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CREDIT UNIONS AND THE FINANCIAL ADVISERS REGIME

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New Zealand now has a system of registration and quality oversight for persons providing financial adviser services. The new registration and quality control regime is set out in the Financial Advisers Act 2008 ("FA Act") and the Financial Service Providers (Registration and Dispute Resolution) Act 2008 ("FSP Act").

Background

The FSP Act establishes the registration system for financial service providers. Registration under the FSP Act will be a mechanical, on-line process. Currently it must be completed by each financial service provider before 1 December 2010. Registration under the FSP Act also requires the financial service provider to be a member of an approved dispute resolution scheme.

The FA Act introduces an additional authorisation requirement for certain categories of financial service providers, as discussed below. This authorisation comes from the Securities Commission. It requires an applicant to demonstrate a level of skill and competence in the giving of financial advice. The FA Act does, as an alternative, allow an entity to become authorised (a "qualifying financial institution" or "QFE") and to take responsibility for its employee/representative advisers.

In combination, the FSP Act and the FA Act therefore introduce a two-tiered registration and authorisation process. The two-tiered approach is related to the complexity of the product which is being advised on, the type of financial adviser service being provided and the class of persons to whom the advice is being provided.

We set out in this newsletter the principal features of the new regulatory regime and how these will impact on credit unions.

Financial Advice

The starting point in applying the new regime is the determination of whether a credit union or any of its employees are financial service providers. Financial service providers include persons who, in the course of business, give financial advice.

Financial advice is a recommendation or opinion in relation to acquiring or disposing of a financial product. Merely giving "guidance" will not constitute the giving of financial advice. In addition, a person does not give financial advice merely by:

- providing information (e.g. the cost or terms and conditions of a product);
- making a recommendation or giving an opinion relating to a class of financial products;
- making a recommendation or giving an opinion about the procedure for acquiring or disposing of a financial product;
- transmitting the financial advice of another person; or
- recommending that a person consult a financial adviser.

Product classification

The new regime draws a distinction between product types, referring to them as Category 1 or Category 2 products.

The categorisation is based on the level of complexity of the product. Category 1 products are more complex and generally include term debt securities and shares. Category 2 products are less complex. They include call debt securities and call credit union shares, as defined in the FA Act.

As a general rule, advice on Category 2 products may be given by registered advisers, but advice on Category 1 products may only be given by a person who is both registered under the FSP Act and authorised under the FA Act (an "authorised financial adviser" or "AFA") or by a QFE adviser.

Personalised or class advice

The new regime also draws a distinction between a personalised adviser service and a class adviser service. A financial adviser service is a personalised service if it is:

- given to, or in respect of, a named client; and
- a client would, in the circumstances in which the service is provided, reasonably expect the financial adviser to take into account the client's particular financial situation or goals in performing the service.

If the service is not a personalised service it is a class service. Examples, of class services include promotional brochures or information on websites. However, material or advice tailored for a particular client would be considered personalised advice.

The consequence of this distinction is that class services may be given by a person or a credit union that is only registered under the FSP Act. Personalised services in relation to Category 1 products may generally be given only by an AFA or a QFE adviser.

Classification of credit union products

The manner in which a credit union must comply with the new financial adviser regime will in part depend on whether the credit union's financial products are Category 1 products or Category 2 products.

As referred to above, shares are Category 1 products but call credit union shares, as defined in the FA Act, are Category 2 products. The issue is whether any shares offered by credit unions come within the definition of "call credit union shares" under the FA Act?

Under the FA Act, a call credit union share is a share issued by a credit union under which:

- the member has a right to demand repayment of the value of the share in full at any time; and
- the credit union has an obligation to repay the value of the share in full not later than 1 working day after the demand is made.

The Friendly Societies and Credit Unions Act 1983 provides that a credit union may not issue shares except on terms enabling it to require not less than 60 days' notice of withdrawal (section 107(4)). In short, all shares issued by credit unions must require at least 60 days' notice of withdrawal. **Therefore, credit union shares cannot be considered call credit union shares under the FA Act and are Category 1 products, not Category 2 products.**

COMPLIANCE REQUIREMENTS

FSP Act

Under the FSP Act, each financial service provider must be registered as such and must belong to an approved dispute resolution scheme. Credit unions all fall within the definition of financial service providers and must therefore comply with the FSP Act. The financial service providers register will open for applications in July 2010. Registration becomes compulsory from 1 December 2010.

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FA Act

In addition, credit unions will have to consider whether they or their employees will have to be authorised as QFEs or AFAs under the FA Act.

A credit union will be caught by the FA Act if its employees or representatives are providing financial advice.

There are a number of different compliance options for credit unions. Application of these will depend upon the business model of the credit union and the nature of any financial advice given to members.

Where credit union does not give "financial advice"

If a credit union makes a determination that its employees are not giving financial advice to members (see our discussion above), the credit union will not be caught by the compliance requirements of the FA Act. The credit union will, however, still have to register under the FSP Act and join a dispute resolution scheme.

If this position is held, the credit union and its employees will have to be particularly vigilant to ensure that those employees do not make any statements to clients that could be construed as providing financial advice. The test is whether in the circumstances in which the advice is given, the member could reasonably expect the adviser to have taken into account the member's particular financial situation or goals.

Employees would only be able to provide generic information and advice. No advice could be tailored specifically to any particular member. For example, employees would not be able to ask a member about that member's personal financial situation or savings goals and then suggest particular share accounts that may assist the member in meeting those goals.

It is of note that if it is subsequently found that advice given to a member was financial advice, both the credit union and the relevant employee would be liable for fines under the FA Act. We suggest that this alternative will be both difficult to sustain and will reduce the ability to give meaningful advice to members.

Where credit union does give "financial advice" and registers as a QFE or registers individual employees as AFAs

The other option for credit unions is to accept that its employees may give financial advice to members and therefore to comply with the FA Act. This allows greater flexibility when dealing with members, but does incur compliance costs.

Compliance with the FA Act would involve either:

- registering the credit union as a QFE, in which case credit union employees would give advice as QFE advisers; or
- registering certain key employees as AFAs, which would mean that only those persons could give financial advice to the credit union's clients.

Register the credit union as a QFE

The first option is for a credit union to register as a QFE. Credit union employees would then be able to give financial advice on both Category 1 and 2 products as "QFE advisers".

To operate as a QFE, the credit union would need to apply to the Securities Commission for QFE status. This involves preparing an Adviser Business Statement. Further detail in relation to the content of this can be found on the Securities Commission website www.seccom.govt.nz. The application fee for a QFE is $4,500. Ongoing compliance fees are also payable.

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QFEs are responsible for their QFE advisers' compliance with the financial adviser obligations. Essentially, QFEs will have to ensure that their QFE advisers meet similar competency standards to those set out in the Code of Conduct for AFAs (referred to below).

Register employees as AFAs

The second option is for credit unions to register key employees as AFAs. The Securities Commission approval fee for each AFA is $840.

AFAs must abide by the Financial Advisers' Code of Conduct ("Code"). The Code is currently being finalised. The Code will specify minimum standards of competence, knowledge and skill, ethical behaviour and client care for AFAs. The Code will also specify the minimum requirements for education and training.

No person will be able to be approved as an AFA unless that person meets prescribed competency standards. Further details on the training and competency requirements for AFAs can be found at www.afacompetence.org.nz.

If a credit union did follow this option, the compliance obligations under the FA Act would rest on the individual AFAs and not the credit union. A disadvantage of this option would be that if an AFA left employment the credit union would have to find a new employee to provide financial advice. That new employee would need to meet all the educational and competency requirements to be authorised by the Securities Commission.

Whether a credit union chooses to register as a QFE or to register key employees as AFAs may depend on the size of the credit union and the number of employees who would actually be giving financial advice.

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