (preferred)**: Balanced regulatory return (i.e. a lighter version of option 2)

In considering these options, we took into account the business structures and profiles of each FAP licence class:

- Class 1 FAPs are smaller businesses (i.e. sole adviser practices) and make up 32% of all full FAP licence holders[4]. Class 1 FAPs may have limited resources to collate and input the information to complete regulatory returns. Class 1 FAPs are less likely to have dedicated compliance and risk personnel, and may rely heavily on the knowledge of the sole adviser. We expect our monitoring of Class 1 FAPs to be focused on high-risk practices and thematic monitoring to ensure effective and efficient use of our resources and reduce regulatory cost.
- Class 2 FAPs are mostly small to medium businesses and make up 64% of all full FAP licence holders.[5] Class 2 FAPs can engage multiple financial advisers and may have authorised bodies under their licence. In the transition to the new advice regime there has been consolidation of providers under this licence class, and understanding the evolution of structures, profiles and characteristics of these FAPs is critical for our risk-based approach to monitoring this licence class.
- Class 3 FAPs are larger businesses, many of which may have significant impacts on a larger number of consumers (e.g. registered banks and large insurers). Advice is generally provided through branch networks, call centres, and online, and often extensively involves nominated representatives. Advice offerings are diverse in nature and scope, and require an up-to-date understanding for effective risk-

[4] As of 13 February 2023.

[5] As of 13 February 2023.

based monitoring. This class is most likely to have specialist or dedicated compliance and risk personnel.

Option 1: Do not issue the regulatory return (status quo)

Description

This option would involve relying on reactive information (e.g. complaints), referrals, and any existing reporting obligations (e.g. Standard Condition 7, AML returns) to support ongoing monitoring of licensed FAPs, but not using Standard Condition 3 to implement a regulatory return.

Impact analysis

This option would not impose any new or additional cost or burden on any class of FAP licence holders; however, there may be consequential costs associated with a less-informed monitoring approach, e.g having to review every aspect of a FAP's business during a monitoring visit, due to a lack of information held about the licensee's financial advice business.

This option would mean we would be unlikely to have sufficient or appropriate data (including up-to-date information) to ensure effective identification of current and/or emerging high-risk practices. We would likely allocate our resources to the most 'visible' misconduct without having a view of the overall market risks.

Section 412 of the FMC Act, regulation 191 of the FMC Regulations, and Standard Condition 7 for FAPs contain some reporting obligations; however, these do not provide for the level of information needed to inform a proactive risk-based monitoring approach. In addition, some market participants under the Financial Advisers Act 2008 were required to submit information to the FMA. This included AFA (Authorised Financial Adviser) returns and QFE (Qualifying Financial Entity) annual returns. These requirements no longer apply in the new regulatory regime. As a result, by not issuing regulatory returns in the new regime, we would overlook lesser-known risks, and be unable to conduct risk-based monitoring that proactively addresses the greatest risks and harms.

This option is more likely to contribute to poor conduct and increased risk of harm or unfair treatment of consumers across all FAP licence classes.

Option 2: Comprehensive regulatory return

Description

This option involves a comprehensive regulatory return of up to 37 questions designed to capture a thorough and wide-ranging package of information. A comprehensive return would help identify areas of risk in a FAP's business practices and develop a sophisticated sector-wide view of current and emerging risk themes and opportunities.

Impact analysis

Option 2 would place a moderately high compliance cost on licensed FAPs. Some level of compliance cost and/or time is unavoidable because FAPs range from sole adviser businesses to large firms, with a variety of systems, processes and resources to support compliance and reporting.

Comprehensive reporting may impose undue compliance cost where the required information does not exist in a readily collectable form, or there are barriers to collecting that type of information. This could potentially impact the availability and quality of financial advice.

There may be initial and upfront one-off costs where FAPs decide to invest in system and process changes.

In terms of benefits, comprehensive reporting would allow us to gain an in-depth understanding of the structure, conduct, and practices of licensed FAPs, and organise our resources to focus on higher-risk areas, types of advice, products advised on, and general conduct risks.

This, in turn, would allow us to design effective monitoring reviews, undertake thematic reviews of the sector, and issue information and guidance. These activities support the objectives of the financial advice regulatory regime, ensuring the availability and quality of financial advice and financial advice services in accordance with FAPs' obligations and responsibilities.

Option 3: Balanced regulatory return (preferred option)

Description

This option is a lighter and more refined question set limited to 29 questions, developed to reflect feedback from the consultation on the comprehensive question set, and focusing on a narrower set of data that we consider is likely to provide sufficiently detailed and robust information to effectively monitor the licensed FAP population.

Impact analysis

The impacts are comparable to Option 2 except that it would generally impose a lower compliance cost across all FAP licence classes, and decrease expected benefits because of the narrower scope of data collected.

Compared to Option 2, this option:

- has lower one-off costs (particularly due to removing and simplifying quantitative questions where FAPs may require significant system changes to provide the required information)
- has lower compliance costs across all licence classes because the information sought is more targeted.

While aspects of the comprehensive question set have been removed or tailored, it is expected that the information will allow us to undertake fair and robust risk assessment to inform our proactive monitoring activities. This option supports our objectives of ensuring the availability and quality of financial advice services in accordance with FAPs' obligations and responsibilities.

We will continue to look for opportunities to carry out thematic reviews to monitor aspects of the financial advice sector with regards to the questions that have been removed from the original questions set.

Summary of assessment of options against objectives

We have assessed the options against the criteria below:

Key:

✓✓ Meets the policy objectives

✓ Partially meets the policy objectives

× Does not meet the policy objectives

Criteria	Ensures the availability and quality of financial advice services	Avoids unnecessary compliance costs	Promotes the confident and informed participation of businesses, investors, and consumers in the financial markets	Promotes and facilitates the development of fair, efficient and transparent financial markets
Option 1: Not issuing the regulatory return (status quo)	Without the information provided in regulatory returns, it is more difficult and will require more resources for the FMA to monitor compliance and enforce FAPs' obligations. Effective monitoring is a key part of ensuring the availability and quality of financial advice and services. ×	This option would not impose any new or additional cost on any class of FAP licensees; however, there may be consequential costs associated with a less-informed monitoring approach. ✓	Regulatory returns information is an important part of enabling the FMA to effectively monitor FAPs and enforce financial markets legislation. Without a well-regulated market, confident participation of businesses and consumers in the financial market will decrease. ×	This option limits the FMA to relying on reactive information (e.g. complaints), referrals and notification requirements to support ongoing monitoring of licensed FAPs. The market may be less fair because the FMA's monitoring approach may be ineffective, and our response may not be proportionate or focused on the highest risk areas. ×
Option 2: Comprehensive reporting	Regulatory returns will provide the FMA with up-to-date, relevant information about FAP licensees, which informs the monitoring approach. Effective	Places a moderately high compliance cost on licensed FAPs. Some level of	A comprehensive return helps identify areas of risk in an FAP's business and develop a sophisticated sector-wide view of current and emerging risk	Comprehensive reporting allows the FMA to gather an in-depth understanding of the structure, conduct, and practices of licensed FAPs, and

	monitoring is a key part of ensuring the availability and quality of financial advice and services. ✓✓	unnecessary compliance cost (and time) may occur. ×	themes, and opportunities for effective monitoring. This is key to promoting the confident and informed participation of businesses, investors, and consumers in the financial markets. ✓✓	organise our resources to focus on higher-risk areas, types of advice, products advised on, and general conduct risks. This helps the FMA to optimally monitor the financial markets; well-regulated markets promote fairness and efficiency. ✓✓
Option 3: Balanced reporting (preferred)	Regulatory returns will provide the FMA with up-to-date, relevant information about FAP licensees, which informs the monitoring approach. Effective monitoring is a key part of ensuring the availability and quality of financial advice and services. ✓✓	This option places a moderate to low compliance cost on licensed FAPs. We consider the associated costs are reasonable and necessary when compared to the overall benefits of well-regulated markets. ✓✓	The information allows the FMA to undertake a fair and reasonable risk assessment, to inform our monitoring approach, making an important contribution towards confident and informed participation of businesses, investors and consumers in the financial markets. ✓✓	Regulatory returns are a key tool the FMA uses to inform our monitoring and enforcement activities. This option ensures effective regulation of the financial markets while balancing the need for firms to manage compliance costs. This is key to promoting fairness, efficiency and transparency in the financial markets. ✓✓

Consultation themes

On 12 September 2022, we released a consultation paper seeking feedback on the appropriateness and format of the proposed regulatory returns for licensed Class 3 FAPs. We subsequently released a similar consultation on 10 October 2022 for Class 2 and Class 1 FAPs.

We received 53 written submissions from a range of stakeholders including industry bodies, licensed FAPs, banks, insurers, and consultancy and law firms. A summary of the key themes raised in submissions and our response is below.

We have carefully considered the feedback we received, and the final questions incorporate several changes that are a direct result of that feedback. The final regulatory reporting requirements can be found on our website.

Key themes

Overall, submitters were supportive of the requirement for the regulatory returns. Most submitters agreed with the proposed period for regulatory reporting.

Other key themes included the following.

- The regulatory returns did not sufficiently consider FAPs operating in certain industries, such as general insurance or registered banks. For example, several of the questions did not apply to the general insurance industry and submitters were unsure whether they would have to answer unrelated questions. Banks and insurers considered it challenging to segregate their financial advice activities to provide data pertaining solely to their licensed financial advice service.
- There appeared to be some overlap and duplication of information requested between the regulatory returns, and returns required for other FMC Act licensed services such as Managed Investment Schemes (MIS) and Discretionary Investment Management Services (DIMS). For larger institutions that are prudentially regulated, there was overlap with information requested by the Reserve Bank of New Zealand – Te Pūtea Matua (RBNZ).
- Our rationale for asking certain questions was not well understood. Submitters considered some of the proposed questions to be intrusive and beyond the scope and function of the FMA.
- Submitters noted we should ensure the information requested was strictly necessary and the compliance cost on FAPs is not disproportionate to those benefits.
- It was noted that some FAPs would be likely to incur significant costs in relation to gathering the data to complete the annual regulatory returns. These costs include monetary costs in establishing systems to collect the information and the time required to collate the information and complete the returns.

With respect to each licence class, submitters also noted the following.

- Class 1 businesses are more vulnerable to cost and time impacts associated with the completion of regulatory returns. Submitters noted that licence holders will face challenges in providing the comprehensive information in the format required.

- Class 2 feedback noted that the data requested is not collected by industry in a standardised format, is overly prescriptive (regarding quantitative data requested) and does not balance the compliance cost to FAPs with the FMA's need for the information. One submitter sought clarification regarding the scope of the return covering an FAP's authorised bodies. Several submitters queried the purpose of the data required.
- Class 3 submitters noted challenges in segregating their financial advice services from other core services to obtain data that only pertains to their financial advice service. Class 3 FAPs anticipated system and process changes would be required. Some Class 3 FAPs noted the data requested overlaps with other FMC Act licence types, and requirements from other regulators, such as RBNZ.

Summary of changes made following industry feedback

We have carefully considered and accounted for industry feedback. The balanced reporting option has fewer questions, and several existing questions have been simplified and revised. We acknowledge some questions are better suited for future one-off request to inform thematic reviews, rather than the annual regulatory returns. We have removed and revised questions on types of clients, revenue indicators, client money and property services, and eligible investor certifications. We have simplified questions about complaints, outsourcing, and business continuity and information security.

For information requested in the regulatory returns where the exact data cannot be obtained during the initial return period, best estimates can be provided rather than definitive responses. We do not expect all information to be perfect in the first year as the market implements information-gathering processes and systems. We will engage with the market to provide guidance and expectations for completing the first regulatory returns in the leadup to the first reporting commencement date. We expect that in subsequent years, FAPs will provide more accurate answers as their processes mature.

We have further considered feedback on compliance costs, and will provide a dynamic reporting form where FAPs only need to answer questions relevant to their licence class and the financial advice services they provide. Where applicable, questions will be pre-populated with data we already hold (e.g. data from previous year or other regulatory returns), so the FAPs will only be required to confirm its accuracy.

See below for specific considerations for each licence class.

Class 1

We have considered the feedback from Class 1 providers and relevant industry bodies, including the associated compliance costs, and weighed these against the information we consider necessary to ensure we can effectively monitor the licensed population.

Our focus on monitoring Class 1 licence holders largely depends on our understanding of their business activities and risks. It is unlikely that all Class 1 licence holders will receive a monitoring visit from the FMA every year, due to the large number of licence holders. Therefore, we consider the balanced regulatory returns do not unduly overburden Class 1 licence holders.

Class 2

We have considered the feedback from Class 2 providers and reviewed our rationale for each question to ensure an appropriate balance. We have also made significant updates to our guidance to help licence holders understand how to provide the data, including for Class 2 licensees with authorised bodies.

We have removed and revised several questions, including those requesting quantitative data (e.g. revenue and replacement business). For all other questions we have revised the guidance to reduce the need for FAPs to incur any unnecessary cost and time burden. FAPs will be able to provide best estimates in some instances.

Class 3

We have considered feedback and reflected on the overlaps in reporting requirements for some Class 3 licence holders by reviewing our purpose for each question and including this purpose in the regulatory returns.

We have removed and revised several questions to address challenges some entities face in segregating information about financial advice services from other services. However, from our perspective having relevant and structured information about the licensed financial advice service (and related business practices and operations) is important for developing risk-based monitoring approaches. We weighed this against any system and process changes to gather the information required to complete the first regulatory return. We note that Class 3 licence holders who previously held a QFE status under the Financial Advisers Act 2008 are well placed to provide information on their licensed financial advice service.

Where we identified overlap with other FMC Act licensed services, we have explored where data we already hold about an entity can be pre-populated. The FAP regulatory returns will also consider any future data requirements for Class 3 licence holders that may be required to hold, or operate under, a financial institution licence under the Financial Markets (Conduct of Institutions) Amendment Act 2022.

Conclusion and reasons

The balanced regulatory reporting returns will allow us to implement a more effective risk-based approach to monitoring FAPs. Neither Option 1 nor Option 2 will meet that objective without imposing unreasonable costs on either FAPs or the FMA, and may not provide assurance to relevant stakeholders that we are monitoring FAPs in the most efficient and effective way. Therefore, the preferred option is Option 3, a scaled-back set of questions that balances compliance cost with provision of information that will give us the ability to effectively monitor the licensed population. This will:

- help us better understand the profile and business of FAPs and the financial advice sector
- allow us to more effectively and efficiently allocate our resources, and focus monitoring and surveillance activity on areas of highest potential risk
- ensure our resources are best directed to help achieve the statutory objectives of the FMC Act, which include promoting the confident and informed participation of businesses, investors, and consumers in the financial markets, and the development of fair, efficient and transparent financial markets.

The preferred option will add initial compliance costs in some cases, but we consider these to be necessary, and generally one-off. Having an up-to-date understanding of FAPs and improved ability to identify risk will help reduce the need for intensive monitoring in the long run. Overall, this option will help to ensure a well-regulated financial advice sector.

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