



## **IFA Submission on Securities Commission Staff Paper on Regulating and Supervising Financial Advisers**

### **INTRODUCTION**

1. IFA welcomes the opportunity to formally comment on the issue of Regulating and Supervising Financial Advisers. We start with some general points then respond to the specific questions in the discussion paper.
2. As noted in the introductory paragraphs, this Securities Commission paper devotes most of the discussion to the QFE regime and how that might operate. The Institute of Financial Advisers (IFA) is a professional association and so would not be eligible to become a QFE. Even so, IFA has had experience in establishing and operating a set of requirements for membership that have many features in common with regulation and supervision. In particular, IFA has created an Approved Training Organisation (ATO) process for major financial institutions that is used to delegate responsibility for competence and ongoing training. We consider that our experience with the ATO system has elements that may be useful for a QFE regime. Accordingly, we have provided IFA's ATO guidelines to the Securities Commission.
3. We anticipate that virtually all IFA members will become AFAs, including those who are employees of major institutions, since most will provide a "financial planning service" and/or advice on products that are not issued by the employer.
4. While understanding that the aim of the QFE regime is to reduce excessive compliance costs for firms with a large number of advisers, IFA is firmly of the view that the standards for a QFE need to be at least the same level as advisers who are not part of a QFE, not lower. There are two reasons for this view. The first is consumer protection – as consumers should receive the same quality of advice irrespective of the basis for regulation of the adviser. The second reason is equity – those who provide advice outside a QFE should not have to meet a higher standard than those advisers who are part of a QFE.
5. There is another aspect of QFEs that could potentially be detrimental to consumers. This relates to the exemption from becoming AFA for employees who provide advice only in relation to products issued by the QFE. This creates an incentive for the QFE to limit the product range and advice to its own products, which means that consumers are not made aware of alternative products or solutions that are not offered by the QFE. The risk to the consumer in this situation is that they are sold products that are less than ideal in terms of their needs. It will be very important for there to be adequate disclosure to consumers if the advice and products they are to be offered by the QFE are restricted to those issued by the QFE. IFA considers a QFE should be required to refer clients with a substantial sum to invest to an adviser who is an AFA and able to provide advice on Category 1 products other than those issued by the QFE itself, with an obligation to provide comprehensive advice. A dollar threshold might be set before such a referral was required, perhaps \$250,000. This could be achieved by making this a condition of the QFE approval.

## **Terminology**

6. In paragraph 10 of the discussion paper, Category 1 products are described as “higher risk or more complex products” and Category 2 as “lower risk or less complex products”. While these descriptive terms were used to justify the creation of the two categories, IFA regards them as misleading and in some cases as deceptive. In addition, they are not used in the Act itself which just lists the categories.
7. The reason for our view is that some Category 2 financial products such as Income Protection Insurance are complex – requiring well-informed advice, and some Category 1 products are simple and low risk, e.g. Cash PIEs. So, the descriptions are inaccurate and misleading.
8. We recommend that reference to “risk” and “complexity” is dropped in future discussion and that descriptions just use the products in each Category.

### **A. Do you have any comments on the suggested approach to interpreting “financial planning services”?**

9. IFA supports the proposed interpretation of a “financial planning service” as excluding the use of basic needs analysis. However, we consider it would be helpful to have a definition of what constitutes a “financial planning service”. We suggest the following:

A “financial planning service” means a comprehensive advice process covering the majority of the key financial planning steps:

- Cash management
- Risk
- Investment
- Tax
- Retirement
- Estate Planning

10. All advice, whether for category 1 or 2 products should be designed to ensure that the customer receives advice and products that are suitable for their personal requirements. Should any needs analysis be considered a “financial planning service”, then we consider that there would be a risk that many advisers (especially for category 2 products such as life insurance) would cease using a needs analysis approach to avoid needing to become AFA. If this were to occur, it would actually reduce the quality of advice available to consumers.

### **B. Do you have any comments we should take into account as we further develop the approach – outlined in summary above – for supervising financial advisers?**

11. IFA agrees with the suggestion in paragraphs 30-31 that there is a need for a culture of professionalism. However, the discussion paper doesn’t seem to include any suggestions on how the desired culture of professionalism will be encouraged and supported, other than the hint that it might reduce the likelihood of “targeted supervision”. IFA would like to see more concrete proposals on how professionalism and best practice could be developed and supported. This might include incentives for professionalism, such as a longer time between periodic renewal of AFA for those who are members of a professional association or those with higher professional status, e.g. CFP<sup>CM</sup> professionals might renew every 5 years, members of a professional association with Level 5 might renew every 4 years while those who are not a member of a professional association might renew every

2 years. Another option might be to require AFAs to belong to a professional association.

12. If there are to be incentives for advisers in relation to professional association membership, IFA recommends that this be restricted to those that are genuine professional associations. We recommend that the Securities Commission develop a specification for a “professional association”, i.e. those that require competency through educational qualifications, experience, “proper person” tests and CPD as well as compliance with a code of ethics and professional practice standards. This would exclude associations that are “interest groups” or benefits-based associations that do not require competency tests as part of membership. This is for consumer protection so that reduced “targeted supervision” applies only where there are additional protections through the standards and processes required by the professional association.
13. A key element for competency and ensuring delivery of sound financial advice is to restrict advisers to the areas in which they have proven competence. IFA’s recent experience with disciplinary cases is that most, where the adviser has been found against, involve an adviser operating outside their area of competence and failing to follow good practice processes. IFA considers that registration and authorisation should include some form of limitation of the areas of advice that an individual adviser is able to provide. This will obviously need to match competency and skills. We consider this is an important feature for consumer protection.
14. Periodic renewal of authorisation is stated as needing to include an assurance that the AFA has complied with requirements such as continuing professional training. IFA already has an annual membership renewal process which is largely based upon self declaration, but is supplemented by an audit of a random sample of members. Similar audit processes will be required by the Securities Commission.

**C. Do you think this approach, centred on the concept of responsibility, creates any difficulties for QFEs?**

15. IFA’s view is that a QFE has to have very clear authority and control over the actions of an adviser before they can be held responsible for their actions. Accordingly, our view is that the QFE should only be approved to supervise agents where they can demonstrate very formal systems, processes and procedures that ensure that they are able to exercise that control at all times.
16. We suggest that this might well include expecting the QFE to maintain its own internal audit checks on employees and agents. IFA also suggests that a condition of QFE status should include an independent, external quality audit of the formal systems, processes and procedures that ensure that advisers meet competency requirements and maintain continuing professional training. The model IFA uses for Approved Training Organisations includes a periodic audit of quality systems. The cost of such an audit is around \$3,000, which is modest relative to the likely overall size of QFEs.
17. We view this type of requirement as part of consumer protection and the counterbalance to effective delegation by the Securities Commission to the QFE.

**D. Do you have any suggestions for alternative ways of delivering more certainty about which agents a QFE is responsible for under the Act?**

18. The ability of a QFE to maintain close control over advisers obviously declines as the distance between the QFE and the agents increases, e.g. the list in paragraph 60 is in

descending order of ability to control. IFA has concerns about the ability of a QFE to ensure adequate control as distance increases. We favour limiting agents as part of a QFE to those whose work status is close to that of employee. We do not consider that this should extend to franchisees and their employees or stand alone product distributors. If these organisations wished to become QFEs, they should probably do so in their own right so that there is certainty for the consumer.

19. There is also the issue of equality of treatment between QFE agents and advisers under other structures. This would become blurred if a QFE was allowed to extend its cover to advisers without close connection.

**E. Do you agree that there should be a standard QFE term and condition that the entity establish and maintain a list of agents it has assumed responsibility for?**

20. Yes, and this should be everyone who provides a financial adviser service – employees and agents. This list should be maintained so that it is current at all times.

**F. Should the QFE be required to publish the list of agents it is responsible for?**

21. Yes, and this should be all advisers – employees and agents - who are advisers the QFE is responsible for. Consumers should be able to search the list of advisers in the same manner as registered advisers and AFAs. With modern technology, we suggest that this should be a single register and part of the on-line register maintained by the Companies Office. Without a single register, consumers will not be able to be sure they are dealing with an adviser who meets the law.

**G. Do you agree that it is appropriate to streamline the authorisation and supervision of AFAs in some or all of the circumstances discussed and in the manner suggested?**

22. There is a fundamental assumption behind this proposal, which is that products issued by a QFE or approved by them are lower risk than other products. This ignores the fundamental point that the key to sound advice is not just the quality of the product, but also whether it is suitable for the client. So, a QFE may have a managed fund that is a growth-oriented product, that is soundly designed, but unsuitable for an elderly client or someone who expects to need to access their funds soon, perhaps to purchase a house.
23. There is also a valid argument that the risk to the consumer increases as the potential product choice is limited to those sourced from a QFE, i.e. the employee adviser or tied agent adviser will be constrained in what they are able to recommend, so are likely to advise the client to take one of the QFE's products, even if this doesn't really match the client's needs. The recent example of employee advisers making inappropriate recommendations to elderly clients in relation to moderate to high risk managed funds indicates that ownership linkage to the product issuer does not necessarily lead to a quality result for the client.
24. IFA's view is that a risk-based approach to "streamlined" AFA authorisation is conceptually appropriate, but we don't think the basis suggested is suitable. Instead, we suggest streamlined authorisation and supervision should be based upon an overall assessment of the QFE in terms of the quality of its systems, processes and procedures, especially those relating to competency of advisers. We recommend the approach of using an independent, external quality audit process (as previously described for IFA's ATOs) as the basis for streamlining.

25. What we are suggesting is effectively what we recommended for streamlined authorisation of IFA full practitioner members as AFA. Essentially, since IFA can demonstrate that we have formal processes for assessment of good character, competency (through qualifications and mentored experience) and ongoing continuing professional training, we recommended a streamlined approval. This would also work for a QFE that followed similarly formal processes.

**H. Do you have any comments relating to the scope of the QFE framework, e.g. whether there should be any restrictions as to the types of businesses that may apply for QFE status and, if so, why?**

26. IFA's view is that the size of the business and the type of business are not the appropriate basis for whether or not an institution should be a QFE. Rather we suggest the test should be the quality and formality of the systems, processes and procedures and whether these are adequate to ensure competency of advisers and operational practice standards that protect consumers. We recommend development of formal criteria with a potential QFE providing an independent, external quality audit report against the criteria.

**I. Do you have any comments in relation to the matters that we propose the Commission take into account in considering an application for QFE status?**

27. IFA agrees on the desirability of developing formal requirements as set out in paragraph 75. We suggest that the criteria should be very closely aligned with the Code for AFAs, since this will set the minimum requirements for AFAs who are "stand alone". The requirements for a QFE should be at least as rigorous as those who are "stand alone", and arguably should be higher since becoming a QFE gives an advantage through not having to register individual advisers and from employees being able to give advice on category 1 products where the QFE is the issuer, without needing to become AFA.

**J. Are there any standards or certification processes we might consider relying on when assessing a prospective QFE's policies and procedures?**

28. IFA commends the use of independent, external quality audits against the criteria.

**K. Are there any other matters you think the Commission should take into account in considering an application for QFE status?**

29. A key aspect to consider should be consumer protection. The whole purpose of regulation is to improve consumer protection. QFE status is a concession to the major institutions and debatably gives them competitive advantage through lowering costs. They should justify that advantage by operating at a high level of consumer protection and demonstrated adviser competency.

**L. Do you agree with the proposed policy of promoting the voluntary adoption of standardised competence measures across QFEs?**

30. Yes. IFA supports the use of NQF qualifications by QFEs as they are well suited to be used by large organisations who are able to provide tailored training to their employees but with moderated assessment that meets the requirements of the Industry Training Organisation. The use of national qualifications by QFEs would also mean that staff gained formal qualifications that were portable and this is in the public interest of having a better qualified work force in the finance sector, for those providing advice. It supports

the overall aim of reform for improved standards.

31. In addition, if the use NQF qualifications by QFEs were made mandatory, especially for those providing advice on category 1 products, this would meet the “level playing field” requirement of competitive equity for standards compared with those advisers who are “stand alone” AFAs.

**M. Further to any submissions you make on MED’s discussion document, do you have any comments on QFE disclosure or on disclosure exemptions from the Commission?**

32. IFA’s view is that consumer protection should drive disclosure. We are not convinced that for a large institution, what is relevant is disclosure in relation to the institution rather than the individual staff member. From a consumer’s view, both the institution and the individual staff member’s skills and experience are relevant as they need to know if they are dealing with an adviser who is likely to be able to meet their needs.

33. On the other hand, for a QFE that is the product issuer, the overall fees embedded in the product are relevant to the consumer. Existing disclosure requirements for employees in relation to remuneration may be deceptive as the product charges are received by the institution, though the employee may be on a fixed salary.

**N. For specific adviser types (such as wholesale advisers) should disclosure requirements differ from those for other advisers? Should the answer depend on whether the adviser is employed by a QFE? We are interested in understanding any (financial and other) costs or benefits of different disclosure, and the practicality of implementation (for example, how a wholesale environment/customer can be clearly identified). Responses that include a client/customer viewpoint would be particularly helpful.**

34. IFA agrees that many large business clients are in a different position than consumers in terms of what disclosure they are able to require before they will become a client. The difficulty is to define what is a business-to-business relationship where there is equality of negotiating power, without disadvantaging corporate entities such as small businesses (where the owners may be a family, even though they operate through a company structure), charitable trusts or incorporated societies whose disclosure requirements are similar to retail consumers. IFA members deal mainly with the smaller client entities so we are not in a position to suggest definitions for the wholesale level.

35. That said, IFA suggests that there is the need for a firm principle in relation to disclosure, that adviser disclosure should be the same irrespective of the employment status of the adviser. That is, the client should receive the same minimum information concerning a product irrespective of whether the adviser is a “stand alone” AFA, or registered adviser or part of a QFE. Nor should the legal entity or employment structure (e.g. employee or agent) affect disclosure.

**O. Do you have any other comments you would like to make about the implementation of the Financial Advisers Act?**

36. IFA appreciates the use of these discussion papers, the willingness of Securities Commission staff to meet and discuss issues and the responsiveness to earlier suggestions, e.g. Question A.

37. What practicing advisers seek is greater certainty over what will be required and adequate advance warning so that there is time to adapt. There is a definite risk that

many advisers will leave the industry rather than meet requirements under regulation. While IFA supports the need to raise minimum standards, we are also mindful of the necessity of there being adequate numbers of advisers to serve consumers. So, the sooner there can be certainty over requirements, the lower the loss rate of advisers is likely to be.

38. As usual, IFA is available for further discussions and consultation.

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