Submission to Ministry of Business, Innovation and Employment (MBIE)
on Issues Paper on
Review of the Financial Advisers Act 2008 and the Financial Service Providers (Registration and Dispute Resolution) Act 2008

18(d)

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Overview

It is time to refine the financial advice marketplace so that Kiwis can access suitable advice with minimum conflicts of interest. Implementing sound, clear, and fair policies will not only boost consumer confidence but may also bridge the widening gap between consumers who need quality advice and qualified financial advisers. This entails tailoring and upholding professional and ethical standards characteristic of more longstanding professions. The most important aspect is to continue the process of creating a profession from financial advisers. This is the world-wide direction.

True professions are marked by high education standards and clear ethical guidelines, which are embedded in behaviour, so outside control can be minimised. For financial advice to be viewed as a profession, regulatory policies should aim to set the same rules of conduct for all who hold the title of 'adviser.' It is overwhelming clear that the various names/designations used by advisers have created confusion among consumers. We believe that further clarity can be easily achieved around this and other issues.

In formulating our submission, we have considered global 'good' if not 'best' practices—as the financial planning/advice field is fairly young when compared to other fields. We have also had discussions with various industry participants including advisers, professional organisation leaders, representatives of MBIE and the FMA. Massey has also surveyed consumers of financial advice to add and inform our Review submission.

Please see below the responses to individual questions for the Review. We are hopeful that our submission will provide a clear and objective view of the strengths and weaknesses of the Financial Advisers Act.

1. Do you agree that financial adviser regulation should seek to achieve the identified goals? If not, why not?

Yes, we agree financial adviser regulation should seek to achieve the identified goals. However, we believe that an additional longer term goal is needed—seeking to create the conditions needed for the professionalization of financial advisers.

This is the world-wide trend and is compatible with the importance of financial advice in securing the financial robustness of NZ families. The consumer protection aspect, and the lack of consumer ability to make sound decisions without skilled advice, ensures that financial advice inherently fits a profession; like accountancy, rather than a sales industry, like car salespeople. This goal should be acknowledged so the government can help create the conditions required to process advisers along the pathway away from the sales force of the 1990's. *It needs to be emphasised that financial advisers are yet a profession*.

In the long run, regulation can progress from the current intensive sales-force–based style to a more hands-off profession approach. This will promote consumer confidence, though during the professionalism building process, consumer confidence tends to lag adviser behaviour.
It is vital to include this objective because the international experience with regulation of financial services is that smart operators can always find a way around prescriptive regulation. The only effective way to ensure a good outcome for consumers is thus to embed ethical values within sector participants.

The essence of successful regulation of financial intermediaries is the active encouragement of a "professional" culture. Without this professional culture advisers will endeavour to evade the letter of regulation. Regulators will spend their time chasing and prosecuting advisers, after damage has been done to consumers. Proactive encouragement of a professional culture will minimise activities which cause damage in the first instance.

The development of a professional culture and ethos should be recognised as the primary aim of FA regulation. As a profession develops the level of regulation should decrease, and move towards primary regulation being handled by professional bodies, rather than government bodies, like other established professions such as the medical profession is.

The problem is that the majority of the financial adviser industry in NZ has reacted to regulation and a FMA visit as a box-checking exercise, similar to a builder viewing a building inspection, rather than an invitation to change the way they view their vocation. Moreover, the current regulatory style and Code does not clearly require AFAs to behave 'professionally'. Code 1 requires AFAs to 'place the interests of the client first', which is very narrow and can be achieved at the level of a tradesperson. Code 6 requires AFAs to 'behave professionally in all dealing with a client' – which does not cover non-client activities. There is no embodiment of the spirit of professionalism.

The additional notes to Code 6 are limited, and leave the impression that professionalism can be achieved by following a check list of best practice. There is a lot more to it than that, it is a matter of culture. Again, regulation needs to embody and amplify that there is an ethical spirit to professionalism, a commitment to a sound process of behaviour. In addition, it may be helpful to define 'professionally', in a way which focuses on ethics.

The essence of 'professionalism' is:

(i) client centred advice,

(ii) a scientific approach to information gathering,
(iii) a regard for all aspects of client needs,
(iv) ongoing education,
(v) awareness of the limits of competence and a willingness to refer and
(vi) a strong ethical professional culture.

A key aspect of professionalism is the discouragement of unethical behaviour and attitudes. International evidence from the financial sector shows that in a profit-based culture, enforcing rules are very difficult as managers encourage compliance with the letter of the law rather than its spirit. Broad wording with regulation should be created requiring AFAs to 'behave as a prudent professional would behave'. This should not be further clarified, as that prescription would narrow the duty.

2. What goals do you consider should be more or less important in deciding how to regulate financial advisers?

The most important goal is to have professional financial advisers, as discussed in Q1.
The second most important goal is to provide accessibility of financial advice. It needs to be emphasised that the general underutilisation of financial advice by NZers, especially in insurance, makes it vital that one of the primary goals of regulation should be to reduce costs on advisers and encourage more entrants. There is a definite industry problem with a lack of new entrants, especially from more diverse ethnic groups.

3. Does this definition adequately capture what financial advice is? If not, what changes should be considered?

The existing definition is too narrow and needs substantial revision. We suggest an alternative definition of:
"*When a person makes a recommendation or gives an opinion to assist another person to achieve their financial goals, where that recommendation or opinion may be in relation to acquiring or disposing of a financial or other product or involve behavioural change*".

Financial advice not does not necessarily have to include activity related to a product, be it financial or otherwise. Thus it is vital to include non-product-based general advice. In addition, it is important to include non-financial products, such as real estate.

4. Is the distinction in the Financial Advisers Act (FA Act) between wholesale and retail clients appropriate and effective? If not, what changes should be considered?

While there needs to be a capacity for experienced consumers to be able to opt out of the regulatory regimen, the current distinction between wholesale and retail clients is not always appropriate. A person with substantial assets may not have sound financial capability. Research reported by Prof. Kempson at the recent *Financial Capability Summit* has shown that there are financially incapable rich people as well as financially incapable poor people.

The difference in meaning between 'assets' and 'size', which are currently used to distinguish between wholesale and retail clients, is not clear.

More thought is needed on what types of people should be permitted to opt out of the FAA frameworks and under what circumstances. However, any decision to opt out of the FAA frameworks must be a clear client decision.

5. Is the distinction in the Act between a personalised financial service and a class service appropriate and effective? If not, what changes should be considered?

The distinction between the two types of service is reasonable, but needs to be enhanced. Where advice being provided is class advice, there must be a requirement for this to be made clear. Where information is being provided about a product or class of product, this is class advice. However, if that information becomes a recommendation to purchase that particular product, or the discussion is about the advantages and disadvantages of that product (or class or products) for that client, it becomes personalised advice.

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

We agree that different requirements for advisers which depend on the risk and complexity of the products advised upon is appropriate.

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?

The categorisation system needs work. The current system of Category 1 and Category 2 products is too black and white in its approach. The difference in products is more a situation of shades of grey, and this needs to be recognised.

The CFP Board in the US provides guidance on the point at which an engagement is considered financial planning as follows:

"CFP Board does not identify a minimum number of subject areas for an engagement to be considered financial planning. While it is more likely for financial planning to exist when multiple subject areas are involved, in some circumstances a financial planning engagement may exist even when a single subject area is involved. For example, a financial planning engagement may exist when a client requests a comprehensive retirement plan or requires a complex estate plan. In determining whether a financial planning engagement exists, CFP Board considers the circumstances involved and, in particular, the following factors:

- The client's understanding and intent in engaging the CFP® professional
- The degree to which multiple financial planning subject areas are involved
- The comprehensiveness of data gathering
- The breadth and depth of recommendation"[1]

There needs to be clear rules so that any adviser or staff member know what type of advice is permitted, and in areas of doubt a referral to an AFA should be made. We suggest the CFP Board explanation can be adapted so that personal advice from an AFA is needed where the product is complex, involves multiple types of financial advice areas or is comprehensive in nature. Simplicity is the key to differentiating between product categories. Personal insurance products, such as income protection insurance and TPD, need to be included as more complex products.

[1] Source: https://www.cfp.net/for-cfp-professionals/professional-standards-enforcement/compliance-resources/frequently-asked-questions/financial-planning

Different levels of AFAs need to be developed. Three additions can include:

(i) Intern AFA, where those in training are regulated under a full AFA. This encourages entry, whereby a senior AFA takes legal liability for the intern. This is similar to a law clerk.

(ii) Mentor AFA, whereby those with a set level of experience can have a period of semi-retirement, advising less experienced staff, without the responsibilities and costs of full AFA,

(iii) Senior AFA, who own large adviser firms, and take legal responsibility for the overall advice guidelines created by the firm. This allows franchise owners or managers to be captured outside their direct role as advisers to particular clients. This could be seen as similar to a senior partner in a law firm.

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?

We are of the very strong view that the term RFA is misleading for consumers. Massey's 2015 *Consumers of Financial Advice (COFA)* survey demonstrated that clients of financial advisers are unclear about the distinction in services between AFAs and RFAs. For example, the majority of the respondents (36%) cite they use an RFA. But the majority (35%) cited investment advice as the dominant service provided by their adviser.

Terms need to be used which clearly indicate the differing levels of advice. This should indicate both level of complexity and product range.

AFAs could be renamed with a term such as *Professional Financial Adviser*, *Qualified Financial Adviser*, *Qualified Investment Adviser*, or use of the word '*Chartered*' as this fits in with the accountants. The objective should be to convey an image of professionalism. Thought should be given to defining and regulating insurance variations of these; e.g., *Qualified Insurance Adviser*. The Australian system of regulations of names such as "financial planner", "Investment Adviser", "Insurance Planner", "Certified Financial Planner", "Chartered Financial Adviser," etc., as well as any other variations, should be imposed to avoid AFAs practising under a misleading title. There is also the probability that unsuccessful applicants may simply continue in business as Category II under a different name by simply providing products with no advice – just hard selling. This leads to consumers being worse off and increases hardship for AFAs to establish a defined market reputation.

It is worth considering a system like that of Britain's. There, advisers who can only advise on a limited number of products, such as QFE advisers, are called Restricted Advisers, or Restricted Product Brokers. We need such a term for advisers who can only give advice on their own products. The issue with the current QFE designation or tied RFA advisers (--advisers who are tied to one or a limited number of product providers) is that there's the impression by the public that when an adviser is recommending a product they are saying, 'it is the best in the market'; however, most advisers are really saying 'this is the best product I can give you but there may be better products out there.'

Consideration could be given to advisers who offer only a limited number of products. We have doubts about the need for a separate QFE regulation arrangement. All QFE staff giving advice should meet normal AFA regulations. Non-AFAs within QFE's should not give advice.
RFA advisers could then be renamed as '*brokers*' or '*product salespeople*'. Given that RFAs currently only have to register and have no inherent education, there is no real need for a regulated term, as they are similar to used car salespeople. RFAs could be regulated as strict product sellers under the FSA Act.

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

We believe the general conduct requirements applying to all financial advisers, including RFAs, are appropriate and adequate. However, discussion in other questions around the AFA/RFA differences needs to be taken into account.

The scaling of advice needs to be considered. The level of advice given needs to correspond clearly to the income the adviser earns from that advice. Not all clients require a comprehensive advice service. There needs to be clear permission given that advice can be scaled. More thought needs to be given around creating certainty in the FA profession around regulation. The industry is currently feeling uncertainty in terms of how much advice can be scaled so they feel that they have to give full advice or nothing. This means that they are unwilling to offer advice to non-wealthy clients (85% of the population) even if it is generic advice. This is increasing cost and reducing advice cover.

This is vital as experience from the UK and Australia shows that one of the worst side impacts of regulation was the closure of small advisers who customised advice, in favour of large firms who offer standardised advice and focused on the sale of in-house products. This led to a worsening of advice quality.

This additional regulation should involve many areas.

(i) One would include regulation which impose a higher level of competence for principal partners or franchise owners. They should be legally responsible for the practises & processes of AFAs and junior staff – the company culture.

(ii) There needs to a change in legislation to allow controls on company structures or mergers if these would lead to the creation of commission driven groups.

(iii) Another area would be regulation relating to qualifications, expertise, authority, quality and legal responsibility of line managers in charge of AFAs. ASIC regulations would be a good guide.

(iv) Also, acceptable practises for the setting of sales quotas, inducements for achieving sales targets and the punishment and humiliation of staff who do not achieve their targets. This will be particularly important for corporate QFEs, as some NZ banks have proved unable to resist these practises. Company managers should be legally liable for deliberate or grossly negligent breaches of these regulations.

(v) International experience with financial institutions shows that the imperatives of meeting profit targets set by higher level managers create insolvable ethical issues for lower level managers who try to use a client-centred professional approach. *One suggested solution is for regulation to require OFEs and adviser/franchise firms of more than a minimum size to appoint a high-level manager to be appointed in charge of financial advice ethics*. This could be a part-time. This manager would be required to create a freely published corporate code ethics (approved by the Commissioner), to ensure the incorporation of this code of this into the company's training courses and to produce an annual ethics report on company compliance with the code. Company directors would be required to sign off on this, and thus be legally liable for it. This report should then be made publicly available so it can be subjected to public and media scrutiny, as public shaming is one of the most effective tools in overcoming corporate inertia.

(vi) AFAs who belong to QFEs as well as responsible line managers should be encouraged to belong to a professional association which has dynamic regular meetings.

10. Do you think that disclosing this information is adequate for consumers? Should RFAs be required to disclose any additional information?

RFAs need to disclose the range of products that they are able to assist with. If their product range is restricted, for example to less than half the market, an RFA should be *unable* to recommend a product as being the 'best' for the client. RFAs should also be required to disclose how they are remunerated, including the receipt of commissions and/or other incentives. Many current issues will be solved with clearer names.

11. Are there any particular issues with the regulation of RFA entities that we should consider?

We have no comment on this question. See the discussion on Q8.

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

We question the value of the ABS, but advisers will be better position to comment on this issue. However, we suggest a simple template would be more appropriate, with justification of the inclusion of all sections within the template by the regulators.

13. Is the distinction between an investment planning service and financial advice well understood by advisers and their clients? Are any changes needed to the way that an investment planning service is regulated?

We question the need for a distinction between an IPS and financial advice. However, if this distinction is considered necessary, then further extension of this concept is needed, for example to include an Insurance Planning Service.

14. To what extent do advisers need to exercise some degree of discretion in relation to their clients' investments as part of their normal role?

We have doubts about the ability of many advisers to actively make decisions about the purchase or disposition of investments for their clients. Any discretion for advisers in this regard should be very limited.

Individual advisers seeking to provide DIMS should be required to hold appropriate qualifications demonstrating the necessary technical skills. The current DIMS framework appears to have a focus on administrative procedures, rather than the technical competence of the adviser. Education and competence requirement need to be reconsidered.

15. Should any changes be considered to reduce the costs on advisers who exercise some discretion, but are not offering a funds management-type service?

We have no comment on this question (Q15).

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

Yes, current disclosure requirements for AFAs are generally adequate and useful for consumers. However there is the potential with current Code wording for advisers to be aware that: (i) the client needs a more comprehensive scope of advice than that offered, or (ii) a product offered by a competitor is markedly superior (or their own products are substantially inferior), and yet to be able to not mention this to the client as it is either not within the scope of service or the client does not ask about it.

The essence of financial advice is that the adviser knows more about the advice the client needs than the client does. The Code guidance notes need to make it clear than if the adviser is aware the client needs more advise than they can offer, or needs differing products than they can offer, then there is a positive duty on the AFA to refer the client for further advice to an appropriate specialist. It is like a doctor being aware a patient probably has cancer, but because they are not a cancer specialist, ignoring it.

17. Should any changes be considered to improve the relevance of these documents to consumers and to reduce the costs of producing them?

The PDS is appropriate because it is short and highly regulated. Work needs to be done to ensure the Secondary Disclosure Statement is shortened to encourage client engagement with the document. Advisers need to be given confidence that they can meet requirements while providing less information. A template-based format of not more than ten pages should be provided.

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

Yes, the process for the development and approval of the Code of Professional Conduct works well.

19. Should any changes to the role or composition of the Code Committee be considered?

The Committee needs to include more advisers from smaller practices. We are concerned that the current committee is overly reliant on institutional members.

20. Is the Financial Advisers Disciplinary Committee an effective mechanism to discipline misconduct against AFAs?

It is difficult to comment on the effectiveness of the FADC given its limited activity to date.

21. Should the jurisdiction of this Committee be expanded?

The FADC's jurisdiction should be expanded to cover all advisers.

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

Yes—as some advisers and other financial professionals are unclear about QFEs, how can one expect consumers to have a clear understanding?

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

Public ignorance around QFEs means that the transparency, or lack thereof, around their obligations has no real impact.

24. Are the current disclosure requirements for QFE advisers adequate and useful for consumers?

No, current disclosure requirements are not adequate nor useful at present. There should be guidance requiring Category I & II advisers to disclose to customers that they can only provide the products of a limited sub-set of suppliers and that the "products offered by other suppliers may be superior or better suited to the client's needs".

These categories should be clearly disclosed to clients in writing. The examples of benefits listed should be widened to include any product volume obligations or volume based bonuses, as well as any potential for action taken of any kind by employers/principles against advisers who do not meet volume targets.

It may be better to create intermediate disclosure categories:

– *Single Supplier/ Agent* – clearly an agent of one provider. Both agent and supplier are liable, including for advice.
– *Multi-supplier/ Agent* – both supplier and agent are liable, but the supplier is only liable in relation to its own products. Agent is responsible for advice.
- *Client/ Agent* – clearly agent for client. Agent alone is liable.

25. Should any changes be considered to improve the relevance of these documents to consumers or to reduce the costs of producing them?

Current disclosure requirements are not adequate. It needs to be made clearer that the advice being provided is restricted to a consideration of the QFEs products. Like an RFA with a limited product range (see Q5), QFE advisers should be unable to recommend a product as the "best" for the client.

We suggest the difference between the fiduciary standard and the suitability standard applied in the US would be an appropriate foundation for changes in this regard. A fiduciary standard entails acting in the *best interest* of the client and recommending appropriate strategies/products for that client. A suitability standard is a lower standard, calling for suitable strategies/products but not necessarily the best products for the client.[2]

26. How well understood are the broker requirements in the FA Act? How could understanding be improved?

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[2] Finke, M. S., & Langdon, T. P. (2012). The impact of the broker-dealer fiduciary standard on financial advice. *Available at* https://avectra.myirionline.org/eweb/uploads/SEC%20Fiduciary%20Study%204-1-12.pdf

We have no comment on this question (Q26).

27. Are these requirements necessary and/or adequate to protect client assets? If not, why not?

Yes, the requirements for brokers are necessary and adequate. They are vital to enhance public confidence.

28. Should consideration be given to introducing disclosure requirements for brokers? If so, what would need to be disclosed and why?

Introduction of disclosure requirements for brokers would be appropriate. Such disclosure should cover basic information about the broker, i.e. name, etc., as well as information about conflicted remuneration, dispute resolution service membership, trust account arrangements, and what happens in the event of a bankruptcy. See reference for Q25 to highlight US issues between brokers and advisers.

29. What would be the costs and benefits of applying the broker requirements in the FA Act to insurance intermediaries?

Modern financial market conditions involve fast transfers of funds between involved parties. There is now no justification for delaying payment transfer and no justification for exempting insurance intermediaries from the requirements of the FA Act.

30. Are the requirements on custodians effective in reducing the risk of client losses due to misappropriation or mismanagement?

31. Should any changes to these requirements be considered?

We have no comment on these questions (Q30-31).

32. Is the scope of the FA Act exemptions appropriate? What changes should be considered and why?

Lawyers and accountants should only be exempt in areas which are incidental to the primary advice areas for which they have competency. Any such exemptions should be very limited in their application. There should be no circumstances under which a lawyer or accountant would be giving personalised investment or insurance advice, unless they are also registered as an AFA. They have no competence in these areas. They should be required to refer clients to an AFA.
Equally an adviser should be referring clients to a lawyer or accountant for specialist advice in their respective areas of expertise.

33. Does the FA Act provide the FMA with appropriate enforcement powers? If not, what changes should be considered?

34. How accessible and useful is the guidance issued by the FMA? Are there any improvements you would like to see?

We have no comment on these specific questions (Q33-34), but would refer back to comments regarding the need for a professional culture.

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.

There is a need to promote the current system, and to provide information about the type of advisers available. There is also a need to amend the name of advice categories (see comments elsewhere on this issue).

36. To what extent do consumers understand that some financial advisers' primary roles may be selling financial products, rather than solely acting as an unbiased adviser to their clients?

We do not believe this is well understood. This is not assisted by RFAs and QFE advisers who are selling products being described as 'advisers'. Use of the term 'adviser' should be restricted to those whose primary role is advice. The majority of respondents in Massey's *COFA* survey cite competence and trust as top attributes sought when seeking advisers. Again while the majority of survey participants cite using a RFA among other types of financial advisers, the majority (34%) receive investment services from their adviser while only 13% and 16%, respectively, gain cash management and personal insurance services from their adviser. If the majority of respondents actually use RFAs we would expect the majority to fall within cash management and personal insurance products as the other financial service categories fall within the category of AFAs. When asked about the type of adviser currently used, one respondent cited "it is likely to be one of the above, but not being a financial expert myself, how am I supposed to know all the intricate names or qualifications of the financial adviser?"

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?

Yes, there should be a clearer distinction because that will influence what types of advisers can undertake these activities. Advice should include anything that is personalised. Sales should be restricted to details of the product and not include any form of recommendation. Information provision can include generalised advised but not any recommendation.

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

Disclosure required from AFAs is adequate. However, rules around mutual fund fee disclosure needs improvement.

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

Simplification of disclosure would be helpful for consumers.

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?

All financial advisers should be required to disclose commissions and conflicts of interests, with a template provided for such disclosure. All advisers should have the same requirements. Different requirements incentivise different ethical behaviours given past and worldwide regulatory efforts.

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?

Commission needs to be dealt with, especially following the recent Australian insurance advisory industry deal. Within the investments sector it is possible to ban all forms of commission and soft-dollar or volume bonuses, as clients are prepared to pay sufficient fees for this advice.

However, within the insurance advice sector clients are not at present prepared to pay sufficient fees to allow commissions to be banned. The ideal solution would be a restriction of upfront commissions and an increase in trails in such a way that overall adviser income is not substantially reduced.

This is the framework in Australia and handles the tendency to churn and sell, while encouraging advisers to service clients. It needs to be noted that, due to customer base size and superannuation arrangements, adviser costs are lower in Australia than NZ, so commission levels need to be set higher in NZ. Care is needed to set commission at levels that do not decrease current adviser income, and that time is taken. Soft-dollar and volume bonuses could be banned, though there is potential for retaining soft-dollar arrangements around training and education, subject to suitable guidelines. Given the need for sale-based techniques to overcome NZer's reluctance to discuss aspects of life like death, MBIE needs to be aware that proven methods of motivating a sales force can have a place with a regulated regime.

Substantial research is needed into this issue as NZ already has high level of under-insurance and more social harm would be created if advisers were discouraged (than harm would be reduced) by reduction in commissions.

Research is needed into:

(i) Why NZers are reluctant to purchase insurance without being persuaded by advisers.
(ii) The ideal max levels of upfront vs trail commissions
(iii) The level of adviser costs and where regulation does or would impact on these.

While Massey is intending to engage in some of this research, cooperation with the Ministry would be useful.

42. Has the right balance been struck between ensuring advisers meet minimum quality standards and ensuring there is competition from a wide range of providers (and potential providers)?

We do not believe the right balance has been struck. From discussions with industry participants, we believe that the quality standards are more cumbersome than necessary. This is discouraging advisers from staying in the field as well as making it difficult to attract new entrants.

43. What changes could be made to increase the levels of competition between advisers?

The current regulatory environment creates barriers to new entrants. The most effective means of encouraging increased competition is to enable a clear introductory pathway for new entrants, and to reduce the regulatory barriers. Some form of trainee pathway, such as paraplanners or junior advisers, is needed to provide a pathway into an advising career.

44. Do you think that the Code of Professional Conduct for AFAs strikes the right balance between requiring them to understand their clients and ensuring that consumers can get advice on discrete issues?

The Code of Professional Conduct is a world-leading approach. It is important to resist the temptation to move away from the current principles based approach.

45. To what extent do you think that the categorisation of types of advice and advisers is distorting the types of advice and information that is provided?

See related comments in response to Q7.
We believe that there is a distortion of the advice and information provided simply by definition of the types of advice and advisers and the associated regulatory constraints.

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

We don't believe there is an undue cost as a result of compliance requirements per se. Rather the undue costs are the result of the lack of clarity and confidence for advisers and for clients. When asked if their relationship with their adviser changed as a result of the FA Act, a *COFA* survey respondent remarked, "he has less time to spend with me and when he does he gives me mountains of paper work."

47. How can regulatory requirements be made less onerous without reducing the quality and availability of financial advice?

Regulatory requirements can be made less onerous by providing greater clarity about what is required, so that advisers have greater certainty as to what they must do to comply. Regulation needs to support the independence of advisers from the product providers, and the ability to represent multiple product providers. In the long run, if there is a focus on the development of professionalism, the sector will become largely self-regulating and the need for government regulation will reduce.

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?

The impact on cost has been substantial, so any reduction in complexity will be useful. Unfortunately New Zealand is limited by its need to adhere to international regulatory requirements.

49. What impact do you expect that KiwiSaver decumulation will have on the market for financial advice in New Zealand? Are any specific changes to regulation needed to specifically promote the availability of KiwiSaver advice?

Moving into the decumulation phase for KiwiSaver will have a significant impact for financial advice, because the need for advice during decumulation is quite different to the advice needed during accumulation. This will grow as KiwiSaver balances grow and become more substantial. In addition, longevity trends makes this issue even more important.

During the accumulation phase, the availability of KiwiSaver advice can be promoted by supporting appropriate promotions, particularly through the professional associations. Changes to categorisation of KiwiSaver products and amendments to related regulations to simplify access to such advice would also be beneficial.

A suggestion has been made of using the Member Tax Credit in the final two years before the age of eligibility to fund a scheme providing free advice for all KiwiSaver members. Such advice should be required to come from independent, non-QFE advisers. See details of UK scheme.

Clearer guidelines around the ability of advisers and other interested parties to give generic advice to groups would be beneficial, as it appears advisers are currently reluctant to do this.

50. What impact do you expect that the introduction of the FMC Act will have on the market for financial advice in New Zealand? Should any changes to the regulation of advice be considered in response to these changes?

The impact of the FMC Act on the market for financial advice is difficult to judge. However, we would not expect this to require any changes to the regulation of advice.

51. Do you think that international financial advice is likely to increase? Is the FA Act set up appropriately to facilitate and regulate this?

International advice is expected to largely take the form of 'robo-advice'.

Consideration needs to be given to the expanding area of advice by software, nicknamed 'robo-advice'. This is still in a very primary stage, but should reach a state where it can be expected to become an increasing part of the NZ FA scene within 5 to 10 years.

This has a strong upside as it will allow advice to be given to the bulk of the less wealthy section of the population at a price they can afford. This is a major factor in the area of advice for those withdrawing KiwiSaver funds.

The possible downsides are:

(i) current advisers will need to upskill—be able to offer more than software can (i.e. added value), especially behavioural issues, which may led to some advisers exiting the field,

(ii) an increasing bulk of advice will be offered by off-shore advisory firms, so that the next round of FA regulation will have to be primarily around international services.

52. How beneficial are the current arrangements for trans-Tasman mutual recognition of qualifications? Should further arrangements be considered?

We have no comment on this question (Q52).

53. In what ways do you expect new technologies will change the market for financial advice?

See the response to Q51.

54. How can government keep pace with technological developments to ensure that quality standards for advice are maintained, without inhibiting innovation?

Provided the regulation remains focussed on the provision of quality advice, it should be technology-neutral so that it is irrelevant whether the advice is provided by a person or by computer software.

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

The essence of successful regulation of financial intermediaries is the active encouragement of a "professional" culture. Without this professional culture advisers will endeavour to evade the letter of regulation. Regulators will spend their time chasing and prosecuting advisers, after damage has been done to consumers. Proactive encouragement of a professional culture will minimise activities which cause damage in the first instance.

The development of a professional culture and ethos should be recognised as the primary aim of FA regulation. As a profession develops the level of regulation should decrease, and move towards primary regulation being handled by professional bodies, rather than government bodies, like the medical profession is.

The problem is that the majority of the financial adviser industry in NZ has reacted to regulation and a FMA visit as a box-checking exercise, similar to a builder viewing a building inspection, rather than an invitation to change the way they view their vocation.

The major problem with the current regulation style and the Code is that it does not clearly require AFAs to behave 'professionally'. Code 1 requires AFAs to 'place the interests of the client first', which is very narrow and can be achieved at the level of a tradesperson. Code 6 requires AFAs to 'behave professionally in all dealing with a client' – which does not cover non-client activities. There is no embodiment of the spirit of professionalism.

The additional notes to Code 6 are limited, and leave the impression that professionalism can be achieved by following a check list of best practice. There is a lot more to it than that, it is a matter of culture. Regulation needs to embody and amplify that there is an ethical spirit to professionalism, a commitment to a sound process of behaviour. In addition it may be helpful to define 'professionally', in a way which focuses on ethics.

The essence of 'professionalism' is:

- *(i)* *client centred advice,*
- *(ii)* *a scientific approach to information gathering,*
- *(iii)* *a regard for all aspects of client needs,*
- *(iv)* *ongoing education,*
- *(v)* *awareness of the limits of competence and a willingness to refer, and*
- *(vi)* *a strong ethical professional culture.*

A key aspect of professionalism is the discouragement of unethical behaviour and attitudes. International evidence from the financial sector shows that in a profit-based environment, enforcing rules are very difficult as managers encourage compliance with the letter of the law rather than its spirit. Broad wording with regulation and the Code should be created requiring AFAs to 'behave as a prudent professional would behave'. This should be further clarified, as that prescription would narrow the duty.

The best way to encourage a professional culture is creation of a collegial atmosphere which encourages members to promote professional ethics-based attitudes and discourage non-ethical attitudes. An effective way of doing this is to encourage and support the development of professional bodies which develop a strong culture of encouraging mutual support of ethical behaviour and condemnation of unethical behaviour. It is vital that the code encourages such professional bodies. A note could be added to Code 6 requiring individual AFAs to be a member of a professional body. See the CFP Board's framework for disciplinary measures among CFP® professionals[3]. How would a lawyer envisage 'best practice' without the help of colleagues in the Law Society?

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

We believe that ethical standards should be the same for all financial advisers. Differences in ethical standards would encourage advisers to adhere to the minimum standards required or provide ways to circumvent said standards.

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

One of the major issues with the current AFA education requirements is that it is tending to lead to a vastly lower levels skill in the industry than was the case pre-regulation. Prior to the Code, financial advisers seeking to follow global trends as well further distinguish themselves as professionals were aiming to obtain a Level 7 qualification via a Graduate Diploma and CFP/CLU. The need to obtain Level 5 before obtaining the AFA designation discourages new entrants from continuing on to the Level 7 qualification.

A Level 5 qualification, however, is only acceptable as an interim measure or for lower level category 2 specialities. The reason for this is that a Level 5 qualification has a very low theoretical content and is more suited to staff involved in routine back-office procedures than expert advisers. Even if content headings indicate some complexity, the very limited classroom hours ensure that AFA is very limited.

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[3] Source: http://www.cfp.net/for-cfp-professionals/professional-standards-enforcement/standards-of-professional-conduct/disciplinary-rules-procedures

Teaching style is repetitive and recall driven rather than the exercise of independent judgement. Level 5 is the lowest class of sub-degree diploma and is below year 1 university education. This is appropriate for category II advisers but inappropriate for a professional expert culture required of a category I adviser. Examples of areas where Level 5 would be acceptable would be a Kiwisaver adviser who is restricted in their activities.

The baseline assessment for category I advisers should be increased above Level 5, preferably to Level 7. Discussion will be needed as to the time scale this can upskilling of the industry will be possible within. A five year period would be a starting point.

Massey staff were involved in the rewriting of Level 5 qualifications, and are aware that the curriculum taught at Level 5 are quite basic, and tied to generalised non-complex situations. Graduates have, thus, no ability to deal with complex situations or nuances of real-life situations. Ideal jobs for a Level 5 graduates are clerical or administrative, rather than client advising.

One of the lessons of the recent financial crisis and the collapse of finance companies is that the level of theoretical expertise required of an investment and/or financial advisers is at a high level. The level of technical competency displayed by NZ advisers has in general been low. Examples of this were the inability of some advisers to understand the relative performance of assets over a business cycle or to tell the difference between a fixed interest rate mutual fund and a CDO mutual fund. In the medium term, investment and comprehensive, advisers need to be subject to a Level 7 qualification.

The Level 7 university graduate diplomas are composed of year 2 and 3 papers from a degree so graduates achieve the same level of complexity as a degree holder (as distinct from a 'diploma' which is composed of Level 6 papers), without the added cost of the additional first year and optional papers.

It needs to be noted, however, that the international trend for investment/comprehensive advisers is a *degree level* requirement. Massey is prepared and able to introduce a degree major in financial advice, if that is regulated

It also needs to be noted that Level 7 qualifications are inherently set at an international level, so NZ curriculum should tie in with similar legislative regimes. In any conflict between international and domestic standards, the international has to be take precedence. Where these international standards are recognised as best-practise, then these should be accepted as setting competency standards, subject to localisation.

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?

The issue of level of qualification of personal risk insurance advisers is more complex. The level of complexity involved in assessing the risk profile and product inter-relationships is very similar to that required by investment advisers. The process is the same 6-step process recommended by the CFP. This includes:

(i) Establishing the client relationship,
(ii) Collecting client information,
(iii) Defining objectives and evaluating risk, both pre and post loss,
(iv) Plan development,
(v) Plan implementation and
(vi) Evaluation and review.

The complexity of income or trauma insurance policies will normally exceed that of investment products.

Thus, ideally personal risk advisers should be treated similarly to investment advisers and their minimum qualifications set at Level 7. However, the current industry adviser profile mix is such that imposing this requirement in the short-term would lead to a large scale exit of advisers. Thus at this stage minimum qualification should be set at Level 5, with a clear indication established that in the medium term (2-5 years) this will be upgraded. Note that Australia treats personal risk as a complex product.

It may be useful to define a more complex set of insurance advisers who deal with clients with complex needs, like business insurance. These clearly have a need for Level 7 qualifications.

As an aside, it would be useful if all Ministry publications could use the term 'personal risk insurance' rather than continuing their use of 'life insurance', as the latter term is highly inaccurate and misleading to the public.

59. How much consideration should be given to aligning adviser qualifications with those applying in other countries, particularly Australia?

There should be limited consideration given to international alignment of adviser qualification. However, it is important to allow for the recognition of adviser qualifications from other countries, particularly credentials from international bodies such as CFP^{CM} from the Financial Planning Standards Board.

60. How effective have professional bodies been at fostering professionalism among advisers?

The professional bodies have become quite professional in their approach. However, the current regulatory environment does not encourage membership of these bodies and this has led to deterioration in the general level of professionalism in the sector; thereby limiting the role and relevancy of belonging to a professional body.

61. Do you think that professional bodies should play a formal role in the regulation of financial advisers and if so, how?

It needs to be recognised that "competence" is not just a matter of obtaining a one-off qualification. It is about having up to date skills and practising a professional approach. There is a requirement for a combination of theoretical knowledge, technical skill, practise management, commitment to ethical and professional behaviour and continued professional training credits. Holders of the Level 7 diploma by itself, therefore, should only be recognised as meeting theory requirements. Therefore, the Level 7 qualification needs to be joined to a professional qualification.

Development of a professional culture is enhanced by the existence of professional bodies. A professional regime is inherently co-regulatory. The best way to encourage a professional culture is creation of collegial atmosphere which encourages members to promote professional ethics based attitudes and discourages non-ethical attitudes. An effective way of doing this is to encourage and support the development of professional bodies which develop a strong culture of encouraging mutual support of ethical behaviour and condemnation of unethical behaviour. It is vital that the

code encourages such professional bodies. A note could be added to Code 6 requiring individual AFAs to be a member of a professional body. How would a lawyer envisage 'best practice' without the help of colleagues in the Law Society?

Regulation should thus require all advisers to be a member of an approved professional body. Such professional bodies must be independent of providers and member groups, and non-profit in nature. The resulting growth in membership that could be expected should lead to economies of scale and enhanced provision of services to members by these professional bodies. While multiple professional bodies should be encouraged, there should be a regulatory limit on the number of professional bodies approved for this purpose.

62. Should any changes be considered to the relative obligations of individual advisers and the businesses they represent? If so, what changes should be considered?

We have no comment on this question (Q62).

63. Is the QFE system achieving its goals in terms of consumer protection and reducing compliance costs for large entities? If not, what changes should be considered?

We believe the QFE system is achieving its goal of reducing compliance costs for large entities. QFE advisers need to make it clear that the advice being provided is very restricted, and they should be unable to recommend a product as 'best' for the consumer.

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

65. What goals do you consider should be more or less important in reviewing the operation of the Register?

We have no comment on these questions (Q64-65).

66. Do you agree that the dispute resolution regime should seek to achieve the identified goals? If not, why not?

We agree the dispute resolution scheme should seek to achieve the identified goals.

67. What goals do you consider should be more or less important in reviewing the dispute resolution regime?

Consumer awareness of dispute resolution is the most important goal, because the other goals cannot be achieved if consumers are not aware that the schemes exist. Greater promotion by the regulator of the existence of these schemes is needed to enhance consumer awareness.

68. Does the FMA need any other tools to encourage compliance with FSP registration? If so, what tools would be appropriate?

69. What changes, if any, to the minimum registration requirements should be considered?

70. Does the requirement to belong to a dispute resolution scheme apply to the right types of financial service providers?

71. Is the current framework for the approval of dispute resolution schemes appropriate? What changes, if any, should be considered?

72. Is the current framework for monitoring dispute resolution schemes adequate? What changes, if any, should be considered?

73. Is the existence of multiple schemes and the incentive to retain and attract members sufficient to ensure that the schemes remain efficient and membership fees are controlled?

74. Should the $200,000 jurisdictional limit on the size of claims that dispute resolution schemes can hear be raised in respect of other types of financial services, and if so, what would be an appropriate limit?

75. Should additional requirements to ensure that financial service providers are able to pay compensation to consumers be considered in New Zealand?

We have no comment on these questions (Q68-75).

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

Greater ability to search the Register would enhance its usefulness among consumers. The Register would also be more useful if it had sections for different types of financial service providers, such as advisers and insurance product providers. The sections should then have different information requirements; for example, the adviser section should detail qualifications, skills, and competencies.

77. Would it be appropriate for the Register to include information on a financial adviser's qualifications or their disciplinary record?

We believe this would be appropriate.

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?

79. Are there any changes to the scope of the registration requirements or the powers of regulators that should be considered in response to this issue?

We have no comment on these questions (Q78-79).

80. What are the effects of (positive and negative) competition between dispute resolution schemes on effective dispute resolution?

We consider it advantageous to have multiple dispute resolution schemes, albeit in limited numbers. However, we are unable to provide a comment on the effects of competition between these schemes.

81. Are there ways to mitigate the issues identified without losing the benefits of a multiple scheme structure?

We have no comment on this question (Q81).

82. Are the current regulatory settings adequate in raising awareness of available dispute resolution options? How could awareness be improved?

Greater promotion by the regulator of the existence of these schemes is needed to enhance consumer awareness.