



IFA Submission on Securities Commission Staff Paper on Authorised Financial Adviser Competence

INTRODUCTION

IFA welcomes the opportunity to formally comment on the issue of Authorised Financial Adviser Competence. We have had many useful discussions with Securities Commission staff and are available to continue to provide assistance to the Commission in any area where we have the necessary expertise.

Defining “competence” is perhaps the most important aspect of regulation of Authorised Financial Advisers as it sets the minimum baseline for professional skills. The processes for assessment of Competence for AFAs will determine the speed of practical implementation and whether or not there are undesirable consequences, such as a high proportion of advisers leaving the industry or advisers restricting their areas of advice so as to remain excluded from needing to become Authorised. Both could occur and lead to a shortage of AFAs in the market.

COMMENTS ON TERMINOLOGY

We have identified aspects of the descriptive section of the paper where we consider the terminology that has been used is confusing and inappropriate.

Category 1 and Category 2 financial products

The first relates to paragraph 12 which states that the Financial Advisers Act divides financial products into two categories. In describing the categories, the paper refers to Category 1 as being “higher risk or more complex products” and Category 2 as being “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.

The reason for our view is that some Category 2 financial products such as Income Protection Insurance are complex, and some Category 1 products are simple and low risk, e.g. Cash PIEs. So, the descriptions are inaccurate and misleading.

We recommend that reference to “risk” and “complexity” is dropped in future discussion and that descriptions just use the products in each Category.

The second aspect relates to personal risk insurance products and the way these are described in the legislation. The terminology used is very confusing for financial advisers, especially as the definition of “life insurance” under the Securities Act is very difficult to follow, since there are exclusions in regulations.

We recommend that Regulations are used to more clearly define which risk insurance products are Category 1 and which are Category 2. We suggest that plain English definitions are used and suggest something along the following lines:

Category 1 risk insurance products are insurance policies issued after 31 December 2008 that include an investment aspect and so are “securities”. This includes whole of life, endowment, unbundled policies with an investment-linked element, and personal superannuation.

Category 2 risk insurance products are those that do not include an investment element, such as term life, trauma, income protection, disability, and health insurance, and all other risk insurance policies issued up until 31 December 2008.

Competence

Paragraph 16 states that “the Code must provide for minimum standards of competence, knowledge and skills for AFAs.” While this is the wording in the Act, it is a tautology since “competence” includes both knowledge and skills.

We consider “competence” needs to include:

- Knowledge (technical information and facts)
- Skills (professional processes for delivery of advice)
- Abilities (practical experience, including professional ethical behaviours)

This becomes relevant when considering the discussion points as “qualifications” alone do not necessarily mean that a holder has demonstrated professional skills and professional behaviours. It is acknowledged that unit standards-based qualifications are designed to demonstrate competence, though this may be more that an adviser is capable of performing an activity, rather than that they have had practical experience of having done so over an extended period.

The “competence” needed for an AFA is what would be required to be a member of a professional association, such as IFA. Typical requirements for membership of a profession include:

- Technical knowledge – normally demonstrated by having passed formal tertiary courses.
- Relevant practical experience – ideally supervised or mentored experience with this having been done under an existing experienced professional and properly documented.
- Ethical behaviour – normally demonstrated through reference checking as well as the absence of evidence of adverse behaviours such as criminal convictions, adverse credit record/bankruptcy, or unresolved serious client complaints.

So, the test of competency is closer to the requirements for professional membership than it is to obtaining a tertiary qualification. This is relevant to Discussion Point A which talks about “qualifications” which may cover only some of the aspects relevant to “competency”, e.g. a university qualification may demonstrate technical knowledge and an understanding of processes, but will rarely require practical experience or ethical behaviour. Similarly, gaining a qualification doesn’t bring with it any requirement for CPT, which is normally an essential element for ongoing membership of a professional association.

RESPONSES TO THE DISCUSSION POINTS

IFA’s responses to the discussion points follow. We have commented only in relation to the typical financial advisers who are members of IFA, namely financial planners, investment advisers and personal risk insurance advisers. These are advisers who are providing advice directly to retail clients but who may work in quite varied employment structures. Some are employees of financial institutions such as banks or trustee corporations. Many work in adviser

practices, varying from large firms to self employment. Some are also chartered accountants, lawyers or stockbrokers. Virtually all IFA members will be required to become Authorised and even those dealing largely with advice on Category 2 products (mostly personal risk insurance) will often choose to become AFAs.

The defining characteristic of IFA members is that with light-handed regulation, they voluntarily joined a professional association requiring demonstration of competence and ongoing compliance with professional standards, ethical behaviour and CPT. Accordingly, as a group they should virtually all meet likely requirements for AFA.

[DISCUSSION POINT A] What qualifications do you consider would potentially meet those criteria (theoretical, practical, CPT)? For each qualification you list, please describe the type of financial advice activity for which it is suitable. Is the qualification you name the only one suitable for that type of financial advice activity?

Response:

As discussed earlier, the IFA view is that “qualification” is not the correct basis for the criteria for AFA, especially since gaining a qualification does not indicate that the adviser will have undertaken any CPT. Our view is that the basis for “recognition” for AFA without the need for formal assessment should be restricted to those with professional status as a financial adviser, including evidence of having both practical experience as an adviser and being up-to-date with CPT.

In an Appendix to this submission, we describe the current requirements for practitioner membership of IFA as well as discuss requirements for those who became members prior to the current education requirements that took effect from 1 January 2009.

IFA practitioner members initially join as Provisional Members. Candidates need to meet ethical requirements evidenced by reference checking, a credit check as well as declare that they do not have unresolved complaints from clients.

To become a full Practitioner Member, over the following two years they need to:

- Complete educational requirements – the minimum requirement is now the National Certificate in Financial Services (Financial Advice) Level 5,
- Adopt IFA’s professional standards, including the globally recognised 6-step process for advice,
- Be mentored for two years by an experienced Practitioner Member with four satisfactory 6-monthly reports, and
- Undertake at least 60 hours of CPT over a rolling 2-year period.

IFA also has professional designations that exceed the minimum requirements for Practitioner Membership. These require additional tertiary study and, in the case of Certified Financial Planner^{CM} professionals, completion of a case study. These professional designations are:

- Associate Financial Planner
- Certified Financial Planner^{CM} professional
- Associate Life Underwriter
- Chartered Life Underwriter

The two Associate-level designations require completion of four courses of a university diploma in personal financial advice, while the two “C-level” designations require completion

of one of the two full university diplomas which are Level 7 or Level 8 (depending on the university).

Excluding Provisional members, 47% of IFA's Practitioner Members hold either CFP^{CM} or CLU or both.

A very small number of IFA members gained Practitioner Membership based upon having had at least 10 years of continuous relevant experience. (This option is no longer available.) All others undertook tertiary study but this may have been less in terms of quantity than would now be required by a new member.

IFA's view is that all IFA full Practitioner Members should receive AFA status without needing to undertake a formal assessment, provided that they have satisfactorily completed their annual "IFA membership renewal process" which ensures that required CPT has been completed for the previous two years. Our view is that IFA requirements for education, mentored experience, ethics and CPT ensure that all full Practitioner Members who have complied with their obligations would meet the minimum requirements for AFA.

Basically, IFA full Practitioner Members are those who have committed to the standards that regulation is seeking to achieve. The real need for assessment is of those financial advisers who have not been a member of a genuine professional association, i.e. those who have never been subject to the formal requirements of professional membership.

With regard to the small proportion who gained membership through at least 10 years of continuous relevant experience, as their experience was assessed by our Certification Committee, they will have met the minimum requirements through prior experience. In addition, by continuing to meet the ongoing CPT requirements, they would have kept themselves updated.

The same logic applies to those who became members having completed tertiary courses that were less in quantity than a completed Level 5 National Certificate.

In terms of ranking IFA professional status from "most qualified" to "least qualified" in terms of AFA competency, the following would apply – starting with "most qualified":

1. CFP^{CM}/CLU
2. AFP/ALU
3. General Member (full practitioner) with Level 5 qualification
4. General Member (full practitioner) with less than a full Level 5 qualification
5. General Member (full practitioner) but without tertiary qualifications
6. Provisional Member

Those with 1-3 would meet or exceed the likely AFA requirements. IFA considers those with 4 or 5 should also be accepted as meeting the AFA minimum standard. Provisional Members are those who are studying to attain what will be required for AFA.

In terms of other "qualifications" we are reluctant to list what are strictly qualifications, since these will not require practical experience and CPT. We do consider that other professional designations such as Certified Financial Analyst may be suitable for some specialised adviser roles. The NZX Diploma may also be suitable, but only if the adviser is currently working for an NZX firm so has both relevant practical experience and CPT as well as being subject to ethical requirements.

While some IFA members are also Chartered Accountants or lawyers, they hold dual professional qualifications. We do not consider that Chartered Accountants or lawyers without other relevant qualifications, will have gained the knowledge necessary for AFA.

Similarly, those with a degree in finance may have technical knowledge but this does not indicate either practical experience or CPT have been completed.

[DISCUSSION POINT B] Do you agree with the introduction, progressively, of NQF definitions for all adviser qualifications?

Response:

In principle, IFA supports progressively defining adviser qualifications in terms of the NQF. However, our understanding is that the NQF structure does not extend to degree level qualifications and over time, some areas of advice may require that advisers have degree level education.

We acknowledge that there are a wide range of products and areas of financial advice. Current NQF qualifications such as the National Certificate in Financial Services (Financial Advice) Level 5 necessarily encompass only some aspects of the current range of financial advice activity. Over time, it would be useful to have unit standards for all the main areas of advice so that financial advisers can demonstrate competency in all areas of their work, rather than just the minimum core in the current Level 5 qualification.

The one aspect that may require care over using NQF is that a global professional designation such as Certified Financial Planner^{CM} professional (and Certified Financial Analyst) needs to comply with global standards and there needs to be sufficient flexibility to ensure that both sets of requirements (global and NZ) are met and that being part of the NQF does not inhibit periodic updating to reflect changes in global standards.

[DISCUSSION POINT C] Do you support the concept of a baseline standard? Do you support the proposal to assess applicants against the baseline standard? Do you consider Level 5 to be an appropriate baseline standard for AFAs?

Response:

In concept a baseline standard is supported and the National Certificate in Financial Services (Financial Advice) Level 5 does give a baseline for the areas of advice that IFA members provide. Typically, IFA members are providing tailored advice based upon a rigorous needs-analysis process, though this may be limited to a particular area, e.g. investment advice, without completing a comprehensive financial plan that may need to include areas such as risk insurance and estate planning.

However, we suspect that there will be financial advisers in other parts of the industry who provide advice on a limited range of products, even though these may be Category 1 products. It may not be reasonable to require all AFAs to complete the same baseline. While we consider Level 5 is appropriate, some AFAs with less than a full Certificate of Financial Services may be competent, provided they operate within a narrow product/area of advice range. An example might be KiwiSaver. Such an adviser would need the skills and knowledge of the advice process, but would need less (in terms of quantity) technical product knowledge.

[DISCUSSION POINT D] Should existing advisers whose **baseline assessment is unsuccessful** be allowed to practice as AFAs for a short period to enable them to further develop their skills? If so, what restrictions should be imposed (for example, work under supervision)? How many months do you consider reasonable?

Response:

IFA considers that the issue is much wider than just those to do not pass a baseline assessment at first attempt. There needs to be provision for people to begin earning through providing advice while gaining the necessary qualifications and experience. All professions require some form of “provisional” status allowing the candidate to do some work, in this case to provide financial advice, while gaining experience and often completing some form of final qualification. The necessary counterbalance to ensure client safety is that this is done under some form of supervision or mentoring.

We suspect that many financial advisers who are currently active in the market will find formal knowledge testing and assessment a challenging experience. We suspect that some may be unsuccessful in passing tests (especially knowledge tests) because of their unfamiliarity with study and testing, rather than because they lack knowledge or are “poor” advisers, e.g. terminology may be an issue as may a computer-based test process for some advisers.

The need for advisers to be able to work while gaining qualifications is especially relevant for financial advice as most financial advisers have been in other roles before becoming an adviser. This means that most need to be earning through providing advice while gaining the necessary technical qualifications.

The Level 5 qualification requires around 500 hours of study. IFA allows a two year period for Provisional Members to complete their minimum educational qualification while undergoing mentoring. This is accepted as a fair maximum (unless there are exceptional circumstances such as illness) considering that they are invariably also working full time while studying.

So, we consider that there needs to be a process similar to our Provisional Membership for new AFAs, but this would need to be clearly stated in the Disclosure Statement.

Similarly, during the transition period for initial AFA authorisation, we consider that there has to be a practical process that enables those who were initially unsuccessful under an assessment process, to continue to earn an income while undertaking action to pass the assessment. We agree that this needs to be under some form of supervision or formal mentoring process, with periodic reporting to provide assurance that clients are not being placed at risk of poor advice.

It is difficult to prescribe the period that should apply in terms of months, but our view is that the period should be related to the quantum of the “gap” to be filled. So, while 2 years would be the maximum for a new entrant to financial advice, this would be a maximum. A much shorter period would need to apply if the adviser was unsuccessful in only a section of the baseline standard. At the same time, this will need to be related to availability of formal courses from tertiary institutions, should that be the required, e.g. if a particular course is required, but not available in the current semester.

[DISCUSSION POINT E] Should existing advisers who **successfully pass baseline assessment**, but do not meet the requisite “top-up” requirements for a particular class of work, be allowed to practice as AFAs in that class for a short period while they develop the

additional skills? If so, what restrictions should be imposed? How many months do you consider reasonable?

Response:

IFA considers that the approach should be similar to that suggested under point D. However, we acknowledge that the time for “make up” work should be shorter as this will be for an area of a higher level of professional skill, so the risk to clients is higher.

IFA also considers that the Securities Commission should consider restricting the use of particular titles to those with relevant professional designations. In particular, within New Zealand the term “financial planner” has been mis-used and the majority of those operating under that title are actually investment advisers. A financial planner is a financial adviser who provides comprehensive advice to their client covering advice on all or the majority of financial/cash management and budgeting, asset management (including investments), risk management (including insurance), tax planning, retirement planning and estate planning. A financial planner will provide an overall diagnosis of all financial aspects for their client, though they may well refer the client to specialists for more detailed advice or for implementation, e.g. to a lawyer or trustee corporation for estate planning, or a chartered accountant for tax advice.

IFA supports using the ability to define “Classes” of AFA to create specialty AFAs with titles restricted to those who have proved to be competent in the relevant specialty. We believe this would assist consumers in choosing appropriate advisers with relevant proven competency.

[DISCUSSION POINT F] We are interested in your views on the use of NQF standards more broadly than for only AFAs.

Response:

As was stated earlier in this submission, some of the Category 2 products are complex. In addition, the way in which even simple products is used may be to solve complex problems. For example, term life insurance is a simple product but may be a core solution used for business succession and debt management issues.

IFA supports the need for all financial advisers to become more professional in their approach. Accordingly, we support encouraging advisers other than AFA to gain qualifications that incorporate NQF standards. In particular, the National Certificate in Financial Services (Financial Advice) Level 5 has two streams – investment and personal risk insurance. While insurance is Category 2, IFA members who specialise in providing risk insurance advice support this level 5 qualification as providing the knowledge and skills needed for their work.

There will also be financial advisers who are employees of product companies, many of which may seek to become QFEs. In many cases, employee-advisers will be providing advice to customers on a narrow range of product types and probably restricted to products provided by their employer. In most cases, these will be Category 2 products. The National Certificate in Financial Services (Financial Advice) Level 4 was designed as being suitable for this situation. Where a QFE adviser provides advice on a Category 1 product, IFA’s view is that they should need to meet the same competency standard as an AFA. To do otherwise would be unfair and potentially place the client at risk.

Our view is that the processes that need to be followed by any financial adviser – the globally recognised 6-step process – are the same irrespective of the product or level of complexity. Accordingly, advisers who provide advice only for Category 2 products, still

need to follow the same general process as AFAs. The difference may be product knowledge or breadth of areas of advice (e.g. for a comprehensive financial planner) rather than level of knowledge.

So, to provide advice with the required “care, diligence and skill” a financial adviser who gives advice solely for Category 2 products may well need to obtain a suitable NQF-based qualification. It is acknowledged that this may not need to be at Level 5 and the level 4 National Certificate may well be suitable, especially for employees of financial institutions.

[DISCUSSION POINT G] We are interested in your ideas for regulatory or other strategies to help promote a culture of professionalism across the adviser industry.

Response:

IFA is a strong supporter of the need for a professional culture for financial advisers. Indeed our whole purpose is to promote professionalism for the benefit of members and the public.

The change in the approach from co-regulation through Approved Professional Bodies to direct authorisation by the Securities Commission, has the undesirable effect of removing any requirement for financial advisers to join a professional body.

As has been described throughout this submission, the requirements for AFA are precisely those for membership of a profession. What a professional institute is able to provide is much more than the minimum requirements for becoming AFA.

IFA is a major source of professional standards for financial advisers in NZ. We benefit from our international links that provide us access to statements of global best practice. Even more, we actively participate in their development and one of our former Presidents currently chairs the global standard setting organisation for financial planning (the Financial Planning Standards Board). We have provided the Securities Commission with IFA’s latest revised professional standards with the aim of assisting the development of the Code for AFAs.

IFA has also developed guidelines for good practice and made these available to other industry participants, e.g. guidelines for disclosure statements, guidelines for replacement insurance.

IFA is willing to continue to provide similar industry-wide guidance material but at present the cost of this falls on the minority of advisers who have chosen to belong to IFA. Some mechanism is required to provide a fairer means for sharing the cost of developing “public good” guidelines.

Professional associations already provide professional development for their members. At present this is made financially viable only with industry sponsorship. Under regulation, all AFAs will be required to undertake CPT. Conceptually, this should boost the number of advisers seeking CPT. However, at present many advisers receive their CPT largely from product providers, without charge. Much of this training is limited in the sense that it concentrates on the products provided by the product company and so is not unbiased. A side effect is that many advisers are reluctant to pay for CPT or prepared only to pay minimal fees that do not cover the cost.

The basic argument is that professional associations like IFA have considerable potential to promote a culture of professionalism amongst financial advisers in general, not just AFAs.

However, professional associations will struggle financially unless there is some incentive for an adviser to join.

IFA considers that there is benefit in the Securities Commission considering whether it could incorporate some form of “delegation” to professional associations such as IFA. The minimum requirements for membership of IFA are likely to be the same as those for becoming AFA. If full IFA Practitioner Membership was recognised as meeting AFA requirements, then the Securities Commission could accept those advisers as AFA, without needing to undertake further processing or assessment. This would create an incentive for advisers to join IFA, enhancing its financial viability. In return, the Securities Commission and the whole sector would benefit from the professional standards and guidelines developed by IFA. Also, as IFA professional standards are likely to be more demanding than those under the Code for AFAs, there would be an overall rise in the culture of professionalism.

CONCLUSION

IFA supports the move to regulate financial advisers and to set minimum standards of competency for AFA. For implementation of regulation to succeed, the initial minimum level of competency needs to be both adequate and realistic. The initial transition process needs to be very carefully handled – balancing the need for assessment against the requirement for existing advisers to pass an assessment, where required, and for adequate time for “make-up” work if an aspect of an initial assessment has not met the standard.

It is important to acknowledge that competency requires more than having a tertiary qualification as a professional adviser needs to also meet ethical requirements, have had relevant practical experience and kept up-to-date through CPT.

IFA recommends that the Securities Commission recognises IFA full Practitioner Members as AFA without requiring them to undertake assessment, provided that they have completed their formal membership renewal process including meeting CPD requirements for the preceding two years. We consider that the initial authorisation process should concentrate on those advisers who do not belong to a professional association and so have not been required to meet formal competency requirements.

IFA recommends that if the Securities commission genuinely wishes to encourage a culture of professionalism, then AFAs and financial advisers in general need to receive a genuine benefit from membership of a professional body. IFA recommends that its members could be recognised as AFAs without the Securities Commission needing to undertake further assessment, since IFA’s requirements meet or exceed those likely to be required under the Financial Advisers Act.

APPENDIX

IFA PRACTITIONER MEMBERSHIP REQUIREMENTS

IFA's requirements for practitioner membership have evolved over the past decade, since the current professional association was formed from the merger of a largely life insurance adviser association with the financial planner association.

Within IFA are a wide range of financial advisers. Some are comprehensive financial planners, who take a generalist approach to financial advice for their clients. Others are specialists, in personal risk insurance or investment advice. Others hold dual professional status as they are also chartered accountants, lawyers or stockbrokers.

The common element is that they all provide tailored advice to their clients, taking into account the client's current financial position and personal requirements and desires.

With a wide range of members, IFA has evolved its membership requirements to set a minimum level for full practitioner membership, called General Membership, with higher professional designations reflecting the desire of members to operate at a more sophisticated level. The proportion operating at the highest professional level has increased and is now 47%.

I. Current Requirements

The current requirements for full Practitioner Membership of IFA are:

- Ethical behaviour – demonstrated through reference checking as well as the absence of evidence of adverse behaviours such as criminal convictions, adverse credit record, bankruptcy, or unresolved serious client complaints.
- Relevant practical experience – 2 years mentored experience with this having been done under an existing experienced professional and properly documented by four six-monthly reports. Approved mentors are those holding CFP or CLU or being the manager of an adviser practice.
- Technical knowledge – demonstrated by having passed formal tertiary courses. The current approved courses are:
 - National Certificate in Financial Services (Financial Advice) Level 5, or
 - Certificate in Financial Services from AdviserLink, or
 - Half the courses for a Diploma in personal financial advice (from either Massey University or the University of Waikato) with an obligation to complete the full diploma within two years.

NCFS (Level 5) is 50 credits and the Adviserlink Certificate is level 5 and equivalent in size to the National Certificate. The Diplomas are 120 credits so half of the courses is 60 credits.

Once a member of IFA, including a Provisional Member, Continuing Professional Development (CPD) becomes an ongoing requirement. The CPD requirement is for 60 hours over the previous two years. This is part of an annual membership renewal process. CPD hours are randomly audited. Any member who does not complete the required number of hours is required to "make up" the missing hours.

II. Former Requirements

The ethical and practical experience requirements have been at the current level for several years. Formerly, the tertiary education requirement was four specified AdviserLink courses, equal to around half the full Certificate.

III. Membership by 10 years practical experience

A small number of members were able to obtain full Practitioner Membership through having completed 10 continuous years of relevant practical experience. This was subject to individual application and review by the Certification Committee. Typically, those applying were very experienced advisers who had received training from product companies, but who did not receive formal recognition of that training in terms of a tertiary qualification.

Historically, advisers mainly worked as tied agents for insurance companies. The companies had formal training programmes as well as providing close supervision of advisers during their first year or two of work. There was a high drop-out rate so that those who succeeded were the ones who were technically capable and gained sound experience.

As the range of financial products expanded, especially the development of managed investment funds, many financial advisers became non-aligned and established their own adviser practices. The amount of training provided by the product companies reduced, especially initial training, but many product companies continue to provide on-going training in product knowledge but also in advice process, especially needs-analysis.