Financial Advisers Bill

16 November 2007

ATTORNEY-GENERAL

LEGAL ADVICE
CONSISTENCY WITH THE NEW ZEALAND BILL OF RIGHTS ACT 1990:
FINANCIAL ADVISERS BILL

1. We have considered whether the Financial Advisers Bill (PCO 8190/8) (the Bill) is consistent with the New Zealand Bill of Rights Act 1990 ('Bill of Rights Act'). We understand that this Bill is likely to be considered by the Cabinet Legislation Committee at its meeting on Thursday 22 November 2007.
2. We considered potential issues of inconsistency with sections 14, 17, 19, 21, 25(c) and 27(1) of the Bill of Rights Act and assessed whether or not these issues are justifiable under section 5 (Justified limitations) of that Act. To that end we examined whether the relevant clauses serve an important and significant objective, and whether there is a rational and proportionate connection between these clauses and that objective.[1]
3. We have reached the conclusion that the Bill appears to be consistent with the rights and freedoms affirmed in the Bill of Rights Act.

PURPOSE

4. The purposes of this Bill are to
    - provide for a comprehensive disclosure regime to ensure that members of the public can make informed decisions about whether to use a financial adviser and whether to follow advice from a financial adviser;
    - require financial advisers to meet competency requirements to ensure that members of the public hire financial advisers who have the necessary experience, expertise, and integrity;
    - provide for a regime under which financial advisers are held accountable for financial advice given; and
    - ensure that there are incentives for financial advisers to manage conflicts of interest appropriately.

BILL OF RIGHTS ACT ISSUES

Section 14 – Freedom of Expression

5. Section 14 of the Bill of Rights Act affirms the right to freedom of expression, which includes the freedom to seek, receive, and impart information and opinions of any kind and in any form. The right has been interpreted as including the right not to be compelled to say certain things or to provide certain information.[2]

6. We note, taking into account the various domestic and overseas judicial pronouncements on the issue, a two-step inquiry has been adopted to determine whether an individual's freedom of expression has been infringed. The first step involves a determination of whether a particular activity falls within the freedom of expression. The second step is to determine whether the purpose or effect of the proposed government action is to restrict that freedom.[3]

Clauses 12 to 23, 65 to 68, 78 to 81

7. Clauses 12 to 23 of the Bill prescribe a comprehensive disclosure regime that requires a financial adviser to disclose certain information to a consumer or client. For example, financial advisers will be required to disclose details about their experience, qualifications, whether or not they have a criminal conviction or have been declared bankrupt, their fees, and other interests and relationships.
8. Clauses 65 to 68 and clauses 78 to 81 of the Bill provide that the Securities Commission (the Commission) and the Court can issue disclosure and corrective orders in situations where the financial adviser has contravened a financial advisers' obligation or exemption (including disclosure obligations). Such orders may require a financial adviser to disclose or publish information or statements.
9. An important component of the first step in determining whether the freedom of expression has been infringed is that the communication in question must attempt to express an idea or meaning.[4] It is arguable whether this component is satisfied in relation to the information that has to be provided under these provisions because the information is of a factual nature and does not seem to be sufficiently expressive in nature to engage section 14. For completeness, we have considered whether, if the provisions place a limit on the freedom of expression, they are justifiable in terms of section 5 of the Bill of Rights Act.
10. The purpose behind the disclosure regime is to address information and knowledge asymmetries between financial advisers and consumers, so that a consumer has enough information to make informed decisions about whether to use a financial adviser and whether to follow the financial adviser's advice. We consider this a significant and important objective.
11. In our view the provisions setting out the disclosure obligations are also rationally and proportionally connected to this objective. The information to be provided is limited to factual information that is private to the financial adviser, and not obvious or otherwise available to members of the public. Making this information available to consumers limits the risk they may make ill informed decisions that are harmful to them.
12. We therefore consider that, if these clauses are considered to be prima facie inconsistent with section 14 of the Bill of Rights Act, they appear to be justified under section 5 of that Act.

Section 17 – Freedom of association

13. Section 17 provides that "everyone has the right to freedom of association". This provision recognises that persons should be free to enter into consensual arrangements with others, and to promote the common interests and objectives of the associating group. The right also extends to the right not to associate, and protects the right of individuals to decide freely whether they wish to associate with others.

Clause 9 (Prerequisites for performing financial adviser service for member of public)

14. Under clause 9(1) of the Bill, a person may not perform financial adviser services for a consumer unless that person is a member of an approved professional body. This requirement is enforced by means of an offence provision (clause 105 - Offence of performing financial adviser service for member of public without being member of approved professional body and registered). This raises an issue of prima facie inconsistency with the right not to associate.
15. The Ministry of Economic Development (MED) has advised that compulsory membership of an approved professional body is necessary to facilitate monitoring and enforcement of professional standards of financial advisers. This is needed to improve the professional reputation of the industry and make consumers more confident to seek financial advice. We find this a significant and important objective.
16. In our view these provisions are rationally and proportionally connected to this objective. The proposed regulatory regime is based on the principle of licensing (only those who are approved can practice) combined with the best features of industry self-regulation. MED has advised that monitoring and enforcing of professional standards may best be achieved by this approach. Examples of these best features are the reinforcement of professional norms, effective industry participation in the standards development process, and high levels of self-monitoring accompanied with State oversight. According to MED, a licensing model such as this cannot work without an institution of which licensees are a member. In this it differs from, for example, a name protection (registration or certification) regime, which provides for freedom of choice in terms of whether one wants the benefits associated with the protected name or not, and does not restrict who can carry out a particular occupation.
17. For these reasons, we have concluded that the limit that clause 9 places on the freedom of association appears to be justified under section 5 of the Bill of Rights Act.

Clauses 51 (Content of rules) and 52 (Characteristics of rules)

18. Clauses 51 and 52 prescribe in detail the content and characteristics of the rules of an approved professional body. The detailed prescription in clauses 51 and 52 affects the freedom of members of an association to freely regulate the internal affairs of their organisation. This arguably engages section 17 of the Bill of Rights Act.

19. MED advises that these clauses are characteristic of a co-regulatory regime. In order to be assured that the industry is able to regulate itself (and therefore ensure the competency and accountability of financial advisers in relation to financial advice), statutory parameters need to be put in place so that the industry regulator knows what it must do. This in turn promotes consistency across the different bodies. We find this to be an important and significant objective.
20. As clauses 51 and 52 only provide for minimum requirements for approved professional bodies, we are of the view that these provisions are rationally and proportionally connected to this objective. The Bill still allows for flexibility as different approved professional bodies can have different standards (within the statutory parameters) appropriate to the type of work undertaken by members of each approved professional body.
21. We, therefore, consider that these clauses appear to be justified under section 5 of that Act.

Section 19 – Freedom from discrimination

22. Section 19(1) of the Bill of Rights Act affirms the freedom from discrimination on prohibited grounds set out section 21 of the Human Rights Act 1993 including family status. In our view, taking into account the various domestic and overseas judicial pronouncements as to the meaning of discrimination, the key questions in assessing whether discrimination under section 19 exists are:
    i. Does the provision draw a distinction based on one of the prohibited grounds of discrimination; and
    ii. Does the distinction involve disadvantage to one or more classes of individuals?
23. If these questions are answered in the affirmative, the provision gives rise to a prima facie issue of 'discrimination' under section 19(1) of the Bill of Rights Act. Where a provision is found to be prima facie inconsistent with a particular right or freedom, it may nevertheless be consistent with the Bill of Rights Act if it can be justified under section 5 of that Act.

Clause 5(2) (Interpretation)

24. Clause 5(2) of the Financial Advisers Bill provides that "For the purpose of deciding whether a person (A) performs a financial adviser service for a member of the public, unless the context otherwise requires, member of the public does not include: (a) a relative or a close business associate of A (etc)."
25. This clause appears to make a distinction on the ground of family status as it excludes relatives from the scope of the terms 'members of the public'. Because the Bill aims to protect members of the public from harm resulting from advice provided by financial advisers who do not meet minimum standards required for membership

of an approved professional body, we have examined whether this distinction results in disadvantage to relatives of financial advisers.

26. We have reached the view that section 19(1) of the Bill of Rights Act is not engaged. We note that clause 5(2) provides that the terms 'member of the public' do not extend to relatives of financial advisers "unless the context otherwise requires". In our opinion this leaves enough room to apply the Bill to relatives of financial advisers where this is required by the circumstances of the case. For that reason, there appears to be no disadvantage and therefore no discrimination within the meaning of section 19(1).

Section 21 – Right to be Secure against Unreasonable Search and Seizure

27. Section 21 of the Bill of Rights Act provides:

"Everyone has the right to be secure against unreasonable search or seizure, whether of the person, property, correspondence or otherwise."

28. There are two limbs to the section 21 right. First, section 21 is applicable only in respect of those activities that constitute a "search or seizure". Second, where certain actions do constitute a search or seizure, section 21 protects only against those searches or seizures that are "unreasonable" in the circumstances.

Clauses 61 and 62

29. Clause 61 (Approved professional body must make annual report to Commission) requires an approved body to send the Commission a written report each year in relation to its activities and its financial statements. The objective of this provision is to assist the Commission in supervising the conduct of approved professional bodies and to ensure that they are performing in a manner that is consistent with the law.
30. Clause 62(1) (Approved professional body must give Commission other information and assistance on request) requires an approved professional body to give the Commission (or authorised person) information, assistance, and access to the approved professional body's facilities.
31. The requirements in clause 61 and clause 62(1) involve compulsory access to information in the context of the Commission's role of supervising the financial adviser regime. It also enables the Commission to exercise its power under clause 59 (Approved professional body must notify Commission of investigation into member misconduct) to assist in approved professional body's investigations into allegations of member misconduct.

32. The requirements in clauses 61 and 62(1) impinge to a certain degree upon reasonable expectations of privacy which members of the public (including financial advisers) would have in relation to that information. For that reason, these requirements constitute a search for the purposes of section 21 of the Bill of Rights Act.
33. MED has advised that the safeguards that exist for the exercise of the power in clause 62 are that the Commission's request must be 'reasonable' for it to carry out its duties (clause 62(1)) and it must be required by notice in writing (clause 62(2)). Further safeguards are provided by means of clause 137 of the Bill that requires that the Commission complies with the requirements of Part 3 of the Securities Act when carrying out its inspection powers under clause 62 of the Bill.
34. According to MED this means that the Commission, inter alia:
    - may inspect only for the purposes of the Bill (refer s. 68 Securities Act 1978);
    - must be satisfied that the inspection is for the purpose of the Financial Advisers Bill (refer s. 68 Securities Act 1978);
    - must have considered any matters relating to the necessity or expediency of carrying out an inspection, for example, whether the information is practicably available from another source in the time available (refer s. 68 Securities Act 1978);
    - can employ only those powers in the course of exercising a power of entry, that are listed in section 67 of the Securities Act 1978 (i.e. require any person to produce a document for inspection, reproduce the document, inspect and make records of the document, and if reasonably required, remove the document for a period of time that is reasonable in the circumstances)
    - must meet the requirements of those exercising powers under the Securities Act 1978, such as: production of evidence of the person's authority to inspect (section 68A), suitably qualified to inspect (section 68A), limits on disclosure of information gained in an inspection (section 68D), and can only keep documents seized for the amount of time that is reasonable in the circumstances (section 67(1)(d)).
35. In light of these safeguards, we have concluded that the requirements in clauses 61 and 62(1) are reasonable and, therefore, are not inconsistent with section 21 of the Bill of Rights Act. In reaching this conclusion we note that the ability to require documents is less of an intrusion into the expectation of privacy than a power of entry.[5]

Section 25(c) – Right to be presumed innocent until proved guilty

36. Section 25(c) affirms the right to be presumed innocent until proved guilty. This means that an individual must not be convicted where reasonable doubt as to his or her guilt exists. The prosecution in criminal proceedings must therefore prove, beyond reasonable doubt, that the accused is guilty.
37. Reverse onus offences give rise to an issue of inconsistency with section 25(c) because the accused is required to prove (on the balance of probabilities) a defence to escape liability. In other criminal proceedings an accused must merely raise a

defence in an effort to create reasonable doubt. Where an accused is unable to prove the defence, then he or she could be convicted even though reasonable doubt exists as to his or her guilt.

38. Similarly, a provision which requires an accused person to disprove (on the balance of probabilities) the existence of a presumed fact, that fact being an important element of the offence in question, would also be prima facie inconsistent with the presumption of innocence.
39. The Bill contains the following reverse onus offences:
    - Clause 105 (Offence of performing financial adviser service for member of public without being member of approved professional body and registered)
    - Clause 106 (Offence if false representation as to membership of approved professional body or registration)
    - Clause 108 (Offence of deceptive, misleading, or confusing disclosure)
    - Clause 109 (Offence of deceptive, misleading, or confusing advertisement)
    - Clause 115 (Offence of failing to comply with Commission's orders)
40. Under clause 126 (Knowledge of matters presumed if employee or agent knows matters) it is presumed, in the absence of proof to the contrary, that a person knew of any matter if an employee or agent of that person knew of the matter in his or her capacity as employee or agent.
41. The following offences in the Bill may also give rise to an issue under section 25(c) BORA by virtue of clause 126:
    - Clause 107 (Offence for failure to comply with financial advisers' disclosure obligation)
    - Clause 110 (Offence of recommending or receiving money in connection with offer of securities when subscription illegal)
    - Clause 116 (Offence of contravening financial adviser banning order)
    - Clause 117 (Offence of contravening section 99 (automatic banning)
    - Clause 118 (Offence of contravening Court order under section 102 or 103)
42. All of these clauses give rise to an issue under section 25(c) of the Bill of Rights Act because a defendant may be required to prove or disprove something to escape liability.

Clauses 105 and 106

43. Clause 105 provides that a financial adviser commits an offence if that person contravenes clause 9, which stipulates that a person must not perform a financial adviser service for a consumer unless that person is a member of an approved professional body and is registered. It is a defence under clause 105(2) if the person proves that the person did not know, and ought not reasonably to have known, that the person was not registered.
44. A person commits an offence under clause 106 if she or he falsely represents that she or he is a member of an approved professional body and is registered. It is a defence under clause 106(3) if the person did not know, and ought not reasonably to have known, that she or he was not registered. We note that clause 12(c) (Financial adviser must disclose experience, qualifications, professional standing, etc) requires

a financial adviser to disclose the name of the approved professional body of which the financial adviser is a member.

45. The objective of these provisions in general is to ensure that persons who provide financial adviser services are qualified and competent to provide these services by ensuring they meet minimum standards required for membership of an approved professional body. Those falling below these standards may be held accountable for their acts or omissions. We have noted the objectives of compulsory membership of an approved professional body (as described in paragraph 15 above) and of the disclosure obligations in clause 12 (refer paragraph 10).
46. In our view, these clauses have significant and important objectives. They contain offences that are regulatory in nature (as opposed to ones that are truly criminal) and the information that can exonerate the defendant is information that is peculiarly in the realm of the defendant.
47. When examining the proportionality of the proposed penalties, we note that as a general principle, reverse onus offences should carry penalties at the lower end of the scale. The penalty for committing an offence under these provisions is a fine on summary conviction not exceeding $300,000 for a body corporate, and $100,000 for an individual.
48. These penalty levels, although rather high, are comparable to the penalty levels for similar offending under the Securities Markets Act 1988 for investment advisers and brokers (not yet in force) and are not disproportionate. They reflect the potential harm that may arise as a result of the offending. For example, offending may lead to a member of the public acting on sub-optimal advice by purchasing an unsuitable financial product, which in turn could generate substantial losses for that person, as well as resulting in income for the adviser which the adviser might not have received if the consumer had purchased a different product. The level of penalty must be sufficient to act as a deterrent for financial advisers in individual cases, as well as to deter systemic conduct which could have an effect on wider consumer confidence in the industry.

Clause 108 and 109

49. The disclosure obligations for financial advisers are reinforced by offence provisions. Clause 108 makes it an offence if a financial adviser makes disclosure that contravenes clauses 20 (Disclosure must not be misleading) or 21 (Disclosure of additional information). It is a defence under clause 108(2) if the adviser proves that, at the time when the disclosure was made, the adviser believed on reasonable grounds that the disclosure was not deceptive, misleading, or confusing.
50. It is an offence under clause 109 if an advertisement contravenes clause 27 (Advertisement by financial adviser must not be deceptive, misleading, or confusing), and has been distributed to a person, and was authorised or instigated by, or on behalf of, the adviser, or prepared with the co-operation of, or by arrangement with, the adviser. It is a defence under clause 109(2) if the adviser proves that, at the time when the advertisement was distributed, the adviser believed on reasonable grounds that the advertisement was not deceptive, misleading, or confusing.

51. MED has advised us that the disclosure regime for financial advisers is the key aspect of the proposed regulation. This regime provides potential consumers with sufficient information about the adviser, so that they can make informed decisions about whether to accept the advice or not. As the decisions taken by consumers may be potentially significant, it is important that consumers be provided with accurate and truthful information prior to making financial decisions in relation to financial advice. The same rationale applies in relation to accurate and truthful advertising in relation to financial advisers. We consider these significant and important objectives.
52. We also note that the provisions contain offences that are regulatory in nature. Further, in both cases, the evidence as to why the defendant believes that he or she or it has not made a misleading, deceptive or confusing advertisement will be peculiarly within the defendant's knowledge. The defendant will know the reasonable grounds on which the belief is based better than the prosecution in any instance.
53. The penalty for committing an offence under these provisions is a fine on summary conviction not exceeding $300,000 for a body corporate, and $100,000 for an individual. The penalty levels are at the same quantum as those under the Securities Markets Act 1988 for investment advisers and brokers (not yet in force) and reflects the seriousness of the offence (refer to the discussion in paragraph 48).

Clause 115

54. Clause 115 provides that it is an offence to contravene a (prohibition, corrective or disclosure) order made by the Commission under subpart 1 of Part 4 of the Bill. It is a defence under clause 115(2)(a) if the person proves that the contravention occurred without the person's knowledge or without the person's knowledge of the order.
55. This offence ensures that where necessary the Commission may direct financial advisers to act in certain matters. These powers to make orders enable the Commission to rectify minor breaches of the law (including the disclosure regime in the Bill) efficiently.
56. We consider that the evidence as to whether the contravention occurred without the defendant's knowledge, or without the defendant's knowledge of the order will be in the realm of the defendant. The defendant will be in a better position to raise evidence supporting the lack of knowledge.
57. The penalty for committing an offence under these provisions is a fine on summary conviction not exceeding $30,000. Given the risks to consumers in such instances, the penalty as such, has been aligned with the penalties for similar offences in the Securities Markets Act 1988 (refer to the discussion in paragraph 48).

Clause 126 and clauses 107, 110, 114, 116, 117 and 118

58. Several clauses in Part 4 of the Bill, including clauses 107, 110, 114, 116, 117 and 118, purport to ensure that where a person knowingly breaches the requisite

minimum standards or where a person breaches a Court order, that the person is accountable for that breach.

59. Where both the employer and the employee are a registered financial adviser, employers can also be held accountable for offences committed under the Bill by their employees. As employers will in many instances not be connected to the act involved in committing the offence, it will be very difficult for the prosecution to establish the requisite mental element. For that reason, clause 126 provides the presumption that they did have the required knowledge of the act.
60. Employers would, however, have information relating to the terms of employment, and other information in the day-to-day employment environment. As such, if the act truly occurred without their knowledge, they would be able to provide information that could easily demonstrate that the employee's act was outside the scope of that employee's duties, or that the employee acted on his own volition without providing any information to the employer.
61. The offences in clauses 107, 110, 114, 116, 117 and 118 are regulatory in nature. The penalty for committing an offence under clauses 107, 110 or 114 is a fine on summary conviction not exceeding $300,000 for a body corporate, and $100,000 for an individual. The penalty for committing an offence under clauses 116, 117 or 118 is a fine on conviction on indictment not exceeding $300,000 for a body corporate, and $100,000 for an individual.
62. Although the fines cannot be considered to be at the lower end of the scale, they do not appear to be disproportionate. These penalties have been benchmarked against those in the investment adviser provisions of the Securities Markets Act 1988 for similar offences which were introduced in 2006. These reflect the potential harm that may arise as a result of failing to comply. The level of penalty must be sufficient to act as a deterrent for financial advisers in individual cases, as well as to deter systemic conduct which could have an effect on wider consumer confidence in the industry. This reflects the gravity of such a breach.
63. For these reasons outlined above we consider that the limitations in the Bill on the presumption of innocence under section 25(c) of the Bill of Rights are justified under section 5 of that Act.

Section 27(1) – Right to natural justice

64. Section 27(1) of the Bill of Rights Act provides that every person has the right to the observance of the principles of natural justice by any tribunal or other public authority which has the power to make a determination in respect of that person's rights, obligations, or interests protected or recognised by law. The Court of Appeal has stated that observance of the principles of natural justice is a flexible concept and is very much fact specific.
65. The right in section 27(1) affirms that decisions are made in a procedurally fair way. Natural justice requires, inter alia, that a decision-maker hears all parties, whether in writing or orally. The parties need to receive adequate notice of a decision, hearing or complaint.

66. Several provisions in the Bill give the responsible Minister or the Commission the ability to make decisions that affect the interests of financial advisers or approved professional bodies (for example, clause 45 - Withdrawal of approval)
67. MED advises that in reality, throughout the inquiry or decision-making process, the Commission will interact with the body. Further, the Minister is free to discuss any matter with any party in determining whether approval should be withdrawn. To this end, clause 50 of the Bill provides that in exercising his or her powers under this Act, the Minister may consult the Securities Commission and any affected party, including an approved professional body.
68. On balance, we consider that approved professional bodies have sufficient opportunities to be heard. We also note that the Minister must take his decision in a manner that is consistent with the Bill of Rights Act. We have, therefore, concluded that these clauses do not raise an issue of inconsistency with section 27(1) of the Bill of Rights Act.

Clauses 71 (Commission must follow steps before making orders) and 72 (Commission may shorten steps for specified orders)

69. Under clause 71(1)(b) the Commission has to give notice prior to making an order under Subpart 1 of Part 4 of the Bill. The notice provisions require the Commission to notify those affected by its orders as follows:
    - 24 hours before the Commission makes the order, in the case of an order specified in clause 72(3) (i.e. a prohibition or corrective order for a financial advisers' obligation or exemption if that order is stated to apply for a period of 14 days or less; or a temporary banning order)
    - 48 hours before the Commission makes the order, in the case of any other disclosure order; or
    - 7 days before the Commission makes the order, in the case of any other prohibition or corrective order.
70. Clause 72 authorises the Commission to make the orders set out in subclause (3) more urgently than clause 71 permits – therefore with less than 24 hours' notice – if it thinks that this is necessary or desirable in the public interest.
71. Under clause 71(1)(c) and (d) of the Bill, the Commission must give each person to whom the notice of the order must be given an opportunity to make written submissions within that notice period or be heard (and be represented by counsel) at a meeting of the Commission after the expiry of that notice period. In making its decision to make the order, the Commission must have regard to any written or oral submissions made (subclause (1)(e)). However, where the Commission makes an order more urgently in accordance with clause 72, the Commission may give persons an opportunity to make only oral submissions, not written, to a member, officer, or employee of the Commission.
72. We have examined whether these clause 72, by permitting such short notice periods in which submissions, if made, must be brought, and by permitting only oral submissions, amounts to an effective denial of the right to be heard and therefore to the right to natural justice.

73. MED advises that a disclosure order may need to be done within a very short timeframe so that an offending advertisement or incorrect disclosure can be quickly remedied, and its exposure to the public (which might be harmful) can be minimised. The notice period is intended to make time available for the financial adviser to voluntarily correct the statement (advertisement or disclosure).
74. In view of the fact that the objective is to prevent harm to the public, and the rationale of the disclosure regime in the Bill, we have concluded that the clause 72 is not inconsistent with section 27(1) of the Bill of Rights Act.

CONCLUSION

75. We have concluded that the Bill does not appear to be inconsistent with the rights and freedoms affirmed by the New Zealand Bill of Rights Act 1990.

Jeff Orr	Stuart Beresford
Chief Legal Counsel	Acting Manager
Office of Legal Counsel	Human Rights/Bill of Rights Team

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1. In applying section 5, we have had regard to the guidelines set out by the Court of Appeal in *Ministry of Transport (MOT) v Noort* [1993] 3 NZLR 260; *Moonen v Film and Literature Board of Review* [2000] 2 NZLR 9; and *Moonen v Film and Literature Board of Review* [2002] 2 NZLR 754.

2. *RJR MacDonald v Attorney-General of Canada* (1995) 127 DLR (4th)1

3. *Ross v New Brunswick School District No 15* [1996] 1 SCR 825

4. *R v Keegstra* [1990] 3 SCR 697, 729, 826

5. *Trans Rail v Wellington District Court* [2002] 3 NZLR 780, 791-792
