



## **IFA Submission on Code Committee Paper on Ethical Behaviour and Client Care for Authorised Financial Advisers**

### **Introduction**

1. The Institute of Financial Advisers (IFA) welcomes the opportunity to formally comment on this paper. As for our comments on the competency paper, we have been mindful of the likely overall impact of regulation of financial advisers and the potential impact on the availability of Authorised Financial Advisers (AFA) to consumers of financial advice.

### **Overall view**

2. The main points in this submission are:
- The draft Code and proposed standards do not provide a cohesive overall framework for AFA advisers. There is a mixture of statements of principle together with some very specific prescriptive requirements concerning processes or record keeping. These do not sit easily together.
  - If the Code is to promote professionalism for retail advisers, then it should include a complete principle-based code of ethics and practice standards. What is included in the proposed standards is only a partial code of ethics, with a focus on what might be thought of as “areas of concern”, rather than covering the broad principles.
  - While the principles that are included are appropriate, they are a sub-set of the internationally accepted principles<sup>1</sup>.
  - An expanded set of principles that is better aligned with international standards would enable a less prescriptive approach in the proposed standards. We also wonder why different wording has been chosen than is in the international standards.
  - The draft Code appears to have been drawn up to apply to investment advisers and financial planners who also provide investment advice. Since anyone providing a “financial planner service” is required to become AFA, many risk insurance advisers will be AFA and covered by the Code. Many of the provisions don’t work for insurance advisers. We suspect they won’t work for advisers

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<sup>1</sup> The Financial Planning Standards Board has developed a comprehensive code of ethics, practice standards and rules of conduct. These are in use by some 120,000 financial planning professionals. The practice standards are based on the six-step advice process that has been used to develop what the Code Committee has called Standard Set C for adviser competence that is part of the National Certificate in Financial Services (Financial Advice) Level 5.

working at the wholesale level either or for those whose roles is investment transactions rather than advice.

- We have considerable difficulty with the section on “independence” which we consider unhelpful and based upon a restrictive interpretation, especially in relation to approved product lists and platforms. We recommend an alternative approach that places greater emphasis on disclosure of potential conflicts of interest, including remuneration.
- The proposed standards go beyond what would be expected in a code of behaviour and intrude into determining the business model of advisers. Examples include the proposed standards about suitability and the suggestion that commission should be banned. We consider that banning commission may well be beyond the scope of what is listed in s.86 of the Financial Advisers Act as the requirements for the Code. In any case, in IFA’s view, it would be undesirable for such a major change to be introduced without legislation.
- If commission were to be banned, there would be considerable practical issues relating to commission for insurance advisers. Most risk insurance is distributed through authorised agents who receive commission. Commission is paid by the product company and the client makes no payment other than the policy premiums. A ban on commission for risk insurance would require the client to make a direct payment to the adviser. This is likely to result in a significant reduction in the volume of insurance purchased, adding to the well documented “under-insurance” in NZ. The result would be greater call upon social welfare benefits from families who might otherwise have taken out insurance.

3. Turning to the specific questions in the paper.

**Q1. Are the ethical behaviour principles (client first and integrity; independence, objectivity and managing conflicts of interest; and good conduct) appropriate to base ethical standards upon? If not, what are the appropriate principles?**

**Response**

4. These principles are appropriate, but are a sub-set of the internationally accepted principles. These are: Client first, Integrity, Objectivity, Fairness, Professionalism, Competence, Confidentiality and Diligence. The first three are in the draft Code, but the last five are not stated as principles, though some aspects are reflected in the client care principles and specific proposed standards.

5. We wonder whether an expanded set of principles that is better aligned with international standards would enable a less prescriptive approach in the proposed standards. We also wonder why different wording has been chosen than is in the international standards.

**Q2. Are the client care principles (professionalism; suitability; capability and capacity; effective communication; effective dispute resolution; compliance and custody) appropriate ones to base client care standards on? If not, what would be the appropriate principles?**

### **Response**

6. The items listed do seem appropriate, though “effective dispute resolution” and “compliance and custody” don’t really seem to be principles. Rather they seem to be headings for sets of prescriptive requirements.

### **Q3. Do you think that the proposed over-arching ethical standard is appropriate? Should it apply to all AFAs?**

### **Response**

7. The proposed standard 1 is actually two principles rather than one and it would be better if they were separated.

8. IFA supports both principles as being appropriate – especially since they are drawn from our own Code of Ethics. We consider they should apply to all AFAs.

9. While the Code will not directly apply to QFEs, IFA is firmly of the view that these two principles should be made a requirement for QFE advisers. Our reasoning is that advisers who are part of a QFE have to take considerable effort to comply with the principle of “client first” and in making sure that the product solutions are suitable for the client, since they will be able to provide advice only in relation to products where the QFE is the issuer or the promoter. This will require special care where the approved products may be less suitable than those available from other providers, but which the QFE adviser is unable to offer. The danger for the client is that they will not be made aware of the constrained choice of solution. If these principles are not required for QFE advisers, then there will be a double standard, with QFE’s subject to lower requirements and a reduction in consumer protection.

### **Q4. Should proposed standard 2 include a requirement that the client must expressly consent to a lack of independence and/or lack of objectivity?**

### **Response**

10. We have considerable difficulty with the terminology used, especially as neither independence nor objectivity are defined. Objectivity is defined in IFA’s Code of Ethics: “Objectivity requires intellectual honesty and impartiality. Regardless of the services delivered or the capacity in which a financial adviser functions, objectivity requires financial advisers to ensure the integrity of their work, manage conflicts and exercise sound professional judgment.”

11. IFA suggests that the Code should adopt objectivity as a principle and define what is required to provide professional services objectively.

12. The term independence is fraught with definitional difficulties – for reasons explained below. It should not be linked with objectivity as the two concepts differ.

13. IFA’s preference is to avoid use of the term and to concentrate effort on use of other terminology, such as “non-aligned”, where there are clear boundaries, but to require very clear disclosure of potential conflicts of interest and how they are to be managed.

14. The concept of “independence” has been raised at many of the meetings held by the Code Committee. Members of the Committee have expressed views that anyone who receives commission cannot be considered as independent. IFA has consistently followed the Advertising Standards Authority ruling from around a decade ago, that an adviser cannot call themselves “independent” if they receive commission. However, this restriction on the use of the term does not mean that an adviser who receives commission cannot be objective in providing advice.

15. We would also like to point out that the focus of the Code seems to be investment advice and commission on investments. Insurance advisers who provide a comprehensive service to their clients may be considered as providing a financial planner service, so would need to be AFA. These advisers would be subject to the Code. However, virtually all risk insurance advice is commission-based, so this requirement would suggest that virtually no risk insurance adviser would be considered independent, and that their objectivity is subject to question. This is far from the reality as there are many non-aligned risk insurance advisers who provide objective advice in the best interests of their clients, recommending products from a variety of product providers, depending upon product features and their suitability for their clients.

16. Code Committee members have also suggested that anyone who works from an approved product list (rather than considering the full universe of products for each client) is not independent. It was even suggested that any adviser using a platform could not be considered independent since the platform might constrain the products they were able to offer.

17. For practical reasons it is not feasible for an adviser to consider the universe of product offerings for every client. Typically, advisers use some form of approved product list. The products on the list will have been chosen through a research process, either their own personal research or through contracted research. For larger adviser firms or groups of firms, there are typically formal committees that approve the products to go on the list.

18. IFA’s view is that the use of “approved product lists” does not by itself mean that an adviser automatically lacks independence and objectivity. We consider that proposed standard 2 is tackling the wrong issue by using the term “independent” and then defining that in such a restrictive manner that it cannot be achieved in any practical sense.

19. IFA suggests that the standard should require an adviser to be objective in providing advice and that any factors that could potentially impair objectivity or the appearance of objectivity should be clearly disclosed to the client. Essentially, these are the potential conflicts of interest that may arise through business relationships or the way in which the adviser practice is structured. This would encompass the potential conflict arising from the way remuneration is structured, the selection of product range, use of wraps or platforms, alignment with particular product providers, etc.

20. We consider that it is important that the way the standards are expressed does not constrain the varied business models that adviser practices are able to adopt.

21. IFA recommends that the Code standards adopt a different approach. We consider that using a restrictive, rather purist definition of “independent” is not useful to consumers. With the requirement to put the client’s interests first, IFA considers that the emphasis should be placed on disclosure of potential conflicts of interest. Remuneration and commission create potential conflict of interest. So too does being an aligned adviser, especially an adviser who is part of a QFE, even if they receive a salary rather than commission. So, we suggest that the emphasis should be on whether an adviser is capable of providing objective advice and disclosure of any potential conflicts of interest that may impact on objectivity. The client should agree to the terms of the engagement after having been provided with the necessary disclosure, which is typically included in the disclosure statement.

22. We note that though this is not part of the Code, the very limited disclosure proposed for advisers who are part of a QFE, will potentially mean that their clients are not made aware of the inherent conflict from the limitations on the products available through a QFE adviser. IFA strongly recommends that QFE advisers on category 1 products should be made subject to the Code provisions and required to make disclosure in the same manner as AFAs.

**Q5. Are the safeguards listed in proposed standard 2(2) appropriate? Are there other safeguards that should be included?**

**Response**

23. We consider the proposed safeguards are too narrow and seem to be based on an assumption that the standards apply only to investment advisers and that advice is being delivered in a particular manner that would make “independent” advice viable as a solution to potential conflict of interest.

24. Global standards provide for independent advice, but this is typically as a means of overcoming limitations on the competency of an adviser (e.g. seeking independent estate planning advice, while the main adviser develops an overall financial plan).

25. Advisers are concerned that requiring what are effectively second opinions, could mean a requirement to send a client to a competitor. There are also concerns that the second opinion might be based upon personal preferences (e.g. in the manner of construction of an investment portfolio) rather than an objective view.

26. As stated earlier, IFA’s preference is to strengthen requirements for disclosure of potential conflicts of interest, together with guidelines on how they might be dealt with.

**Q6. Is it sufficient that AFAs who receive commission or payments from financial product providers or others in addition to, or instead of, payments from clients cannot call themselves “independent” or “objective”? Or should AFAs be required by the Code to indicate that they are not independent by specifying that they are “non-independent” or “aligned” or some other similar term?**

## Response

27. As set out at some length under the response to Question 4, our view is that use of the term “independent” in the restrictive manner proposed will not help consumers. Almost everyone has some potential conflicts of interest, since they are in business and need to earn income from providing a financial adviser service. IFA’s recommended solution is to define what should be disclosed as potential conflicts of interest. We favour terminology that is able to be clearly defined and measured on a factual basis, such as “aligned” or “non-aligned”. All QFE advisers are aligned. Non-aligned advisers may be objective, despite receiving commission.

28. The potential for lack of objectivity in relation to receiving commission rather than a fee or percentage of assets under advice, is where the rates of remuneration vary between products so that an adviser might be tempted to favour a product with a higher rate of commission. The practical reality of commission received by investment advisers is that few advisers receive “up-front” commission, but “trail commissions” are common. (Even where up-front commission is paid, it is often rebated.) The majority of trail commissions are very similar in rate for particular asset types, so the potential for favouring one company product over another is in practice usually quite limited. In any case, if the adviser discloses commission fully – including the differing rates that might apply to different products – then the client is fully informed and able to decide whether to accept the recommendations.

29. What also seems to be lost sight of in this debate is the need to find some practical mechanism for advisers to be paid on a “drip feed” basis, rather than entirely up-front if there was to be a fee-only basis. In practice, those with significant assets are prepared to pay fees (hourly or a fixed sum) or a percentage of assets under advice. Those with more modest assets favour some form of “drip feed” payment, since they do not wish to pay a lump sum. In many cases, advisers take on clients with modest assets, charge trail commissions that do not cover the cost of their time in preparing the initial recommendations, but do so in the expectation that they will develop a long term relationship with the client and that this will generate adequate income over the long term. In such a situation the adviser’s and the client’s interests are aligned to the extent that client retention and growing the client’s assets over a period of years will benefit both the client and adviser. (We have also made comments under Question 8 that are relevant and provided some data from a survey of IFA members.)

30. In passing, we note that for finance company debentures, the standard commission rate was 0.5% pa and a typical sum to be invested was \$20,000, resulting in commission of \$100 pa. This is hardly going to cover much time for discussions with the client, let alone research. We also wonder whether some commentators have misinterpreted data relating to overall commission paid as being an annual rate, e.g. in the example given 0.5% pa for a two year term is 1% overall, or \$200.

**Q7. Do you agree with the proposed independence, objectivity and managing conflicts of interests standards (proposed standards 2-4)? Should the standards be modified or expanded in any way? Are there other independence, objectivity or conflict of interests standards which should be included in the Code?**

## Response

31. As explained in the responses to questions 4-6, we consider the approach is wrong and the problem arises from seeking to use the term independent, but to define it in a restrictive manner.

32. IFA suggests that this standard be replaced with one requiring comprehensive disclosure of potential conflict of interest, including remuneration, with guidelines on how this disclosure might best be achieved.

**Q8. Some overseas regulatory bodies have considered stopping financial advisers from accepting commission. The Committee would like to hear your feedback and submissions on whether you think such an approach would be appropriate in New Zealand (so that receiving a commission without rebating it to the client would be a breach of the Code). What effect would this have on consumers and the industry in various sectors: insurance, investment, financial planning, credit contracts and any other relevant sector?**

## Response

33. We are concerned that the proposed standards go beyond what would be expected in a code of behaviour and intrude into determining the business model of advisers. We consider that banning commission may well be beyond the scope of what is listed in s.86 of the Financial Advisers Act as the requirements for the Code. In any case, in IFA's view, it would be undesirable for such a major change to be introduced without legislation.

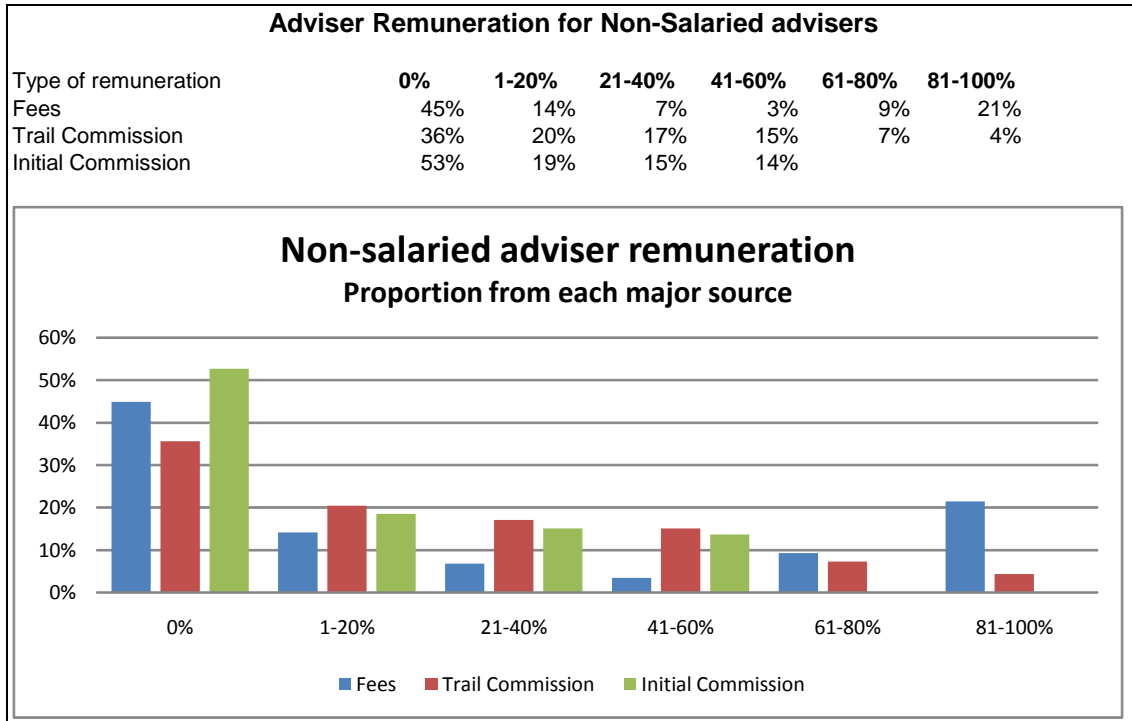
34. The discussion about commission – in the draft Code but also in the media – seems to largely be based upon hearsay without objective data on actual remuneration practice by financial advisers in NZ. Some media articles quote commission rates for investment products from other countries that exceed any known rates in NZ. In Australia, the debate is largely over commission in relation to their compulsory superannuation scheme. In NZ, KiwiSaver legislation places severe constraints on commission payable so there is no similar issue here. We understand that in the UK, moves to restrict commission is leading to consumers with modest sums to invest being unable to obtain professional advice.

35. In NZ, for investment products initial commission is much less common than it used to be. Even where it exists, the majority of advisers rebate any initial commission. While trail commissions are common for investment products, the rates paid by the various fund managers are generally very similar. The argument against commission is that it incentivises the adviser to select a product that pays a higher rate than another. The counter argument is that if the rates of trail commission on offer are very similar, the theoretical bias has little practical impact, and the ethical requirements - client first, professionalism and objectivity – become the driving force.

36. Advisers are already required to fully disclose commissions. Experienced IFA members report that their clients are comfortable with commission as a basis since it allows “drip feed” payment. Once the amount is fully disclosed, the risk of systemic bias in recommendations is

largely eliminated.

37. IFA has some limited data on remuneration practices for its members, drawn from a recent survey in October 2009. This is set out in the box.



38. This data needs to be interpreted with care as it covers all types of IFA adviser – financial planners, investment advisers and insurance advisers. It excludes members who are primarily salaried, e.g. those working for a bank, trustee corporation, so covers the two-thirds of advisers who are in small practices. It should be noted that around three-quarters of IFA members provide some investment advice and a similar proportion provide some insurance advice, with around 60% providing financial planning. This is to be expected as comprehensive advice typically covers both risk and investments, and may include financial planning. Some members are specialists, e.g. in risk insurance or in investments, but most provide a range of advice.

39. Some of the important information that can be drawn from the data.

- 30% of advisers receive the majority of their income from fees – with 21% of these receiving more than 80% of their income from fees.
- 45% received no fee income, which means that fewer than half received income solely from commission. A high proportion of these would be insurance advisers, though the survey did not gather data on source of commission, so we cannot separate insurance from investment commission.
- Only 11% receive the majority of their income from trail commission. These are probably insurance advisers.

- Initial commission is probably largely insurance commission. Financial planners will often provide some insurance advice and may receive some insurance commission, even when the majority of their income is from fees.

40. The debate about commission often assumes that the only products affected are investment products where the commission directly impacts the return to the investor. Commission may relate to many financial products including insurance and even in relation to investments, there are many varied types of commission payments, e.g. in addition to commission relating to investment advice, there may be brokerage on transactions such as by stockbrokers which may be on trading transactions but could also be in relation to new issues. Many IFA members (28% in a survey of members) provide some general insurance advice (usually as part of financial planning) and may receive brokerage.

41. If commission were to be banned, there would be considerable practical issues relating to commission for insurance. While the Code will mostly apply to investment advisers, those who do comprehensive financial planning or risk advisers who provide a financial planning service will also be AFA.

42. Most risk insurance is distributed through authorised agents who receive commission. Commission is paid by the product company and the client makes no payment other than the policy premiums. The commission is gross revenue (rather than net income) and an insurance adviser has many overhead costs since they provide distribution for insurance companies.

43. A ban on commission for risk insurance would require the client to make a direct payment to the adviser. This is likely to result in a significant reduction in the volume of insurance purchased, adding to the well documented “under-insurance” in NZ. The result would be greater call upon social welfare benefits from families who might otherwise have taken out insurance.

44. IFA recommends that there is considerable research undertaken on actual remuneration practices for the various types of adviser, before any policy conclusions are reached. At present policy is being suggested without objective, factual data. If any change were to be contemplated, we recommend that there would need to be careful transitional provisions to avoid disruption of service and some mechanism would need to be found to ensure that those with modest sums to invest were still able to access advice. This would probably need to be linked to financial literacy education for the general public so that consumers better understood the value of advice.

**Q9. Do you consider that non financial benefits should be taken into account in determining whether an AFA is independent and objective?**

**Response**

45. See earlier comments on our suggested approach. Non-financial benefits may be potential conflicts of interest that need to be disclosed.

**Q10. Do you consider an AFA is independent and objective if his or her financial adviser services are limited to financial products available through a particular platform where the AFA and all connections of the AFA have no financial interest in the platform?**

**(A platform in this context is any defined range of financial products made available by a particular financial service provider, or any form of portfolio administration or reporting service.)**

**Response**

46. Setting aside earlier comments on terminology, IFA's view is that use of a platform, by itself, should not impact on whether an AFA is able to provide objective, unbiased advice. What needs to be determined on a case-by-case basis is whether the range of products available through the platform is broad or narrow and restricted to a single product provider or a very small number of product providers so it is like being an aligned adviser. In many cases, the adviser may choose which clients use the platform and it would be rare for an adviser to require all clients to use a platform.

**Q11. Are the definitions of "connection of the AFA" and "member of the AFA's family" appropriate? If not why not?**

**Response**

47. No. The definitions are not appropriate. The problem is that by moving to a prescriptive approach, the concept of what causes a potential conflict of interest seem to be lost in the detail.

48. The family connection definition has been drawn very widely to include grandparent relationships, irrespective of whether there is any practical connection or likelihood of practical influence or financial benefit. Many relatives may operate businesses that in practice are entirely separate and while there may be a theoretical relationship of influence, does not exist in practice.

49. IFA recommends that the detail be removed from the standard which should revert to a principles-based statement about potential for conflict of interest where there is the risk of material financial benefits to the adviser that could influence their advice to the detriment of the client. The detailed aspects could become some form of guideline that list potential circumstances that would potentially cause conflicts.

**Q12. Do you agree that the proposed standards concerning lending and borrowing to/from, and joint investments with, clients (set out in standards 5-6) should be included in the Code? Are there any other standards concerning dealings with clients that should be included in the Code?**

**Response**

50. We agree with the standards relating to lending and borrowing – which match IFA's own rules. We also agree with the concepts relating to joint investments, but consider the standard is actually an example of a potential conflict of interest situation and the standard is

written in a very prescriptive manner.

51. As suggested previously, we recommend a strengthened standard for potential conflict of interest and joint investments would fit within a guidelines section, as a potential conflict.

**Q13. Do you consider that the Code should include standards governing AFAs who take on personal trusteeships and act as directors of corporate trustees of family trusts? If yes, what standards should be included?**

**Response**

52. Again, this is another example of a potential conflict of interest. Our view is that this might also be included in guidelines.

**Q14. Are there any other good conduct standards that should be included in the Code?**

**Response**

53. IFA uses global principles for its Code of Ethics and Practice Standards. Of the 8 principles, Fairness, Competence, Confidentiality and Diligence are not specifically included in the proposed standards, though some aspects are partially included, or use different word. We are disappointed that the principle of Confidentiality seems to be missing.

54. What also seems to be missing is a specific requirement to follow the advice process that forms the core practice standard of the Level 5 National Certificate that is the basis for AFA minimum competency. Without such a specific requirement in the Code, an adviser may be able to pass a competency assessment, but not consistently adopt the processes in practice.

**Q15. In particular should the Code include a good conduct standard which restricts the ability of AFAs to criticise other AFAs or include other standards which regulate dealings and interactions between AFAs?**

**Response**

55. This is a difficult area since AFAs will often be competitors. It is probably adequately covered by proposed standard 7.

**Q16. Should this section on good conduct (or any other section of the draft Code) include standards providing guidance on advertising and/or marketing of financial adviser services over and above the restrictions in the Financial Advisers Act? If so what should the standards require?**

**Response**

56. We consider this is adequately covered by legislation.

**Q17. Do you consider the proposed over-arching client care standard is appropriate?**

**Response**

57. While agreeing with the proposed content of the standard, IFA suggests that item (2) would be better expressed in terms of requiring an AFA to restrict their advice to areas where they can demonstrate competency. We commend the wording of IFA's rule 25: "A financial adviser shall offer advice to clients only in those areas in which he or she is competent. In areas where the financial adviser is not competent, the financial adviser shall seek the counsel of, and/or refer clients to, qualified professionals."

**Q18. Do you agree that a standard concerning scope of services should be included (proposed standard 10)?****Response**

58. We agree with the concept that there should be an agreement between the adviser and their client. We disagree that the standard should be as prescriptive as is proposed. IFA's view is that the detailed items to be disclosed should be set by disclosure regulations rather than as part of the Code.

**Q19. Is it appropriate to require that where a trail commission or monitoring fee is charged, the AFA must provide ongoing proactive advice?****Response**

59. No. Trail commission may be part of an overall agreement between the client and the adviser on how the adviser is to be remunerated for their services. The client may prefer a "drip feed" method of payment, rather than an up-front fee.

60. In terms of a monitoring fee, this may also be part of an overall agreement to "drip feed" payment of remuneration. However, in many cases there is genuine ongoing active advice and monitoring.

61. Overall, we consider this suggestion is intruding into determining the way in which an adviser should structure their business practice and remuneration. Our view is that these are matters for agreement between the client and the adviser. We agree that there should be requirements for proper disclosure of remuneration and the services to be provided, but the Code should not dictate the content of the engagement.

**Q20. Should there be a standard requiring written terms of engagement with clients?****Response**

62. Broadly, having a written terms of engagement is desirable, especially where the adviser is providing a relatively comprehensive service, such as a financial planning service or an investment plan involving a recommended portfolio. This suggestion seems to be based upon an assumption that the Code applies exclusively to this type of activity.

63. However, the definition in the Financial Advisers Act includes making an investment transaction. While most IFA members provide advice services rather than transactions, there

are other types of advisers who assist clients with transactions based upon telephone contact. For this type of activity, written terms of engagement may not be practical.

**Q21. Should AFAs be permitted not to undertake a suitability analysis? The Committee seeks your views on two options:**

- (a) Should AFAs always be required to carry out a suitability analysis and provide advice that is suitable for the client? or**
- (b) Should AFAs be permitted not to carry out a suitability analysis and to provide services that are not necessarily suitable for the client, provided that the benefits of the suitability analysis are clearly explained to the client and the client consents in writing not to receive such advice (as proposed above)?**

#### **Response**

64. We consider proposed standard 11 is going beyond what should be in the Code and intruding into the actual services that may be agreed between AFA and client. While it is desirable for consumers to receive expert advice that is based upon a suitability analysis, some clients do not seek such a service. Some consumers are seeking assistance with a transaction or may wish to have an opinion on some technical aspects of a financial product, e.g. assistance with understanding the terms and risks of an offer set out in an investment statement. In seeking such advice or assistance, the consumer may not wish to disclose their personal details or to incur the additional cost of a suitability analysis.

65. Accordingly, IFA does not support proposed standards 11, 12 and 13. Instead, we consider that the consumer should be free to choose whether or not they wish to have the adviser undertake a suitability analysis. This should be part of the initial agreement on the scope of the engagement.

66. We do agree that the steps set out in proposed standard 11(1) (a)-(c) are the standard process that should be followed, where the client wishes to have a needs-analysis approach to advice. Item (d) should be limited to providing financial advice or plans that are regarded as suitable for the client. We do not consider the Code should prevent the AFA from assisting with implementation where, after providing advice, the client rejects part or all of the advice and requests assistance with implementing particular actions or transactions. To prohibit this within the Code, would be to override consumer choice, something we consider would be paternalistic.

67. IFA does consider that it would be appropriate to require AFAs to document in written form the client consent to seek limited advice or no-advice. As we commented under Q21, there are some situations where the client may be seeking advice over the phone so that it may be impractical for this to be signed by the client.

**Q22. Is it appropriate that where the suitability analysis shows that the financial adviser services offered by an AFA are unsuitable for the client, the AFA must not provide the financial adviser services or should the AFA be able to provide the services if the AFA informs the client that the services are not suitable but the client still wishes the AFA to provide the services?**

### **Response**

68. IFA's view is that the client must be able to choose whether or not to proceed with services or a transaction, despite the AFA's view that the solution is not suitable. We consider that the AFA should make their views clear and document this in writing. If the activity is being done by phone, the AFA should send a copy of such documentation to the client.

69. IFA does not support the suggestion that the Code should stop a consumer doing something they are determined to do, even if an AFA considers it unwise.

### **Q23. Do you agree that the proposed standards concerning suitability set out above should be included in the Code? Are there any other standards concerning suitability that should be included in the Code?**

### **Response**

70. Proposed standard 14 is very similar to IFA Rule 42: "Consistent with the scope of the engagement, a financial adviser shall undertake a reasonable investigation of the products and services to be recommended to clients. A financial adviser may rely upon an investigation undertaken by a third party provided it is reasonable to place reliance on the quality of such of such investigation."

71. We recommend that the proposed standard add the "Consistent with the scope of the engagement" phrase, since the client may have deliberately limited the scope.

### **Q24. How long should AFAs be required to keep records? Should there be specific standards relating to electronic records?**

### **Response**

72. IFA's view is that recordkeeping should match provisions of tax legislation and the Companies Act. There is no need for separate provisions relating to electronic records.

### **Q25. Are the proposed capability and capacity standards appropriate? Should the standards be modified or expanded in any way? Are there other capability and capacity standards which should be included in the Code?**

### **Response**

73. While the proposed standards 17-19 are valid requirements, they are expressed in a prescriptive manner, rather than as principles.

74. IFA's view is that Standard 18(2) should be given greater prominence as this is the requirement that an AFA restrict their practice to areas of competence. The minimum competency requirements are likely to be the Level 5 National Certificate, but this is a 50 credit qualification that may be gained in either investments or insurance. The potential range of areas of advice is much wider than the qualification, e.g. comprehensive financial planning requires much more and someone giving investment advice may also need to know about life insurance and some aspects of estate planning to provide adequate advice. We recommend

that Standard 18 starts with the requirement for an AFA to provide advice only whether they have the necessary competency, etc. with 18(1) becoming the action to take where the adviser lacks competency.

**Q26. Do you agree that information and/or advice should be or provided in writing unless that is not practicable?**

**Response**

75. Yes. However, there should also be an obligation for the AFA to endeavour to ensure that the client understands the advice provided.

**Q27. Should the client be able to waive this requirement by agreeing in writing that subsequent disclosure of specified information or advice is not required to be in writing?**

**Response**

76. Yes, where the subsequent activity is more in the nature of implementation or repeat transactions of a similar nature. The consumer needs to be able to choose. The AFA would be wise to document this, but this need not be part of a standard.

**Q28. Proposed standard 21 requires AFAs to have an internal dispute resolution process. Is this practical? How should an individual AFA who does not practise with other AFAs be required to deal with complaints?**

**Response**

77. As acknowledged in the question, there are many financial advisers who operate as sole practitioners (perhaps with a support staff member) who will find it very difficult to have an internal dispute resolution service.

78. We question the need for this standard as it mainly repeats the obligations under legislation and adds little.

**Q29. Are the proposed internal dispute resolution standards appropriate?**

**Response**

79. We question the need for standard 22. It is in the AFA's own interests to resolve complaints internally and there is no need for a Code provision. Standard 23 is acceptable.

**Q30. How long should records of complaints be kept?**

**Response**

80. IFA's view is that recordkeeping should match provisions of tax legislation.

**Q31. Are the proposed compliance standards appropriate? Should the standards be modified or expanded in any way? Are there any other compliance standards that should be included in the Code?**

**Response**

81. Yes. We note that standard 26 may cause an AFA personal liability as they may not have any statutory protection such as under whistleblower legislation. This standard may also lead to employment issues.

**Q32. The general rule in proposed standard 28 is that an AFA must not disclose information without the client's prior express written consent. Are the exceptions to this general rule (set out at (1)(a)-(e)) appropriate? Should they be modified or expanded in any way? Are there any other exceptions that should be added?**

**Response**

82. Yes, though we note that there doesn't seem to be statutory protection in all cases.

**Q33. How long should the records for trust accounts, client money and client assets be held?**

**Response**

83. IFA's view is that recordkeeping should match provisions of tax legislation.

**Q34. Is it appropriate to require trust accounts to be audited annually by a chartered accountant?**

**Response**

84. Yes.

**Q35. Are the proposed custody standards appropriate (standards 27-35)? Should the standards be modified or expanded in any way? Are there other custody standards which should be included in the Code?**

**Response**

85. The proposed standards seem overly prescriptive, e.g. standard 33. Surely, a more principles-based approach could be adopted without having this degree of detail, which raises concern that an AFA could be found in breach of Failure to follow some detailed aspect yet be honouring the overall intention.

**Q36. Noting the Ministry of Economic Development's targeted consultation on the regulation of investment transactions, are there any standards that you think should not apply to those who only make investment transactions (as defined in s 5 the Act) and who do not provide other financial adviser services?**

**Response**

86. IFA members are generally not involved in investment transactions as their normal mode of operation. As has been noted throughout our comments, the draft Code seems to have been drafted as if all AFAs provided investment advice. Many of the proposed standards have limited application to those undertaking investment transactions.

**Q37. Is there anything else you would like to comment on in relation to the proposed minimum standards of ethical behaviour and client care?**

**Response**

87. As AFAs will include any adviser who provides a financial planning service, so a wide range of advisers other than investment advisers. This will include those who take a comprehensive approach to risk insurance analysis and perhaps even lending advice. It also includes those who do not give advice, but assist consumers with investment transactions.

88. IFA is concerned that the draft Code seems to have been drawn up with an investment adviser focus. Accordingly, we do not think that the approach is adequate as it does not make adequate provision for these wider areas of advice or for investment transactions.

89. We are also concerned that the approach often becomes prescriptive and detailed rather than keeping to a principled approach. We note comments made by Code Committee members that the draft has been drawn from a variety of sources. Frankly, this shows in terms of a lack of overall coherence in approach. Much of the detail concentrates on exceptions and issues rather than the setting out the standard advice process.

**Q38. Do you consider there are areas other than competence; knowledge and skills; ethical behaviour; client care; and continuing professional training that should be covered in the Code?**

**Response**

90. There is no specific requirement to follow the advice process (often called the six-step process) even though this is set out in the Level 5 National Certificate (and the university diplomas proposed as acceptable alternatives).

**Conclusion**

91. IFA hopes these comments are useful. We are of course available to meet with either Code Committee members or their secretariat to discuss our suggestions and to explain any aspects that are unclear.

92. Contact details and background information on IFA follows.

**Background information on the Institute of Financial Advisers**

The Institute of Financial Advisers is the professional body for some 1,300 members, representing financial advisers in New Zealand. All members are individual members, not corporate members. We estimate that our members provide advice to some 200,000 New Zealanders each year, many of whom would be couples rather than individuals, with an overall client base of around 600,000.

Our members provide advice to their clients in the areas of insurance, investments, financial planning, work-based savings and insurance, retirement planning, estate planning and

financial services generally. Their professional practices reflect the broad spectrum of New Zealand businesses – they operate as local SME's, are part of large regional or national dealer groups, are associated with strong financial organisations, services companies in banking, funds management, or insurance, work in employee benefits organisations, or sometimes practice as lawyers, accountants and other professional advisers.

The Institute reinforces compliance with a code of ethics and practice standards, runs a Professional Conduct Committee and Disciplinary Tribunal that are independently chaired, offers education pathways that can lead to professional designations and the attainment of internationally recognised adviser marks, maintains and ensures compliance with a continuing professional development programme, and provides networking, education, development, and business practice forums at a national and regional level for members.

**Contact information:**

Institute of Financial Advisers  
Level 6, Technology One House, 86 Victoria Street  
P O Box 5513  
WELLINGTON 6145  
Ph: (04) 499 8062  
Fax: (04) 499 8064  
Mob: (027) 446 2656  
Email: [info@iffa.org.nz](mailto:info@iffa.org.nz)  
Website [www.iffa.org.nz](http://www.iffa.org.nz)