

# NZFUNDS

**To:** Financial Markets Policy, MBIE  
**From:** Richard James, Chief Executive, NZ Funds  
**Date:** 17 February 2016  
**Subject:** FAA Review

## Background

Please excuse the memorandum form of this submission; however our perspective is centred largely on just one of the questions you pose. Specifically:

### **35. Can you suggest any alternative packages of options that might work more effectively?**

Our thinking is forged from more than two decades of involvement in managing the life savings of New Zealanders; working extensively with independent financial advisers throughout that period and, more latterly, with our own salaried team of Authorised Financial Advisers nationally (we have 17 AFAs currently on the team at NZ Funds).

## Macro Perspective

NZ Funds is strongly supportive of the regulation of financial advice in New Zealand. We believe that the existing FAA regime has contributed to improved outcomes for consumers and enhanced the credibility of the financial advice industry that serves them.

We concur that the existing regime has identifiable shortcomings which can be remedied, or at least further improved upon.

Broadly we would like to see the evolution of the regulatory regime for financial advisers progress through three distinct phases:

**Phase One:** Internal infrastructure - a basic regulatory framework which captures all advisers (now complete)

**Phase Two:** External communication - redefinition of framework in consumer terms (under consideration)

**Phase Three:** Professional elevation - introduction of higher education and fiduciary standards (future)

We will focus our specific comments on the Phase Two elements canvassed in your Options Paper and currently under consideration.

We will conclude by making some general comments about the elements we see as important to consider in Phase Three.

## Challenges

We agree with the barriers you have identified and set out on pages 7 and 8 of the Options Paper.

However, we identify two additional dimensions which can be broken down as follows:

### 1. Adviser Specialisation

- Consumer conversations with advisers are often centred on **either** investment or insurance;
- This may be driven by either the client's expressed need or the adviser's predominant area of focus;
- The subject matter and expertise relevant to each of the investment and insurance areas is extensive;
- Advisers typically specialise in one or other (we are aware that some advisers advise on both elements);
- Adviser fee/compensation arrangements are generally quite different in investment than in insurance.

We believe that it is in consumers' interests for advisers to clearly and accurately communicate the area(s) in which they have expertise – defined simply in consumer terms "insurance" or "investment". This should enable consumers to make better choices as to where to seek advice appropriate to their primary needs.

### 2. Limited Advice

- Certain customers seek advice pertaining to a need with only modest financial consequences;
- This occurs across the investment, insurance and debt advice spectrum ;
- The current advice regulatory regime does not differentiate the compliance requirements by the quantum of risk involved;
- The cost of meeting the current regime (primarily time cost) makes serving these customers prohibitive for advisers.

We believe that a sensibly designed "Limited Advice" framework, across each of the advice domains, would serve to broaden the availability of advice to New Zealanders.

We believe that both of these matters could be addressed within the broadly outlined packages of options presented.

## An Amended Options Package 3

We support the proposed Package 3, including:

- the removal of the distinction between class and personalised advice;
- the removal of product complexity distinctions;
- the neutralisation of requirements between human and systematic ("robo") advice;
- the requirement for all financial advice providers to be licensed, and, by extension:
  - the elimination of QFEs;
  - the elimination of RFAs;
- the introduction of universal ethical obligations;
- the introduction of a new designation, covering investment/insurance product salespeople.

We would however suggest certain refinements to Package 3, as follows:

1. A more specific definition of the Authorised Financial Adviser designation. An adviser could be an Authorised **Investment** Adviser (and advise only on investment matters); an Authorised **Insurance** Adviser (and advise only on insurance matters); or, if they advise on, and have completed the educational requirements for both, an Authorised Financial Adviser.

An Authorised Financial Adviser (with or without a specialist designation), whether independently licensed or employed by a licensed entity, could not have a contractual employment, remuneration or other obligation which might impede their ability to act in their clients' best interests. This would include any form of volume based insurance commissions, as are commonplace within the insurance industry.

We foresee that specialist designations, with more consumer intuitive labelling, would make it substantially easier for consumers to find the advice they need and/or want. It would also lower the risk of advisers with just one area of true expertise straying into the other when market conditions make it attractive to do so, as occurs periodically.

2. Define the sales person role set out in Package 3 as "Financial Representative". That label accurately describes the role they play in terms the consumer is likely to understand. Financial Representatives should be subject to the same disclosure requirements and the same base educational requirements as Authorised Financial Advisers. They should also be subject to an ethical obligation to provide advice and product solutions which are fit for purpose.

Financial Representatives could be either independently licensed or employed by a licensed entity. In either case we would propose that they be required to have a contractual arrangement which sets out the terms of their representation and which should be available to view by the consumer, on request. Alternatively, those arrangements could be a required component of the Financial Representatives' disclosure statement. In no circumstance should the licensed entity be able to fulfil any of the obligations of the individual Financial Representative (as occurs under the QFE regime today).

3. Both Authorised Financial Advisers and Financial Representatives should be required to meet a universal ethical obligation to provide advice and product solutions which are fit for purpose. However an Authorised Financial Adviser would have an additional, higher ethical obligation – to act in clients' best interests and, as alluded to above, would be required to attest to clients that they are not party to any contract or other arrangement which could prevent them from fulfilling that obligation.
4. Provision should be made for a limited advice service. Limited advice could be provided by either an Authorised Financial Adviser or a Financial Representative.

A limited advice service would be applicable where the total value of the advice/decisions under consideration is modest (for example, say <\$50,000 for initial investment or annual premium of less than \$2,000 for insurance, or a credit contract of less than \$10,000). A limited advice service could be provided only as long as that was agreed in writing between the adviser and the client.

Broadly speaking, we would propose that a limited advice service would not require the adviser to consider *all* of the client's circumstances, nor demonstrate that they have researched *all* of the available alternatives nor extensively document their advice in writing. We would however foresee that the adviser would still need to fulfil and demonstrate the same base obligation to provide advice and product solutions which are fit for purpose.

We do not believe that a limited advice service should be allowed where the value of a client's financial decisions are above the value threshold, even if there is mutual agreement between the client and the adviser. We say this because we believe (and have observed) that clients are not generally aware of

what they do not know and are susceptible to being directed as to the scope of service they require. We would like to mitigate the risk of advisers convincing clients of the merits of a limited advice service, especially where the scale of the clients' financial decisions justifies more comprehensive consideration.

5. Both the individual and the entity should be licensed. In the case of sole/small practitioners that could effectively be granted as a single licence, to avoid unnecessary duplication and compliance cost.
6. There should be standard, regulator drafted descriptors of each designation which should be required to be mandatorily disclosed in all material adviser/client communications (eg. disclosure documents, financial plan, website, email signature)
7. The only exception to the above should be execution-only services. Execution-only providers should however also be mandatorily required to set out a standard, regulator drafted description of their service, including its limitations, with all material client communications.

## Phase Three

We see that Phase Three would be focused on trying to bring financial advice up to the level of the other major service professions, in terms of educational requirements, fiduciary standards, compensation transparency and standardisation of reporting. Specifically we would suggest consideration of:

1. Introduction of a specific tertiary education requirement (ie. full Bachelors Financial Advice degree) as a minimum standard for new entrants into the financial advice profession.
2. Elimination of the payment of all initial or ongoing commissions to advisers, by product providers, in relation to investment advice and/or investment product provision.
3. Elimination of all soft dollar arrangements related to both insurance and investment advice and/or product provision.
4. Limitations on the level of initial commission payable by insurance product providers to advisers.
5. Introduction of mandatory minimum standard client reporting requirements (including the basis for investment performance reporting).
6. Introduction of mandatory minimum standard client review requirements (where an ongoing fee or insurance commission is charged or received systematically).

We would welcome the opportunity to discuss or elaborate on any of the points raised above, either in relation to the current review or our summary comments in relation to the proposed Phase Three.

Thank you for the work you do in building the integrity of financial markets in New Zealand.

Regards

**Richard James**  
Chief Executive

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