

What should you expect from a financial adviser?

In the wake of the finance company failures many are rightly questioning the value of the financial advice they may have received. There has also been plenty of finger pointing from within the advisory community - some of it informed, and much of it not. In this article Simon Hassan, an experienced adviser, and President of the Institute of Financial Advisers, gives some straightforward answers to the important question "What should you expect from a financial adviser?".

During the last couple of years tens of thousands of Kiwis have lost more than half a billion dollars in finance company failures.

Many have lost a lifetime's careful savings - a nest egg accumulated through years of careful budgeting and doing without.

Some did not seek advice, and entrusted their life's savings to a shoddy company on the basis only of a newspaper ad featuring a credible looking name and a high interest rate. Others paid for professional advice - and lost money all the same.

There is risk in all investments

We must be clear from the start that all investments carry a degree of risk, and that some risks cannot be predicted or guarded against. To use an extreme example, few if any investors considering an investment in central New York before September 2001 would have considered the possibility that the Twin Towers could be struck by passenger liners and destroyed.

Few finance company investors would be concerned about risks of this type. But the fact remains that making any investment involves taking some risks.

Risks can be managed

On the other hand many investment risks can be avoided, managed or reduced by commonsense strategies like doing your homework (professionals call this research), and by not putting all your eggs in one basket (professionals call this diversification). Managed this way, risk can be positive for an investor - because in the end a well chosen diversified mix of risky investments usually does better than safer investments.

Given the complexity and the risks involved, it is not surprising that many people do look for professional advice on their investments. If you have paid for advice (either directly - through fees, or indirectly - through commissions from a product provider), or if you are considering getting advice about your investments, how should you choose your adviser, and what should you expect?

What does the law say?

Until now, the law in this area has fallen very short. And changes taking effect at the end of February 2008 don't go far enough.

For now, anyone can call him or herself a financial adviser. You don't need any qualifications. You don't need any supervision. You don't have to belong to a professional body. You don't have to belong to have a formal way of dealing with disputes. And until 29 February 2008 - unless asked a specific question, you don't have to disclose anything other than certain criminal convictions, bankruptcy and banning orders.

From 29 February 2008 amendments to the Securities Markets Act 1988 will change the rules on disclosure by investment advisers (but not other kinds of financial advisers), but that's pretty much all.

It will not be until 2012 when new law is expected to come into full force regulating all financial advisers and addressing most of the current gaps.

From 29 February, before they give you investment advice, an adviser will have to tell you in writing (whether you ask them or not) about their:

- Experience and qualifications
- Criminal convictions, and adverse findings in any court on their professional role
- The nature and level of any fees charged
- Details of remuneration or rewards the adviser has received/will receive from anyone else
- Other interests and relationships that could affect the advice, and
- Types of securities the adviser advises on.

Will the new law protect you?

Not well enough.

The improved disclosure rules in the amended Securities Markets Act only mean that investors will know more about who they are dealing with (if they read and understand their disclosure document).

The wider law expected in 2012 will be a much bigger improvement, but there will still be gaps. The form that is likely to take was revealed just before the end of 2007 when the Financial Adviser Bill was tabled in Parliament. After consultation and select committee processes over coming months the new law may be passed by the end of the year, but won't come fully into effect until 2012.

The proposed new law will apply to anyone who gives advice or guidance about financial products or decisions to the public for a living. This will cover a very large group of individuals and firms, and not only those who give investment, savings and insurance advice - it is also likely to cover advice on bank accounts, mortgages and other loans, general insurance, estate planning, tax and real estate investment. Depending on the fine print it may cover as many as 40-50,000 advisers.

But this won't happen until 2012. The main reason for the delay is that the law will require financial advisers to belong to an "Approved Professional Body" (APB). For the protection of the public APB's will:

- Set and enforce minimum standards for:
 - Competence
 - Education
 - Conduct, and
 - Ethics; and
- Have complaints and discipline processes.

The delay is to enable professional bodies to form, be approved, and then give advisers time to meet their requirements to join.

Of course regulation won't mean the end of problems. Laws don't change human nature. Lawyers and accountants have been regulated for years, and yet members of those professions are regularly exposed as crooks. Financial advisers are regulated in Australia, but that hasn't stopped ordinary folk across the ditch being preyed upon by financial sharks.

But regulation will mean that unprincipled and incompetent advisers can be taken out of business, and face real financial penalties. Nonetheless the changes will be a big improvement on what we have now - after 2012.

This is of course no use at all to consumers who need to make decisions before then.

But all is not lost. There is already a professional body that meets virtually all the requirements expected under the new law, and more in some areas. This is the Institute of Financial Advisers.

The Institute of Financial Advisers

The Institute, with 1250 practitioner members, is the largest professional body for financial advisers in New Zealand, representing about three quarters of advisers who belong to any body. The primary reason the Institute exists is to set and enforce professional standards for advisers - in the interests of Kiwi consumers.

The Institute is committed to helping create an environment in which Kiwis can have confidence about the financial advice they receive. It is keen to help educate the public about financial decision making and is involved with a number of financial literacy projects around New Zealand.

The Institute already requires members to disclose remuneration and conflicts, submit to rigorous, independent complaints and disciplinary processes, and follow a [code of ethics](#) and [practice standards](#) that among other things require them to:

- Act in the interests of clients (this is a higher standard than expected in the new law, which will require advisers only to "act with integrity")
- Act only where they are competent
- Undertake an average of 30 hours a year of ongoing education
- Ensure that their advice has a reasonable basis
- Make all the disclosures that are to become law for investment advisers required - and more
- Ensure that their remuneration is fair and reasonable, and
- Have professional indemnity insurance cover for the protection of clients.

But under current law membership of the Institute is voluntary - and perhaps not surprisingly most financial advisers choose not to belong. Membership imposes obligations - it is a "business risk". Some prefer not to join to avoid the risks. Others don't want the cost (membership costs \$550 a year). Others, often those later in their careers don't want to face the hurdle of getting qualified.

Ask your adviser if they belong

Of course the Institute can only regulate its members. But a very basic question that any investor should ask an adviser is whether they belong. You can [check this out - or find a member near you](#) - by going to the Institute's website www.ifa.org.nz, or by calling its national office on 0800 404 422 during business hours. You can also contact the Institute with questions, or to lay a complaint about a member.

In 2012, or whenever the new law arrives, New Zealand will be the last OECD country to regulate its financial advisers. It's a great pity that successive governments have taken so long to get the process underway - something we have wanted for years. And it's a crying shame that the finance company collapses happened before the reforms were in place.

Meanwhile the Institute is working with Government, the Ministry of Economic Development, the Securities Commission and other professional bodies to ensure that the new environment - when it arrives - will live up to its expectations.

Some investment basics

Plenty of experts have been prepared to comment on events around the finance company collapses and criticise those who lost money and/or their advisers. But I haven't seen anyone prepared to give clear guidelines on what investors should have done. More on that later, but first here are some investment basics.

As I said earlier the golden rule of investing is to diversify - spread things around. Generally a portfolio should consist of a mix of "risky" assets like shares and "safer" assets like bank deposits. More in risky assets if you have a long time frame and/or no immediate need for investment income. More in safer assets if you need an income and/or if your investment is short term.

The basic mistake made by many who lost money in finance companies (or the mistake made by their advisers) may have been to look for higher returns from interest-bearing assets rather than from traditional sources of investment risk, like property or shares. Unlike shares and property, interest-bearing investments only have "downside" risk. They either pay you what they promised or (if things go wrong) less than that.

Shares and property have both "downside" and "upside" risk. When the share market turns down (as it has here and overseas in recent weeks) someone with a well chosen mix of shares usually only has to wait to see values come back up again. Time is their friend.

"High interest" usually also means "high risk", and often when an interest-bearing investment gets into trouble the only question that remains is how much of each dollar you will eventually get back. Time is your enemy. The longer a fixed-term investment is from maturity the greater the chance of things going wrong.

There are no hard and fast rules, and it can depend on a variety of factors like those in the bulleted list below. But if you had \$200,000 to invest for 10 years or more, and a balanced portfolio was right for you, then about half of the total might go into interest-bearing investments of one sort or other. Of this, only a small part - if any - into higher-interest (read "higher-risk") deposits, say no more than \$10,000 in total.

And no matter what, unless you want to gamble, you shouldn't put all your money with a single or a few high-risk (read "high-interest") finance companies.

What should you expect from a competent financial adviser?

Before giving you any advice they should take the time to learn about your situation, needs and attitudes. In your initial discussions they would have learned key things about you:

- Your time horizon (how long you were planning to invest for)
- How much income if any that you need
- Details of your wider situation, especially of any debt
- Details of other resources, and especially of any other investments
- Your experience and sophistication as an investor
- How you feel about investment risk (your risk appetite), and
- How much risk you can afford to take (your risk capacity).

Their advice would take account of all these things and form part of that bigger picture. It should also conform to core principles like those explained above, including the need to:

- Diversify (even at the most basic level we all know it's foolish to put all your eggs in one basket)
- Match your time frames and those of your investments (you wouldn't invest short-term money in a long-term investment)
- Ensure that there is a "reasonable basis" for any advice or recommended investment (such as an external research report, or some other robust evidence of suitability).

And on top of that, even it is wasn't the law, a competent adviser who is also a professional would be sure to give you all relevant details about anything that could have influenced their advice - including:

- Their remuneration (fees and or commissions) or other rewards (including "soft dollar" incentives like trips) they will get if you follow their advice, and from whom
- Any relationship or constraint that could have affected their advice, and of course
- Full details of any conflict of interests (such as if the investment recommended offered them twice what other similar alternatives offered).

What can you do if you get poor advice?

If your adviser was a member of the Institute of Financial Advisers at the time; and if they were being paid to give you advice (rather than just acting on your instructions for example - advice costs money and not everyone is willing to pay); and if any of the key elements listed above was missing from the process they went through with you - then you may have a valid basis on which to lay a complaint and you should contact the Institute (www.ifa.org.nz). The Institute will not protect a member who has breached its rules or the law.

If you have lost money as a result of poor advice, you may be able to sue for damages (on your own, as part of a group). You should contact EUFA (www.eufa.co.nz) or your solicitor. EUFA is a ginger group set up to help those who lost money because of poor advice or the unacceptable behaviour on the part of suppliers of financial products.

We deserve to live in a society where people can be confident in relying on those they go to for advice about investments and other financial decisions. New laws will help, but in the meantime you should be sure you deal with a member of the Institute of Financial Advisers.

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