

26 April 2018

Code Working Group
C/o Code Secretariat (Poppy Haynes and Max Lin)
Ministry of Business, Innovation and Employment
PO Box 1473
Wellington 6140
New Zealand

Dear Sirs/Madams,

Re: Code of Professional Conduct for Financial Advice Services – Consultation Submission

Our Background:

- We are a 7 person, independent, boutique financial advisory and investment management firm with offices in Auckland and Tauranga. The business was established in 2003.
- Our advisers are Authorised Financial Advisers with extensive industry experience. We are also a licensed Discretionary Investment Management Services provider.
- The two principals of the firm Mike Newton and Wayne Ross are making this submission. In addition to our 15 year experience in providing financial advisory and investment management services, we both have extensive institutional funds management backgrounds and have managed large funds management businesses in New Zealand.
- We are uniquely placed to understand the needs of institutional providers and the smaller owner-operator advisers.

First Impressions:

Following the provision of the Consultation Paper (“CP”) and CWG presentation on the Code of Professional Conduct (“COPC”) at the Auckland University Business School, we have some serious concerns with the scope of Consultation in addition to the specific areas of submission the CWG is seeking.

Key Scoping Issues:

The CP in several places ties itself into knots trying to accommodate a scope that is too wide and unwieldy. The outcome is a confusing creation of concepts that lacks accuracy. We believe there are 5 key scoping issues that the CWG should urgently address which would simplify the scope and clarify the COPC development needs.

- 1) **Good Advice Outcomes.** This is at best an ambiguous concept and at worst misleading. It is a vision constructed to accommodate product advice.

“**Client First**” is unequivocal to all participants. It leaves no room for interpretation and should be the simple focus for all COPC standards. Making this change alone addresses many of the conflicting aspects of the CP.

- 2) **Remove the concept of product advice.** This is an institutionally driven concept and not required to deliver the ‘advice volume’ the CWG thinks it needs to be achieved. The concept of Product Advice is “**the**” key issue for the conceptual complexity and ambiguity in the CP.

Recommending a single issuer product or products to a client does not constitute advice as a consumer would expect and we believe is misleading. We think it is dangerous to legitimize sales as advice by creating this concept. Where the FAP is also the issuer (or a related party or commission or other benefit receiver) any product provision to a customer should be information only where a customer knows their own needs and is just seeking a product fit. Where a client is not sure of their needs and a recommendation is being made then this should constitute higher level advice and must be regulated at that level accordingly.

E.g. A bank teller providing information on their bank’s term deposits and even Kiwisaver is fine. As soon as they are asked “what do you advise or what should I do” or similar, they need to speak to a qualified person. Customers need to understand they can no longer expect front line bank staff to provide this type of advice. This is about customer education and not facilitating front-line staff to provide “Product Advice” to appease customer service expectations or facilitate fast transactional delivery.

- 3) **Person vs Entity Adviser.** Introduce the concept of person provide advice and entity provided advice. It would be helpful to structure the COPC into entity provided advice (not provided by a person) and person provided advice. Robot advice or mass generated advice recommendations would fall into the entity advice category.

Personal advice providers would then have “Occupational Code” obligations under the new COPC and entity provided advice would have “Service Code” obligations under the COPC.

- 4) **Use the industry understood definitions for advice types.**

Presently the CP has Product Advice then Financial Planning as advice type categories. This is not appropriate and drags too many providers into the Financial Planning definition.

Financial Planning has a clear international concept of practice and education. Financial Planning refers to holistic advice for a client. This includes, insurances, debt, investments, asset structuring, estate planning, etc. Very, very few advisers in NZ participate in Financial Planning as very few customers are prepared to pay the cost for undertaking such an extensive exercise. Care needs to be taken in generally placing advisers into this category of definition. It is mislabeling and does not reflect market understanding or industry practices.

The CP needs to break down advice categories into Investment Advice, Investment Planning, Financial Planning, Life Insurance, General Insurance and Mortgage advice. These definitions are well understood by the industry. This would also assist to align the Competency, Knowledge and Skill standards.

- 5) **Aggregated or combined Competency, Knowledge and Skill (“CSK”)**. This is fatally flawed concept that will ensure a completely unskilled person provides poor customer advice. There are no systems, processes, governance, compliance, ethics, audit regulations or standards that will prevent customers being poorly advised if the person providing the advice is not competent. Combined CSK is a construct to accommodate institutions provide volume advice. Where an individual is providing advice (person advice), they need to meet the individual occupational code standards. Otherwise it should be product information provision as with point 2) above.

Further issue not covered in the COPC:

Wholesale vs Retail. The definition for wholesale means there are far too many consumers who are not sophisticated that fall into this definition and do not receive the protection of the FMCA and now also not the COPC. This continues to be the elephant in the room for the industry with many advisers operating specifically in this area on a largely unregulated basis. It would have been good to test this issue with MBIE and the government to try and drag in wholesale advice to the COPC for regulation where it relates to anyone other than professional institutions.

The rest of this submission provides a more detailed response to the points raised in the CP.

We advised the prior government’s Minister, Jacqui Dean in writing that we believed the make-up of the CWG members was problematic in that there were no practicing advisers on the board. This concern appears to have been reinforced by the present drafting work of the COPC. It was critical to have a practicing adviser(s) involved in the early debate and scoping. It now appears the CWG has progressed too far down its current path and possibly too late to enable meaningful change through this submission process. We hope that this assumption is incorrect.

We would like to offer (as previously extended) our services to the CWG to provide further input or to assist to workshop the scope or any specific aspects of the CP.

Yours sincerely,

S 9 (2) (a)

S 9 (2) (a)

Mike Newton
Director

Wayne Ross
Director

Submission Detail

- 1) **Principles for drafting the Code.** (Points 46-71) Questions A,B
 - a) **Good Advice Outcomes.** This is at best an ambiguous concept and at worst misleading. It is a vision constructed to accommodate product advice. “Client First” is unequivocal to all participants. It leaves no room for interpretation and should be the simple focus for all COPC standards.
 - b) **Principle 1.** Introduce the concept of person provide advice and entity provided advice. It would be helpful to structure the COPC into entity provided advice (not provided by a person) and person provided advice. Robot advice or mass generated advice recommendations would fall into the entity advice category. Personal advice providers would then have “Occupational Code” obligations under the new COPC, entity provided advice would then have “Service Code” obligations under the COPC

Principle 2. Basis of client knowledge. Drafting the code on the basis that most retail clients have basic knowledge is in our opinion is a false starting point. No knowledge should be assumed. That is our starting point when dealing with clients. The board might be shocked at how little people, even supposedly educated people, know...even understanding what a % is. Putting some knowledge expectation back on the client means advisers may have an inappropriate defense for inappropriate advice.

Aggregate or combined competence, knowledge and skills. What does aggregate capability even mean? This concept is a construct to support large institutional delivery. There is no client focus with this. This enables a front line NR with little or no competency to deliver advice to a consumer under a “system’. Presumably this is about volume of “advice” rather than quality. A clear example is where an NR is recommending someone go into particular Kiwisaver fund. But not necessarily addressing if a customer should even be in Kiwisaver. The answer lies in removing the concept of Product Advice and just having product information provision. Customers must acknowledge no advice is provided. If they want advice they need to go into a person or entity driven (Robot) advice process. Regardless of any “Service Code” standards, the use of aggregate or combined competence concepts will lead to poor customer advice.

Principle 3. Fine.

Principle 4. Indicates the Code will be agnostic to how advice is delivered (point 68) and regard the cost of compliance. This principle then seems to be ignored in the rest of the CP which is highly prescriptive in both areas.

2) **Ethical Behavior** (Points 72 to 116). Questions L,M,O,P,Q,R,S,T,U,V,W,X,Y

- a) Establishing ethical standards in the code is fine. However, trying to impose standards around ethical processes is fraught. The code is the code and FAPs, FAs and NRs should just be required to demonstrate they are meeting that standard...their processes should be up to them.
- b) Ethics training should be included in the continuing education requirements of the FAs only. FAPS should only undertake this responsibility when they have NRs.
- c) Ethics resolution training should be part of continuing education as per b) above. This requirement sounds like a new consulting industry is being nurtured.
- d) Compliance Functions and ethical responsibility for whole advice including suppliers. The CWG needs to understand the commercial impact of this type of thinking on small advisory businesses that do not have the financial capacity to put some of these concepts into practice. Smaller businesses are more likely to sub-contract suppliers and therefore would disproportionately wear the cost of this compliance. If FAs and FAPs with NRs are required to undertake ethics training as part of continuing education then the job is done.
- e) Reinforcement of good ethical behavior...see d) this is ridiculous and looks designed for bureaucratic appearances only. Set the high level standards but don't delve down into this type of detail that is effectively telling businesses how to set up their operational activities to achieve the standards.

3) **Conduct and Client Care**. (points 117 to124) Questions Z

- a) **General.** There should be one set of standards for financial advice and the present AFA code works well in this regard. The FA should be responsible for meeting those standards and the FAP only where they have NRs or provide robot advice and take on that responsibility for them. Let the FAP work out how they will meet the standards in terms of practice and process...again don't go to this level (as per 2(e) above).
- b) **Advice Giving Standards** (Points 125-130) Questions AA to EE

We think the AFA standards are effective and should be adopted. For FAs and FAPs with NR). The non-person delivered advice might have some tweaks for that application. The AFA standards can be a compliance burden but this is where the compliance burden should reside. Advice giving standards are where the customer is most importantly protected. Limited advice is provided for under the current code and can be dealt with efficiently with the existing standard. We are aware of advisers using 'class advice' provisions to defeat some of personalized advice standards under the current code. The removal of the definition will assist this.

On CS7. A critical issue is whether the advice being provided is being done so from an independent basis or whether the advice provider is not independent by either using own firm products or receiving any form of benefit other than a transparent fee for that advice.

We think an adviser should have to explicitly say whether their advice was “Independent” or not.

On Point 130. Additional matters...where do you draw the line on issues? We think the existing code wording is fine subject to the requirement to declare independence or not.

c) Advice Process (Points 131 to 134) Questions FF to KK

As per our previous comments. We don't think you should try and introduce standards or guidance around process. Process is a business decision on what is required to meet the rules of the code.

Personalised suitability. The removal of the distinction between Personalised vs Class Advice is positive as too many were gaming class advice that in our opinion was personalized. The present AFA code uses the words “having regard to the nature of the personalized service being provided”. While this applies to making reasonable enquiries as to a client's situation it could also be used as a broad measure for suitability standard as follows:

“An adviser should determine suitability having regard to the nature of the contracted service being provided”

This then leaves the adviser and client to contract for the service provided/ received. We would recommend staying away from trying to determine suitability standards for different types of advice otherwise you are back to the class vs personalized concept.

d) Organisational Standards (Points_145-150) Questions LL, MM

Putting in standards around organization culture & values is esoteric and difficult to define let alone put into regulated practice. We think this is highly subjective and looks like rich ground for external consultancy businesses. The issues identified in this section would be covered with a **‘Client First’** standard and the requirement for FAs to undertake ethical training as part of their continuing education. Please be aware of the regulatory burden overlay of introducing these types of concept standards onto small to medium size organizations when they issues can be dealt through other standards' requirements.

Point 151. CS 9 can deal with this. The issue relates to having an appropriately scoped written contract for service with the client. The contract for service will say what the adviser will deliver, the benefits and risks and the client should sign off on this. If this service requires detailed client enquiries and detailed paperwork, then that is what the service contract will indicate or not, if not.

Point 152. Having to have a “demonstrable process that determines a client's reasonable expectations” is gobbledygook. Written advice documentation as a standard should show what the client's needs are and how they have been addressed with the advice.

4) **General competence, knowledge and skill** (Points 153-168) Questions PP,QQ,RR,SS

The concept of aggregate or combined expertise in delivering an advice outcome is deeply flawed. It implies a FAP could have strong CKS within the organization but the FA or NR does not. Combined or aggregate CKS might be appropriate to apply to entity advice (robot advice) but not to person delivered advice. An NR and FA must be able to meet General and Particular CKS as it might apply to the scope of service they are delivering to the client. The aggregate or combined concept should be removed. Where a FAP is taking responsibility for CKS equivalency it should only be for entity advice services (robot advice).

The CKS standards as drafted are clearly designed to provide relief for large institutions running NRs. All person advisers must meet the CKS standard personally, not on some combined institutional measure.

For general competence use Level 5 Core and then add on strands as they relate to particular competence areas – mortgage, personal insurance, investment advice/financial planning.

5) **Particular competence** (Points 169-188) Questions TT,UU,WW,XX,YY

The CWG seems to have tied itself in knots here to accommodate product provision. We have to ask why? Separating product provision from advice is not difficult and really is the fundamental issue throughout this paper.

a) **Proposed Minimum Standards. Product Advice.** The concept of Product Advice is wrong and caters for vertically integrated providers. Where a single issuer product or products are being provided to a consumer this does not constitute advice as a consumer would expect and calling it so is misleading. It is dangerous to legitimize sales as advice by creating this concept.

The solution. Where the FAP is also the issuer (or related party or commission or other benefit receiver) any product provision to a customer should be either be information provision only. Or, where a client is not sure of their needs and a recommendation is being made then this should constitute higher level advice and be regulated accordingly. For compliance a customer would sign a form to confirm that either no advice and only product information has been given or to confirm that advice is being given.

E.g. A bank teller providing information on term deposits and even Kiwisaver is fine. As soon as they are asked “what do you advise or what should I do” or similar, they need to speak to a qualified person. Customers need to understand they can no longer expect front line bank staff to provide this type of advice. This is about customer education and not facilitating front-line staff to provide “Product Advice” to appease customer service expectations.

b) Financial Planning. This has a clear international concept of practice and education. Financial Planning refers to holistic advice for a client. This includes, insurances, debt, investments, asset structuring, estate planning, etc. Very, very few advisers in NZ participate in Financial Planning as very few customers are prepared to pay the cost for undertaking such an extensive exercise. Care needs to be taken in generally placing advisers into this category of definition. It is mislabeling and does not reflect market understanding or industry practices. The CWG needs to include on the spectrum Financial Advisers provide more limited advice than Financial Planners, while Investment Planners, Investment Advisers, Insurance and Mortgage Advisers advice scope is self-evident.

It appears you are also dragging into Financial Planning all types of non-product advice provision. Does this mean that mortgage, life insurance and general insurance advisers potentially have to have a Bachelors' degree and specific knowledge at Level 6? That will clear out the industry pretty quickly! Everyone will have to join a major issuer/provider and take cover under their FAP as an NR. Back to the old tied insurance company days. AMP and co. will be delighted.

Please note there is a clear industry understanding of the different types of advice areas and their designations. These should be used rather than trying to re-define them.

Use the current AFA COPC for any advice provision relating to investment advice. This includes investment planning, investment advice and financial planning. Entity advice (robot advice) should be dealt with separately to person provided advice and focus on processes to meet standards rather qualifications.

Those working in insurance and mortgage advice should only be required to obtain level 5 qualifications. Those RFAs without that current level should be required to undertake some form of short term bridging CKS tests for transition with a longer term requirement to obtain formal level 5.

Overseas equivalency. If someone has an existing Diploma in Financial Planning (or similar) to an NZQA assessed (at the applicants cost) equivalency level 6 then it should not matter if the Diploma was earned in 1985 and in South Africa. As long as the adviser meets continuing education requirements in NZ why make them re-sit a Diploma again in NZ?

Care needs to be taken to reasonably assess and accept existing overseas qualifications.