2013 IFA Conference

'Keeping it real!'

Sean Hughes

Chief Executive

Financial Markets Authority

"FMA's Compliance Focus for 2013"

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(20 minutes speaking)

**Introduction**

Good morning everyone and thank you Jordi for inviting me along to speak to you today.

Given the breath of issues in our financial markets I thought it would be of interest to provide an overview of our compliance focus for 2013. But, before I start, I want to acknowledge that some of you may have borne the brunt of heavy criticism in the wake of high profile cases like David Ross or Andrew Robinson.

In my view, those cases are few-and far-between and do not accurately reflect the majority of advisers doing a commendable job. Nevertheless, those cases have catapulted the industry into the spotlight and raised questions on the integrity of AFA's, how they are regulated and if more could have be done.

It is inevitable that our monitoring or a tip-off or a complaint may reveal other areas of concern, but while the true story of what happened with Ross is yet to be told, the real fallout for the rest of us, especially the adviser community is not financial; the real fallout is trust.

For investors who are trying to recover from the likes of Ross or even the failed finance companies, it will take some time before they can answer a fairly direct question for themselves: Can we trust this person or business with my money?

This is a question that resonates to our heart, because in our view, it's our job to restore investor confidence and put trust back into New Zealand's financial markets.

And this leads me into what I came to talk you about today. In February we released our compliance focus which outlines FMA's four priorities for this year - the first one being; building customer trust.

**Compliance Focus**

**1. Building Customer Trust**

Building or restoring customer trust has probably got to be one of the biggest challenges we face. It's safe to say that stories like Ross, Robinson and the finance company collapses (where there is little chance of a happy ending for investors) have devastated confidence, especially for those who relied heavily on advisers to manage their money and act with integrity. In particular we do expect the market to put customer interests ***first*** in their day-to-day financial activities especially when designing, marketing or selling new products.

But on the other side of the coin, we ***expect*** investors to take responsibility for their own financial decisions. They have to do their homework, ask questions – basically pay attention to their investments. We know that financial markets can be confusing to the uninitiated, but Ross highlights that inexperienced investors don't know what they don't know. For example some didn't think to research his background and capability or ask questions; like who was his auditor? What was he investing in? When should I expect to receive my statement or report?

Financial literacy is a concern and we acknowledge that it is a weak component in New Zealand's financial markets. There's no magic 'silver bullet' that will solve this problem in the short-term and we can't do it on our own. Across the ditch, Australia has been throwing money at this problem for over 16 years and it remains a singular challenge for the community there too.

However it's not all bad news. We are very much part of this important discussion and are assisting to broaden investor understanding by working closely with other agencies, like the Retirement Commission and Citizens Advice Bureau's. Our website provides information for investors, and we have produced a range of brochures which I encourage you to refer your clients to.

Alongside building literacy, we are mindful that in this low interest rate environment, investors are attracted to higher risk products. The cost of money has never been so cheap, so this could temp investors into products that they don't fully understand or which are inappropriate for their needs. This is especially the case if they are reliant on income from their investments, like retirees who are less able to recover from loss of capital.

Clear, concise and effective disclosure is vital here. We expect product issuers who are promising to achieve higher yields, to properly explain the product, including clearly stating ***all*** the risks and ensuring information is available to allow investors to determine if the price or return appropriately reflects those risks. Offer documents are already under a great deal of scrutiny but we also expect others managing peoples' money to take into account the vulnerability of customers' financial literacy and circumstances, when advising on or delivering financial products.

## 2. Raising the Standards in Existing Regimes

Our second priority is about raising standards and making sure existing regimes are working well.

Since the financial crisis, it's fair to say we want the market to up its game. For activities that have been regulated for some time, we expect people to operate above the bare minimum required, and expect senior management to sponsor a culture of integrity and good conduct.

Obviously, we will continue to play an active role in monitoring Financial Advisers, including Qualified Financial Entities. In some of our monitoring visits to-date, we have identified a number of concerns about compliance with the Code of Professional Conduct, including suitability of advice, the clarity of the nature and scope of services provided, and standards of client care.

As many of you will be aware, we have recently finished conducting monitoring visits to Financial Advisers for the last quarter. I'm sure many of you will eager to know our findings, and these will be published soon so I encourage you to keep a look out for that.

Actually, on the topic of adviser visits; if you haven't had the privilege of being visited by FMA yet or you want to know more about how to prepare for these visits, then I understand my colleague Derek Grantham is hosting a webinar for IFA members next week. This will offer practical advice, including what to expect.

Those visits (and the Ross case) teach us a lot and help us to '*keep it real'* because it does influence both our regulatory reform agenda, as well as our compliance focus. One of the initial findings from Ross was the lack of separation between his own funds and client money, so it's no coincidence that our lens extended to the provision of discretionary investment management services, which Ross effectively was.

Brokers are required to keep retail funds separate from their own and in trust, so we are now visiting a wide range of brokers to monitor their compliance, focusing on segregation of roles and reconciliations between internal and external records. This is also high on our checklist when visiting Discretionary Investment Service Managers.

**Compliance Continuum and Helping the Market Comply**

FMA does recognise that Advisers have a huge responsibility handling clients' money and it can become a balancing act with rising compliance costs and running a successful business. While we will come down hard on those who don't have customers' interests in mind or who resist complying, our role is not about waving a stick. It's about helping individuals to identify poor practices as well as educating and assisting participants to do the right thing.

We have 23 pieces of legislation to enforce, however, our compliance continuum emphasises a “top of the cliff” approach, focusing on lifting standards though education and engagement. In a mature market, enforcement should take a less visible role as the market proactively and willingly complies, because it’s clear about what is being expected and the competency is there to deliver it. We would rather focus your attention on being compliant than simply prosecute law-breakers. However, to encourage good practice it’s worth giving a few pointers, so for example, we are big on giving guidance.

In the last 18 months we’ve released five pieces of guidance just for Financial Advisers. These provide clarity around aspects of the Financial Advisers Act, sales and distribution around KiwiSaver and soon we will be issuing guidance for Discretionary Investment Service Managers. Further to this, we know corporate governance needs to be improved, so in conjunction with the Institute of Directors we’ve published “A Directors Guide” which is available on our website. It’s there to help new and existing directors understand their obligations including questions to ask, legal requirements for signing of financial statements and what to do when things go wrong.

Keeping compliant means keeping in the loop. I encourage you all to read our guidance notes, participate in consultation processes, talk to us and ask questions. Our role in the financial markets is not a singular one, we need you to contribute as well.

### 3. Embedding new regimes

Our third priority in the coming year will be embedding new regimes.

Financial regulation is designed to make markets resilient, efficient and robust for the benefit of investors and the financial community. Therefore, it is important that everyone adapts to the new regulatory obligations in a timely manner, so that the regimes can achieve their objectives.

This year will see the introduction of the Financial Markets Conduct Bill which overhauls the 35 year old Securities Act and focuses on governance, disclosure and licensing. This is a once-in-a-generation opportunity to rewrite the rules from credit through to investment law. The rules are intended to be made clearer and those who break the rules will be held to account. Our focus will be working closely with you to raise awareness of your new obligations through education, setting clear expectations and monitoring compliance.

Taking center stage shortly is the new Anti-Money Laundering and Counter Financial Terrorism legislation, and we are one of three supervisors helping entities to assess their readiness. We know that the new rules and regulations that go with it have been overwhelming for some, but we are encouraging all businesses to comply from the start, so we will be monitoring how this goes and how you are assessing your risks.

Fund managers should also expect FMA to be closely watching their activities. We expect fund managers to act with integrity in their dealings with customers and market participants, including their activities as issuers and managers of KiwiSaver schemes. With the new legislation coming into force this year, we encourage fund managers to review the robustness of their operational arrangements in preparation for future licensing.

**4. KiwiSaver**

Our fourth priority is KiwiSaver.

For many New Zealanders, KiwiSaver will be their first and only investment, hence it's an important priority for us. Relative to global standards, New Zealand has a largely inexperienced retail investor base. However, as awareness that retirement income is increasingly becoming the responsibility of the individual, and as investors become more educated, KiwiSaver has become appealing as an easy way of providing an income stream into our non-salary years.

With a plethora of KiwiSaver providers, it can leave investors vulnerable. Our focus areas will be specifically on investments, unit pricing, disclosure, trustees, advice and fees and we won't be shy in taking action if we need to. We have already taken steps to raise standards and help investors get the information they need to help them make informed decisions – particularly around advice. We have also issued warnings and taken action in relation to some sales practices.

5. **Christchurch**

Earlier I said we have four priorities however in addition to those, we are mindful of the unique situation in Christchurch where support is needed for participants and investors alike.

We are all too aware that Christchurch could be an environment where fraud or mis-selling could easily take hold. Many Cantabrians are looking to invest compensation or insurance money while they plan their futures and we expect participants to deal appropriately with these investors. We will maintain surveillance of advice practices in Christchurch and will continue to provide information for investors where needed to promote a confident, healthy marketplace.

**Conclusion**

So those are our key priorities, but what I want to emphasise is that these are not meant to be a complete list of all the work we will do this year, rather they are where we are presently focusing our resources. Necessarily, an unforeseen crisis may necessitate us shifting our resources.

As our monitoring of financial markets evolves and we evaluate emerging risks, we anticipate these themes will continue beyond 2013. As I said earlier, it's our preference to work in partnership with the market to enhance the industry and we respect the views of professional bodies such as yourselves. You provide a valuable insight on how our regulatory approach impacts the world you work in, which in turn helps us keep pace with an ever-changing and dynamic market place.

I hope what I’ve outlined today gives you a sense of what’s important to us right now and no doubt some of the issues I’ve mentioned will be a starting point for debate in today’s discussions.

Thank you everyone and enjoy the rest of your conference.