

MBIE - Issues Paper

Review of the Financial Advisers Act 2008 and the Financial Service Providers (Registration and Dispute Resolution) Act 2008

Submission to the Ministry of Business Innovation & Employment regarding the review of the Financial Advisers Act 2008 and the Financial Service Providers Act 2008

This submission has been compiled by:

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Background

I thank you for the opportunity to submit my views and thoughts on the future direction of the financial services industry in New Zealand and wish to make comments in particular as it relates to my work as a financial adviser.

My thinking is based on nearly 30 years in the financial services as an independent financial adviser where I have helped many New Zealanders with growing their life savings as well as providing personal risk management strategies ensuring that their financial goals are not put in jeopardy by unforeseen events.

The views expressed in this paper are mine along and do not necessarily reflect those of the TripleA Advisers Association which I am Immediate Past Chairman and Board member nor the AMP Quality Advice Network (QAN) which I am on as an advisory board member representing AMP's independent financial advisers.

Executive Summary

I believe that the introduction of the regulatory environment established under the Financial Advisers Act 2008 and the Financial Services Providers Act 2008 has had a very positive impact on the financial advisory industry and has laid a sound foundation for us to improve on and move forward. I am confident that with well-informed and balanced changes, the future is promising for all New Zealanders to have the opportunity to seek and receive high quality personalised financial advice.

For many New Zealanders understanding the financial environment and taking full advantage can be highly complex and confusing for them. Many investors over the past 20 years have received less than favourable outcomes from their investments and as a result there exists much mistrust and misinformation about financial markets and advisers who work in the industry. The need for high quality financial advice has never been more important. Financial advisers need to be professionally trained and qualified to help educate and train consumers around important financial behaviours, that help mitigate risks (or at least minimise the risks) both with their investments and personal insurance as they move through the various stages of their lives. We need to understand that financial advice is not simply about good investment advice but also about sound personal risk management. The consequences of getting either of these wrong can and most likely will have poor outcomes for consumers.

Many of the changes that I have based my recommendations on in this paper revolve around two key issues, transparency and simplification.

I do not support the banning or removal of commission payments but strongly advocate that only two forms of commission payments be allowed, upfront and renewal. Many other forms of commissions such as volume bonuses are very hard to accurately disclose to customers at time of implementation. Whether perception or reality these payments could easily be seen as leading to mis-selling or causing a conflict of interest. Commissions need to be completely transparent and simple for the customer to understand. At present they are not and for this reason they need to change.

All financial advisers should be held personally accountable for their actions. The QFE model should be removed from all financial advice models involving self-employed advisers, as the corporate entity holds the responsibility, removing direct accountability from the adviser. No other profession has such an entity.

The use of acronyms such as AFA or RFA to describe financial advisers should be removed. These terms are confusing and mis-leading for the customer. All financial advisers should be just that, advisers, and come under the same rules and regulations with each holding their own area of competency or competencies.

One important issue I believe not addressed in this paper is education from an early age on financial literacy and understanding. I would like to see the Government introduce compulsory basic financial literacy programmes into both the primary and secondary schools curriculum. Establishing sound principals about money matters needs to start early.

FAA Review Submissions

I have answered a range of questions raised in the Issue Paper. In some case I have grouped a number of questions together with my views covering them all.

6. Is it appropriate to have different requirements on advisers depending on the risk and complexity of the products they advise upon?

7. Does the current categorisation system accurately reflect the level of complexity and risk associated with financial products? If not, how could it be improved?

No to both questions. I believe that both investment and life insurance products both create an unnecessary and dangerous risk if not adequately and appropriately advised by highly qualified and trained advisers. Trying to put various categories and some arbitrary risk assessment on each separately not only creates risk in itself but also very confusing for the consumers. Eliminate as much financial jargon as possible ie AFA, RFA or QFE. All should be noted as financial advisers with simple and clear definitions of qualifications and competency upon which they can advise. For example, investment advisers, life insurance advisers and mortgage advisers. Customers can relate to these terms.

8. Do you think that the term Registered Financial Adviser (RFA) gives consumers an accurate understanding of what these advisers are permitted to provide advice on and the requirements that apply to them? If not, should an alternative term be considered?

No. This is simply another confusing and unnecessary term. The word registered in itself implies that they have been registered to give full financial advice and this is simply not true. There should only be one financial adviser designation, an authorised financial adviser with clear areas of competency upon which they can give advice – eg investments (including KiwiSaver), life insurance, mortgages, fire and general.

9. Are the general conduct requirements applying to all financial advisers, including RFAs, appropriate and adequate? If not, what changes should be considered?

The present situation is totally unacceptable. Given my previous statement that there should be only one adviser classification all should therefore be accountable under the Professional Code of Conduct and the disclosure rules that presently apply only to AFAs (including those under a QFE). The non-requirement of an RFA not to have to disclose any commission payments, when this is the area that such payments would apply, is ridiculous. If our aim is to provide full transparency to the consumer across all areas of financial advice, then this must change.

12. Are the costs of maintaining an adviser business statement justified by its benefits? If not, what changes should be considered?

This is an interesting question and not an easy one to answer. From a business perspective it is a useful document to prepare as it requires you to carefully describe and review your business on a regular basis. I personally see this as a useful business tool as it forces you to look closely at your business and how it operates. Prior to legislation, from what I had seen many AFA's (and RFA's) had no written business plan. ABS now requires their business to have a written record of their business operation and in particular key components of their business.

From a direct customer perspective this would have little value as it is not something they are able to see. Indirectly it probably is a business tool that owners/mangers of a financial planning business should have as part of their best practice. Perhaps for the FMA when business audits are sought it is a useful summary upon which to base their review.

Initially it is a time consuming document to produce but once accurately completed, updating and reviewing is not too difficult. I would be happy to see it continue to be a requirement, mainly seeing it as a best practice tool which financial advisers are "forced" to complete.

16. Are the current disclosure requirements for Authorised Financial Advisers (AFAs) adequate and useful for consumers?

The present use of two disclosures, Primary and Secondary is too long and wordy, much of which is confusing, unnecessary and in some cases simply repeats itself. Adviser disclosure to clients prior to giving personalised advice is very important. Clients do take notice of information such as:

- Years of experience
- Qualifications
- Services they offer
- Range of companies the adviser utilises in providing advice
- The advice process
- How they are paid
- Complaints procedure

Surely one concise disclosure document would provide far greater value to the client in assessing the overall value in dealing with an adviser than two overly prescribed wordy documents.

If used correctly by the financial adviser this document (assuming one is adopted) can be a very good marketing and "sales" tool. Unfortunately at the moment clients simply find them too long and hard to disseminate the information that is important to them.

18. Do you think that the process for the development and approval of the Code of Professional Conduct works well?

Firstly I think the Code of Conduct under which I work is an excellent document and one of the best things that has come out of the FFA Act. The rules of the Code are clear, easy to read, to understand and follow as the guiding principles upon which I work. I see no reason why the present development and approval process should change.

22. Does the limited public transparency around the obligations of Qualifying Financial Entities (QFEs) undermine public confidence and understanding of this part of the regulatory regime?

23. Should any changes be considered to promote transparency of QFE obligations?

I have a strong view that the true integrity of being a financial adviser is on the basis of individual responsibility and accountability, not under the auspices of a corporate entity. If we are truly to build a profession and wish to mirror other professions such as lawyers, accountants and doctors then QFE's should be removed.

QFE's offer little if any transparency to the public when choosing or dealing with an adviser. Ignoring the bank QFE structure (which employ staff and generally simply sell products) many industry QFE's such as AMP create a dichotomy, in that on the one hand they deal with a range of so called self-employed financial advisers, but place limitations on what products they can and cannot use with their clients. If you are a financial adviser under a QFE and providing personalised financial advice and recommending the best product/solution then stating you are putting the interests of the client first may easily be brought under question.

The only possible role I believe a QFE may have is in a bank environment where employees recommend the bank product. This I believe is not an advice model but a sales model. If a QFE is to remain then clear and explicit disclosure to customers must be set up and monitored.

35. What changes should be considered to make the current regulatory regime simpler and easier for consumers to understand? For example, removing or clarifying the distinction between AFAs and RFAs.

If there was only one change that was to be made to the present regime, it is the removal of the terms AFA and RFA. Simplify the designation to Authorised Financial adviser with noted competencies - Investment Adviser, Insurance Adviser, and Mortgage Broker. If an adviser has multiple qualifications then this is fine. This provides complete transparency to consumers. At present there is complete confusion between what the two designations represent, and what they can and cannot do. I want to see the regulators treat both investment advice and insurance advice with the same degree of importance. There seems to be this strange belief that getting good investment advice (or wrong advice) has far greater consequences than getting good or poor insurance advice. I totally disagree with this position and for this reason believe high competency and education levels should be required for both.

37. Should there be a clearer distinction between sales, information provision, and advice? How should such a distinction be drawn? What should or should not be included in the definition of financial advice?

Advice and sales need to have a clear distinction and be totally understood by customers. Advice follows a true needs based discovery process and based on this information certain steps are recommended for the client to follow and implement so achieving their stated goals and objectives.

Sales generally involve little if any advice and transacted on a request from the customer. Customers should be fully aware that this is not an advice process but simply a sales transaction. No full suitability analysis has been done.

To ensure that customers are fully aware of the difference between sales and advice, clear and concise disclosure must be made **prior** to the sale, showing clearly that the customer understands the consequences of their actions, either good or bad.

Financial advice is just that, advice. Following the stated 6 step discovery process the customer should be fully confident that the advice they receive is truly based on their needs and the solutions recommended has been sourced from a range of suppliers. Important to also note, that if the customer accepts the advice from the adviser, it may or may not involve the sale of a product.

The distinction between advice and sales must be clearly defined and a clear and understandable disclosure be made for either. Failure to do this will continue to lead to customer confusion and in many cases inappropriate products being recommended with the potential for significant negative outcomes.

QFE's (notably banks) and the sales process they have followed has I believe created in many instances very poor financial outcomes which they show little compassion or regret for. Recent examples both here in New Zealand and Australia have shown many of our largest banks have not only been negligent in their financial advice but fraudulent, and with devastating consequences for their customers.

It could be argued that liability really sits with the customer when making a decision to buy. Various consumer protection laws would however apply and I am sure professional legal discussion would need to be done to get this point of difference clearly defined. This is outside my competency.

38. Do you think that current AFA disclosure requirements are effective in overcoming problems associated with commissions and other conflicts of interest?

39. How do you think that AFA information disclosure requirements could be improved to better assist consumer decision making?

40. Do you support commission and conflict of interest disclosure requirements being applied to all financial advisers? If so, what requirements are appropriate for different adviser types?

41. Do you think that commissions should be restricted or banned in relation to financial advice, and if so, in what way? What would be the costs and benefits of such an approach?

I would like to make 3 key comments here with regards to commissions:

1. I believe that there is still a place in the financial advice model for commissions to be paid for advisers.
2. Commissions should only involve two possible payments – an initial commission and a renewal commission. Any other commission payments such as productivity bonuses, incentive payments should be banned.
3. **Every** financial adviser receiving commissions should be required to fully disclose the amount being received.

I have never had a client who has disagreed with me receiving commissions as a result of the implementation of my recommendations. This method of payment to the adviser for their services is happily accepted. My greatest fear if commissions were banned is that it:

1. Potentially could significantly reduce the number of New Zealanders seeking financial advice, especially life insurance, due to the cost directly billed to them, and
2. For those dealing wholly in a market whereby commissions fund their business operation, any immediate change could force them out of business and again, as with point 1, reduce the number of people receiving financial advice.

I have no doubt that due to the complexity and lack of clarity around commission payments it could and most likely is producing conflicts of interest, much of which is never disclosed (or able to be) to the customer. Commission payments such as productivity bonuses and incentive payments based on production levels only give the public greater reason to distrust commission based advisers. Only up front and renewal commissions are simple and easy to disclose. Productivity bonuses are impossible to disclose accurately to the client as they are paid either quarterly or annually in arrears. Such bonus percentages will be based on levels of production and increase accordingly. Many insurance companies also offer additional incentives around off shore conferences 3 to 6 months out from the event and with only one simple goal, to sway the adviser to place greater amounts of business with them. Again surely the basis of much customer mistrust and obvious mis-selling.

Recommendations:

1. Allow commission payments to continue but only on the basis of upfront payments (percentage of annual premium) and renewal payments. Immediate banning of any additional incentive payments based around productivity or off shore conferences should be recommended. This would enhance customer confidence in the use of commissions as they are now simple to explain and completely transparent. I would be happy to see some maximum level of up front commission brought in, say around the 150% of annual premium over a specified timeframe, as have Australia recently brought in, although not as low.
2. **ALL** financial advisers should be required to disclose any commissions received.

Appendix 1: My Secondary Remuneration Adviser Disclosure

I have enclosed my remuneration disclosure simply to show the complexity I have to deal with when disclosing any insurance commissions paid to me by 3 of my life insurance providers – AMP, Fidelity and Sovereign.

46. Are there specific compliance requirements from the FA Act regulation that have affected the cost and availability of independent financial advice?

There is no doubt that there have been significant costs involved in being an AFA. One of the reasons many advisers decided to remain RFA and not become an AFA was the lower compliance costs that they would incur (along with other no-disclosure requirements).

There have been numerous costs incurred but the main costs incurred have been:

1. Annual FSP registration fee
2. Two yearly AML audit fee
3. Personal time in ensuring all compliance requirements are met

48. What impact has the Anti-Money Laundering and Countering Finance of Terrorism Act had on compliance costs for advisers? How could these costs be minimised?

I do appreciate that adhering to AML and CFT is a requirement in meeting international standards. However coming up to the required standards has been an extremely time consuming and costly exercise. I agree with the principals behind AML but would like to see some degree of common-sense when applying the laws to financial adviser practices. One example is KiwiSaver. I find it incredibly hard to see how anyone wanting to launder money would choose to use KiwiSaver as their vehicle of choice and yet it is viewed in the same way a bank account is. A tougher concentration on casinos would probably yield better results.

A careful and logical review of what and where the true AML & CFT risks are would be helpful.

55. Are the minimum ethical standards for AFAs appropriate and have they succeeded in fostering the ethical behaviour of AFAs?

I believe the Code of Professional Conduct is an excellent document, setting out clearly the principals around what ethical behaviour and conduct is expected from AFA's.

56. Should the same or similar ethical standards apply to all types of financial advisers?

All financial advisers should be required to adhere to the principals and ethical behaviour set out in the Code. It is quite simply ludicrous that this was not implemented at the start and I cannot see any reason why it should not be brought in immediately.

57. What is an appropriate minimum qualification level for AFAs?

58. Do you think that RFAs (for example insurance or mortgage brokers) should be required to meet a minimum qualification relevant to the area of advice they specialise in? If so, what would be an appropriate minimum qualification?

Both of these questions can be answered together. Minimum levels of qualification should be required for all financial advisers, whether investment, insurance or mortgage advisers. What the actual level to this minimum standard is I am not yet sure of. However if we are to be truly recognised as a professional group then a minimum tertiary level will be required. Developing such courses would take a lot of time and consideration. I do not believe we have at present any tertiary qualification designed accurately to help advance the level of financial advice. There appears to be a gulf between academic and principled thought and effective practical financial planning that can easily be implemented once completed, "in the field".

Given that financial advice covers a range of disciplines, each should have tailor-made minimum qualifications set. If any adviser wishes to advise across more than one discipline then they would be required to have achieved the minimum qualifications standards in each.

64. Do you agree that the Register should seek to achieve the identified goals? If not, why not?

If the aim of the Register is to be both a useful tool for the regulator and public then it has to improve markedly on where it presently is. I see very little value in it for the consumer both in terms of relevant information held and public awareness that it exists.

The effectiveness or lack of protection it provides can be seen by a recent example in Christchurch, where investors appear to have lost nearly \$10m in a fraudulent Ponzi scheme. Several investors in this scheme commented that after visiting the Register and checking out the promoter of this scheme, had been approved and registered giving the perception that he was legitimate and could be trusted. This is a clear example to show the Register is not working and does nothing to enhance public confidence in the financial sector.

76. What features or information would make the Register more useful for consumers?

I would like to see every financial Adviser Disclosure document held on the Register and for this to be a mandatory requirement. It would be up to the individual adviser to ensure an up-to-date Disclosure is on.

The regulator must take greater control of the Register and have measures in place to ensure the public can have confidence in those advisers who are registered and that the “gate keeper” has control of those they let in and most importantly those they do not. A list of those banned from registering and the reasons why could also be helpful.

78. Do you consider misuse of the Register by offshore financial service providers is a significant risk to New Zealand's reputation as a well regulated jurisdiction and/or to New Zealand businesses?

Protection measures to control and police entry of foreign companies and individuals onto our Register must be introduced. I am sure there are more capable people than me to figure out how best to do this but I do believe it should be on their priority list.

Appendix 1: Secondary Disclosure – Advisers Remuneration

SECONDARY DISCLOSURE STATEMENT - REMUNERATION

AUTHORISED FINANCIAL ADVISER

John Raymond Wood – Financial Service Provider Number FSP63021

| | |
|--|----------------------------|
| ADDRESS: | 9 (2)(a) |
| TRADING NAME: | John Wood & Associates Ltd |
| TELEPHONE NUMBER: | |
| FAX NUMBER: | |
| EMAIL ADDRESS: | |
| THIS DISCLOSURE STATEMENT WAS PREPARED ON: | / / |

RELEVANT REMUNERATION

John Wood & Associates will or may receive the following types of remuneration for providing financial adviser services.

COMMISSION ON INSURANCE PRODUCTS

| Type of insurance | Provider | Initial commission rate % | Renewal Commission rate % | Production Bonus Commission % | Persistency Bonus Commission rate % |
|-------------------|---------------------|--|---------------------------|-------------------------------|-------------------------------------|
| Life | AXA/AMP | 100% | 6% | 50-70% | 15-30% |
| Life & Health | Sovereign | Initial Commission = Nil As-earned commission = (AP x 200%) / 24 x 5% Renewal Commission = 7.5% of annual premium Production Bonus Commission = Nil (80%) Persistency Bonus Commission = Up to 21% of annual premium | | | |
| Life - Platinum | Fidelity | 140% | 17% | n/a | n/a |
| Life | Tower | 100% 85% IP & WOP | 7.5% | 70% on NB | n/a |
| Health | Accuro – Smart Care | 30% | 15% | | |

| | | | | | |
|--------|----------------------|--|-------------------|-----|-----|
| Health | Accuro – SmartStay | As earned commission – 10% of monthly premium Initial – n/a Renewal – n/a Production bonus – n/a Persistency – n/a | | | |
| Health | Southern Cross | Refer rates below | Refer rates below | | |
| Health | UniMed | 12% | 8% | | |
| Travel | Comprehensive Travel | 40% of gross premium (Comprehensive) If discount is given then commission is reduced eg if giving 20% discount then commission will be 20% (40%-20%=20%) | n/a | n/a | n/a |

INITIAL COMMISSION

This is the commission payable to John Wood & Associates Ltd by the product provider when a client initially effects an insurance policy (or increases the amount of insurance cover) with that product provider. The commission paid is a percentage (as specified in the table) of the annual premium paid by the client.

AS EARNED COMMISSION

This is the commission payable to John Wood & Associates Ltd by the product provider when a client initially effects an insurance policy (or increases the amount of insurance cover) with that product provider. The commission paid is a percentage (as specified in the table) of the annual premium paid by the client.

RENEWAL COMMISSION

This is the commission payable to John Wood & Associates Ltd by the product provider when a client renews an insurance policy with that product provider each year. The commission paid is a percentage (as specified in the table) of the annual premium paid by the client.

RENEWAL COMMISSION ENHANCEMENT

As part of an incentive programme by AMP, John Wood & Associates Ltd may also receive additional renewal commission on all AMP Risk Protection Plan policies (term life, trauma, total and permanent disablement insurances (TTT) and income protection insurance (IP)) that were in force prior to 1 September 2012. To qualify for this incentive I must have qualifying Risk Protection Plan in force annual premium (IFAP) greater than \$40,000 for TTT and \$10,000 for IP at 1 September 2013, and IFAP growth over the campaign quarter for AMP Risk Protection Plan policies of \$10,000 for TTT or \$2,250 for IP over the campaign period. The commission paid will be a percentage (as specified in the table below) of the annual premium paid on existing AMP Risk Protection Plan policies (in force prior to 1 September 2012). This incentive runs from 1 September 2013 to 31 December 2014 and the additional commission will be calculated and paid to John Wood & Associates Ltd after every 3 month period of the incentive.

| IFAP annual growth | Commission increase |
|--------------------|---------------------|
| 0% | 0% |
| 4% | 2% |
| 8% | 3.5% |
| 12% | 5.5% |
| 16%+ | 8% |

PRODUCTION BONUS COMMISSION

This is a bonus paid to John Wood & Associates Ltd by the product provider based on the total Initial Commission paid to John Wood & Associates Ltd by that product provider. The commission is paid as a percentage (as described in the table) of the annual premium paid by the client.

PERSISTENCY BONUS COMMISSION

This is a variable bonus paid to John Wood & Associates Ltd based on the Practice's retention of all eligible product providers' insurance policies. This bonus is an additional percentage of the initial commission paid by the product provider.

CLIENT FEES ON INVESTMENT PRODUCTS

NZ FUNDS MANAGEMENT PORTFOLIOS

The tiered rate applies to:

| Portfolio | \$0 - \$100,000 | \$100,001 to \$250,000 | \$250,001 to \$500,000 | Above \$500,001 |
|----------------------------|-----------------|------------------------|------------------------|-----------------|
| Cash | 0% | 0% | 0% | 0% |
| Income, Inflation & Growth | 1.00% | 0.50% | 0.25% | 0% |

The above fees are + GST

KIWISAVER

| | |
|--|---|
| Source of remuneration | NZ Funds Management Ltd |
| Amount or rate paid to John Wood & Associates Ltd | NZ Funds Management, as manager, pays me a commission of 0.20% p.a. of your KiwiSaver account balance. This is not a cost to you. |

AMP

| | |
|----------------|----------|
| AMP NZRT | Flat fee |
| All portfolios | 0.563% |

No fee will be charged for regular contributions.

In all cases where fees apply, the fees will be explicitly stated in the Client Agreement and/or in the Statement of Advice.

FEES APPLICABLE TO YOU

| DESCRIPTION | APPROXIMATE AMOUNT |
|--------------------|--------------------|
| Advice Fee | \$??? |
| Implementation Fee | \$??? |
| Ongoing Fee | \$??? |

If it becomes apparent that the fee is likely to exceed the above, a revised estimate fee will be provided before progressing.

Where you engage me to provide financial adviser services to you, I will provide a revised fee estimate for you in the financial plan based on the investment recommendations outlined in the plan.

OTHER NON-CASH REWARDS AND BENEFITS

[Insert details of any soft dollar or other rewards you may receive from a product provider that is known to you at the time and is specific to the individual client. You should state what the reward is, who it is provided by and provide an indication of the value of that reward or benefit to the extent practicable]

ARRANGEMENTS TO MANAGE ANY CONFLICT OF INTEREST ARISING

[Please add any additional details of any other specific arrangements that you have not previously disclosed in your Secondary Disclosure Statement (#1 Template) you may have to manage any conflict of interest arising out of the specific disclosure relevant to your client in this document]

DECLARATION

I, John Raymond Wood, declare that, to the best of my knowledge and belief, the information contained in this disclosure statement is true and complete and complies with the disclosure requirements in the Financial Advisers Act 2008 and the Financial Advisers (Disclosure) Regulations 2010.

Signed: _____

CLIENT ACKNOWLEDGMENT & RECEIPT OF REMUNERATION DISCLOSURE

Signed: _____