Submission to Code Working Group

Financial Advice Code

9 November 2018

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Thank you for the opportunity to submit. We have elected to follow a free format.

We were highly critical of CWG's first Consultation paper on a number of levels.

We are pleased that CWG listened to those earlier submissions and has decided not to write the mandatory "how to run your practice" bible.

We recognise that a number of commentators have welcomed this redraft. Some passed judgment within hours of its release, and praised its brevity and the fact that it is an easy read. But we caution that this does not automatically make it a good document, nor a sound basis for regulating the industry.

Indeed we are as critical of this draft as we were of the earlier consultation paper, but for different reasons.

The overwhelming tenor of our submission is that the draft Code is both lacking in content and platitudinous.

We have several fundamental criticisms.

1. CWG appear to have abrogated what we think was its duty as set out in FSLAB. Instead, they have made high level statements in a number of important areas, but left the flesh to other regulatory entities to provide:
    - CPD details apparently left to the professional bodies, despite no obligation to be a member of a professional body
    - a lot of things that were expected to be in the Code left to FMA to sort out via the licensing process
    - competence assessment effectively left largely to an unknown APL (assessment of prior learning) capacity.

2. Case studies – the few case studies CWG has included have defects:
    - the replacement business one has been almost universally panned
    - the CKS ones are trivial – an entity who has 4 nominated reps who are all Level 5 qualified is most unlikely to occur in practice; and any half-intelligent reader would have easily come to the same answer;
    - Case studies in our opinion should be used to assist in less clear-cut cases.

3. The Code has a number of components that we would say are platitudinous or "apple pie and motherhood" [AP+M] statements. Everyone nods their head in approval when the words are read – "that sounds right" – yet no two people actually agree what the concept means. This continues the defect in the AFA Code's overarching Code standard 1 - to "put the client's interest first". The debate over the last few years culminating with the Code Committee's own amazing submission to FSLAB on the meaning of the concept amply illustrates the problems with using AP+M slogans.

For example:

- Standard 1 has two concepts, “fairness” and “act in the interests of the client”. “Fairness” gets ample treatment as to how to define it;” interests of the client” just stands there naked.
- Standard 2 uses the phrase “do the right thing”. What does that really mean? We have scanned the internet for enlightenment, and discovered there are a number of ethical frameworks that are used that might come up with different answers. Often there is not just one way of doing the right thing, there are several “right things” that could be done. If a financial adviser applies their framework to choose which one is right, what happens if the regulatory reviewer has a different framework and says the adviser should have done a different “right thing”?
- Standard 8 talks about “bringing the industry into disrepute.” We had the same problem with the AFA Code. But there has been no successful prosecution under that standard and we doubt if there ever could be, especially when no other charges had been found proven, because there is absolutely no context to it.

4. We believe that there are a number of useful matters the AFA Code covers that we think should be added back into the new draft Code
    - The prohibition on borrowing from or lending to a client
    - Rules around record keeping
    - The hard-fought-for approval in AFA Code Standard 8 that it is OK for the person providing advice and the client to agree upon a scope that is less than a full plan covering all the issues that anyone anywhere might have thought arise under the particular circumstances.
    - Explicit acknowledgement that it is up to each adviser to determine what counts as CPD for themselves, within a framework of simple and easy-to-understand principles
    - A quantitative standard for CPD

5. Special case – replacement business in life and health insurance

    There is a limp-wristed attempt to handle this topic in the much criticised case study in Standard 3.

    We believe the area of replacement business in life disability and health insurance is a critical area, where special requirements are needed to protect the consumer. The risk of losing coverage under the replaced (existing) policy and having a claim declined under the replacement (new) policy that would have been paid under the old policy is a strong theoretical possibility.

    We think regulators continue to turn a Nelsonian blind-eye to the issue in their tacit approval that there is no obligation on the adviser writing the new policy to enquire as to whether there is an existing policy that will be replaced. Anecdotally this occurs often when

a VIO adviser is involved. Clients must be advised never to cancel an existing policy until the replacement policy has been accepted and issued.

We accept the general proposition that the adviser and his/her client should be free to determine a limited scope. But we think this area of life and health insurance replacement is a special case and the adviser should not be able to exclude from scope any enquiry as to whether there is existing insurance that will or might be replaced.

Our suggestion is that based on that enquiry:

IF a comparison of the old and the new is excluded from scope, the adviser must give a written warning that has been agreed with the regulator** as to the risks of not doing a comparison;

ELSE otherwise the adviser is required to give a comprehensive analysis of the relative costs and benefits of both the original and the replacement policies.

** We believe there is a huge advantage to the Regulator (working with the industry) to publish a statement as a "general health warning" about the risks and disadvantages of not doing such a comparison that has to be used by the whole industry in these cases.

6. Nominated representative name – we doubt that many financial advice providers who are licensed to employ nominated representatives to provide advice on their behalf will actually give such persons the job title nominated representative. They won't be able to call them financial advisers (except individuals who are separately qualified as financial advisers) but we reckon the public will be faced with a plethora of job titles – which has the great possibility of simply leaving the public confused – will they know what an ANZ Mortgage Coach, a BNZ Investment consultant or an ASB Kiwisaver Specialist, for example, are under the law? We sincerely doubt it.

   This is a major concern that we have not seen raised elsewhere.

7. Our submissions on the actual text of the draft Code are set out as a Schedule to this cover letter.

Once again we offer to meet with CWG to discuss any aspects of our submission.

This submission is prepared on behalf of SIFA Inc by Murray Weatherston and Robert Oddy.

No part of the submission is confidential.

SIFA Inc is a professional body, founded in 1994, largely for owners and senior management of non-aligned privately owned financial advice practices.

Schedule - Comments on Individual Draft Standards

Standard 1

There is a lot of commentary on fairness but there is none on "act in their interests"

In the 5th bullet point, we object to having to act in accord with the spirit and intent surely the words should clearly specify the standard. Given this Code has the force of Statute, the specific words of the standards need to encapsulate the intent. The spirit seems to be a cop-out along the lines of "even if the specific words don't say so, we really mean……." That is just too arbitrary.

We have difficulty in seeing how the concepts listed in the commentary apply to entities in general, and to robo-advice in particular.

Standard 2

The concept of "[doing] the right thing" is too fluffy. While it is sometimes very clear what the "wrong thing" is, it is not always clear what the "right thing" is. The concept has different meanings in different philosophical frameworks, and therefore the concept is meaningless absent a definition of the philosophical framework that is deemed to be the right one.

Standard 3

We believe the first bullet point "where practicable avoid conflicts of interest" should be removed.

We believe it could be interpreted to impose an absolute obligation to avoid conflicts. This is not set out in the Statute as an obligation. The Statutory Duty is to give priority to the client's interests. This is explicit recognition that COIs may occur.

Rather we think the Standard should cover situations where a conflict is actually present.

We don't see why the actual section of the Act is included in some places and not included in others. Our preference would be that there should be references to the applicable section of the Act, but the text of the Act should not be included.

Standard 4

We think you are combining two separate issues in this standard

(1) the nature and scope of what the client and adviser agree is the scope of the advice; and
(2) the actual advice tendered within those parameters.

These happen at different and discrete times in the advice process. We submit you should separate them out into separate standards.

The replacement advice case study is seriously defective. The obvious question to ask is "if the new policy provides similar benefits to the existing policy, why would Beth even consider switching?"

Next there are two possible scopes of the advice

1. where Beth said she would be comparing the old with the new; and

2. where Beth said she wouldn't be comparing the old with the new.

Your characterisation says Beth would not be making the comparison, yet your example then sets out a comparison.

We think in the scope 1, Beth should be required to explicitly compare the benefits and costs of each of the alternatives, and point out what the client might be giving up.

In scope 2, Beth should be required to give a specific warning about the implications of switching which are things like she might no longer be covered for some things that she would have been covered for under the old policy, or her pre-existing conditions might have expanded or occupational and recreational activities might have changed since the original policy was issued.

We do not see the need to include the wording of specific sections of the FMCA in this Code.

Standard 5

The example seems to us to be a sop to the banks. The example is actually trivial and is restricted to a situation where a deposit client wants to know which term to make their deposit for – call, specific term or flexible term. We have always thought it crazy that this simple transactional information should be caught under advice.

But where the teller goes beyond that into matters such as deposit or PIE fund, or deposit vs one of the banks managed investment products, that is a different kettle of fish.

Standard 6

There may also be the requirements of PI insurers as to the time period that records are required to be retained.

Standard 7

This standard seems to be restricted to internal complaints systems.

In some cases, the FAP or financial adviser will not be able to resolve a client complaint. That's why FSPR requires we have an EDRS

The commentary should make clear that the client cannot escalate the complaint to EDRS until the adviser has been unable to resolve the complaint.

Also we have never agreed that the FMA should be encouraged as an alternatives complaint mechanism.

Standard 8

We do not like the pretty open-ended definition of "bringing the industry into disrepute". We realise there are restrictions in the commentary.

We are also aware that there are similar clauses in other professions, but we are not aware of such charges being successful against a defendant absent some other breaches. We would not like this standard to be used in situations where there was no specific other charge against an adviser but the

regulators felt the adviser had been “naughty” so they use this standard as a blunt instrument to clobber someone where no other charge could be substantiated.

We think this is simply a “feel good” situation where “if we can’t get him on anything else, we will throw this one at him”

PART 2: COMPETENCE, KNOWLEDGE, AND SKILL

We do not see why the road map is included before Standards 9 -12

We should say that we have a lot of concern about the way these standards are written. In some cases we think it is because the wording you have used does not reflect what we understand to be your thinking.

Standard 9

We do not think you understand the structure of NZ Certificate level 5.

You state that standard for general competence is the qualification outcomes level 5 Core and Financial Advice Strands

You then say that you will allow anyone who has NZ Certificate Level 5 to be deemed competent. However NZ cert Level 5 is awarded to anyone who has passed Core and any one of the individual strands – this includes Financial Advice, Investments, Life and health, General Insurance and Residential Property Lending.

Do you not see that these are different?

We are also concerned about the consultation note in the commentary, which suggests that if NZQA adopts a new version of the NZ Certificate, that new version might be specified in the Code. However we are concerned about the impact of this change on any persons who have attained and been awarded NZ Certificate Level 5 using an earlier version. This is the same issue that has arisen with the AFA Code, when pre 2011 Diplomas were no longer recognised as an alternative qualification.

Individual/Entity/Nominated Representative Framework

We think the framework for the individual, entity and nominated representative needs to be better specified.

Advice will be delivered either by an entity or an individual on behalf of the entity.

If it is delivered by an individual, then that person has to be either a financial adviser or a nominated representative.

So we think the categories you use should be financial adviser, nominated representative and entity.

Financial Advisers

We think the number of financial advisers in the new regime will be somewhere between 5,000 and 10,000. There will probably be 20,000 nominated representatives.

There are fewer than 2000 AFAs. Information we have received from NZQA tells us that fewer than 300 NZ Certificates Level 5 have been awarded, and only 12% of them included the Financial Advice Strand.

So you are deeming people who don't have Financial Advice Strand as being competent because they hold a NZ Certificate that doesn't include Financial Advice Strand.

We think your text

> "The code does not limit the ways that a person may demonstrate their general competence, knowledge, and skill. However, a person may demonstrate the standard by any one of these ways:"

is not clear.

The text could be interpreted to say that the ways are limited to the bulleted points. We were initially surprised to see the commentary because it did not appear to us to tie in with the standard.

However we now understand your proposal is that a financial adviser can demonstrate their general CKS by

- holding a NZ certificate
- being an AFA; or
- showing that they have equivalent qualification outcomes to someone holding a NZ Certificate
- any other way.

The text in the commentary is clearly in explanation of the 3rd bullet point above.

We have no idea as to

(a) who would be able to assess that equivalency?
(b) who has appointed the people in (a) to give them the authority so that we can rely on their assessment?; and
(c) does this industry if it exists have the capacity to assess say 5000 financial advisers (i.e. those not previously AFA, or who have not attained NZ Certificate Level 5)?

Nominated Representatives

We think a FAP should be able to appoint as a nominated representative anybody who in their individual right is qualified to be a financial adviser. This is additional to your proposal.

We have immense difficulty in accepting the logic of your text about nominated representatives.

We interpret your text as saying that:

> **IF** the person has completed the learning outcomes specified for their role by their financial advice provider.
> **AND**
> the provider has procedures, systems and expertise,
> **THEN** the nominated representative has the capabilities equivalent to those of an individual who alone has achieved the general qualification outcomes.

This is clearly an untenable proposition. The nominated representative's role might be quite narrow, and to say that automatically makes them equivalent to a financial adviser is absurd. It would be Exhibit 1 in our case against you for having been captured by the VIOs

It will be a great fraud perpetrated on the consumer to hold out that nominated representatives are equivalent to financial advisers. If that really were the case, why does the legislation differentiate between them?

Entities

We have huge problems with your second bullet point. We just fail to see how you can compare procedures and systems of an entity with the competence knowledge and skills of a human person. We have difficulty in seeing also how you would measure the expertise of an entity. We think it will simply be an act of faith by the licensor.

We think the measure will be in practice "You are a reputable entity. Therefore we will say you have the expertise."We are sure the Australian regulators had the same view of Australian VIOs before the Royal Commission laid that premise bare.

We think this is just another manifestation of your earlier "in aggregate" concept. We think both notions are crazy.

Examples

Your first example is an example of the obvious, and therefore not requiring the status of an example. Also we doubt there will be many FAPs who interact with customers through nominated representatives where all their nominated representatives will be NZ Cert level 5. So it would be an example of a rarity.

The second example merely repeats the standard. It doesn't add anything.

Standard 10

We think this standard is a giant step backward from the CPD Standard in the AFA Code.

In ridding the Draft Code of process you have thrown the baby out with the bath water.

The AFA Code left persons providing advice free to determine for themselves what counted as CPD. There were three principled requirement – the activity had to be within the person's PDP, the material had to be delivered by a subject matter expert, and the person's undertaking of the activity had to be verified by a third party.

Second we believe there should be a minimum number of hours specified, at least as a "safe harbour" for the adviser. We know of no other professional code that does not have a minimum activity amount specified. And we bet that the Professional Bodies who are applauding the non-specification of hours will include a CPD quantity criterion in their own rules.

We think the omission of a quantity is just a sop to the professional bodies, (of which SIFA is one} to give them another potential member benefit.

We can tell you for free that not all financial advisers will join a professional body, absent a regulatory requirement to belong to one. And we know the legislators have not gone that far. Perhaps we should qualify that with a "Yet".

Standard 11

We could repeat a lot of our comments about Standard 9.

To provide an investment planning services under FAA, a person had to be an AFA. To be an AFA they had to have passed at least the Investment strand and the Financial Advice Strand.

Your proposed standard waters this requirement substantially.

We think that the only persons who should be able to do investment plans are humans who are financial advisers and who either

- were AFAs in the old regime, or
- have the NZ Certificate or National certificate level 5 Investment strand, or
- can demonstrate that they have equivalent (or better) skills than the above.

or entities doing robo-advice.

We do not think nominated representatives should be able to provide investment plans as defined in the Statute. We think that in reality, most nominated representatives will simply be salespersons for their financial advice provider's own products.

Standard 12

We repeat much of our submissions for standard 9.

We do not see why an AFA is a pathway only for specific competence for investments. Currently an AFA can provide any advice for which they claim competence. Most AFAs will have attained the investment strand or have an equivalent qualification. Most AFAs will not have passed any other strand, but may currently do life and health insurance and/or mortgage broking.

Under this Standard, many AFAs may have to cease doing Life Disability and Health insurances and/or mortgages. This regulation will create silos and may reduce the availability of advice in some disciplines.