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FAA REVIEW SUBMISSION

As a NZX Participant firm, QFE and one of the largest single employers of AFAs, Forsyth Barr has a unique perspective on the operation of the Financial Advisers Act ("FAA").

We have contributed to the Security Industry Association submission, but also wish to provide a separate but simpler submission outlining three key issues, and possible solutions to them.

This submission does not respond directly to any particular question in the Issues Paper, but is relevant to questions 1-3, 5-7, 8, 35-37, 56, and 62-63.

Simple = Accessible

In many ways, the current FAA is "inward-looking" – that is, it focuses on the obligations of financial advisers and those who supervise them, rather than the needs of consumers.

That has been effective in raising standards and building trust in the industry. However it has also resulted in a complex and increasingly prescriptive regulatory regime where there are many different classes of advice and advisers, and where the scope of advice that some advisers can provide is restricted by law, either in relation to the complexity of the product that can be advised on, or the products of which provider can be advised on.

These various distinctions are not well understood by consumers and we consider this to be a problem that needs to be addressed.

We believe the current regime is fundamentally inaccessible to consumers. They simply do not understand who can give them advice on what products. With growing savings and a desire for consumers to access quality financial advice, it is imperative that consumers can easily understand where to access advice.

We think that there is a real opportunity in the current review for the regime to be simplified without losing the "inward looking" gains made thus far in relation to conduct and standards, and without increasing providers' costs.

In particular, we think that the focus should be on simplicity of regulation of the most important area of advice: personalised advice on category 1 products provided to retail clients.

This could be achieved by:

- What is now personalised advice being renamed “advice”. We think that when consumers think of advice, they are thinking of something that takes their needs and goals into account, rather than general opinion. General opinion and “no advice” information could just be referred to as “product information” or similar. We note that the recent Parliamentary Joint Committee inquiry in Australia reached a similar conclusion, with a distinction clear between what is financial advice and what is product sales/ product information.
- “Advice” on category 1 products being only able to be provided by a “financial adviser”. Consumers do not know how to distinguish between an AFA, an RFA or a QFE Adviser. Some recent research has indicated that they consider an RFA to be the most “superior” of all. It is not hard to conclude that a member of the public will see the word “adviser” in any of these terms and conclude they can receive advice from that person as it pertains to their needs.
- Product scope restrictions being expressly drawn to the attention of the consumer, for example by requiring a QFE adviser or a tied AFA to be described as a “restricted financial adviser” (should the QFE regime be retained, which we discuss later, and the concept of restricted (in effect, “conflicted”) financial advice be permitted going forward).

Consumers would then know that, if they wanted “advice” on anything involving significant financial risk, they would either need a “financial adviser” (or a “restricted financial adviser” if they were happy to be advised on only one providers’ products). Everything else would effectively become sales.

Consumers would also expect people providing similar services to be subject to the same obligations. For that reason, we would suggest that all “financial advisers” would be subject to the same code of conduct.

We believe these changes could be effected without raising provider’s costs – in effect, the same people in the industry would be doing the same things they are doing now. However, consumers would be clearer on who can provide them advice, and any scope restrictions on that advice. (We have more to say on scope restrictions below.)

Category 1 vs Category 2

It is appropriate that the requirement referred to above - that only a “financial adviser” can provide “advice” - applies only to a defined “category 1” product set.

We query, however, the current approach of defining the product set according to complexity.

Another way of looking at it would be to define the product set by looking at the amount of financial risk involved (in the context of the consumer), taking into account the nature of the product. So, for example, KiwiSaver accounts with a balance of less than (say)

\$20,000 could be categorised as “category 2”. Insurance products which aren’t effectively investment products could also be categorised as category 2.

In simple terms, category 1 products would be subject to financial advice rules (under the simplified approach described above) and category 2 products would be subject to product sales / product information requirements.

This approach would be consistent with consumer expectations, and improve accessibility for those with smaller amounts to invest. As the legislation stands, these consumers are effectively frozen out of the advice market.

The QFE model – past its use-by date?

The QFE model is a cost-efficient way to supervise a large salesforce, and was probably necessary at the time of introduction of FAA given the wide definition of financial advice in the FAA and the similarly wide range of advice practices and competencies in the market.

However the model is, over time, having the unintended effect of driving the market towards vertically integrated product and advice providers, where advice is only provided on that provider’s products. In effect, “conflicted” advice.

This is clear from the Issues Paper, which states that there are approximately 23,000 QFE advisers but only 1,900 (and declining) AFAs. Industry observers have also noted a trend for “tied” AFAs to become QFE advisers. We understand that some QFEs in fact encourage this with recent decisions by some to state to their AFA employees that they will no longer support them with CPD time or other resources required to maintain their AFA status.

We understand that MBIE does not have detailed numbers as to how many of the 23,000 QFE advisers provide personalised advice, and how many of those provide personalised advice on category 1 products. However given the numbers above, it is likely that the vast majority of personalised advice being provided on category 1 products is being provided by advisers who cannot provide advice that compares the products of different providers.

This situation will not meet the future needs of New Zealand consumers. In particular, KiwiSaver is fast becoming New Zealanders’ largest non-real estate asset, and increased consumer interest in comparing the performance of their scheme to that of other providers is inevitable. However, it is not clear how 1,900 AFAs (or the smaller number of these who actually provide advice across KiwiSaver providers) will be able to meet this need.

Part of the solution here is financial literacy. Consumers need to understand when they should be seeking advice from someone who can advise on products from a range of providers. Demand should lead to supply, eventually.

However another part of the solution is to ensure that consumers fully understand that QFE advisers are only able to provide personalised advice on category 1 products that are their own products. We think that QFE advisers (or “restricted financial advisers”, as we have described them above) should be required to ensure that consumers understand this limited scope of advice, and agree to it.

More fundamentally, however, we think that the QFE model is no longer required as part of the New Zealand regulatory landscape. Structural change is required in order to foster the provision of the non-conflicted advice that New Zealanders require. If, as we suggest above, the regulatory focus should be on “advice” from “financial advisers”, the QFE regime could be amended to apply to sales practices only, with “financial advisers” regulated by the FAA but outside the QFE regime.

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