MILFORD

Submission on the consultation – New Financial Advice Regime

Thank you for the opportunity to provide feedback on the draft Financial Services Legislation Amendment Bill and proposed transitional arrangements.

Overall, Milford is supportive of the proposed regime and think that it will be a positive change for consumers and the financial adviser profession in New Zealand. There are a number of issues that we see affecting Milford and our clients, and we set these out below. We have only provided feedback to the questions that we feel are more significant in this context. We acknowledge however that other aspects of the consultation will also impact us, but to a lesser extent.

Although we have submitted on a range of issues, our key messages are:

- We think that the transition period description lacks clarity and may, in our opinion, result in an issue for firms like Milford that are not QFEs but may wish to operate with FAs and FARs during the transitional period. The current approach could result in imposed inertia and delayed business evolution during the transitional period, or create major projects in the run up to it.

- We think that further consideration is required of the wholesale and retail demarcation issue. As drafted, we believe there could be potentially unintended consequences for firms with a broad range of clients, like Milford, and our clients.

Part 1 of the Bill amends the definitions in the FMC Act

Question 1

If an offer is through a financial advice provider, should it be allowed to be made in the course of, or because of, an unsolicited meeting with a potential client? Why or why not?

In our view, it is important to retain the ability for a financial advice provider (FAP) to be able to continue to make offers as a result of unsolicited meetings. Without being able to make these types of offer, an adviser could potentially not approach an existing client about a service or product that they (because of their knowledge of the client's particular circumstances) think may be suitable for, or of interest to, them. We believe that clients with a pre-existing relationship with the adviser, or who already hold a product provided by the firm that the adviser works for, should be excluded from the any prohibitions regarding unsolicited approaches.

Whilst we are supportive of consumers being safeguarded against being sold products in a way that reduces their ability to make an informed decision, we suggest that a statutory cooling off period would be a preferable way of ensuring this protection for most types of product. Having said that, a cooling off period would be challenging in the

context of products sensitive to market fluctuations as that would essentially require a capital guarantee, or would need to be managed via additional disclosure.

Question 3

Do you have any other feedback on the drafting of Part 1 of the Bill?

In terms of other feedback on the drafting of Part 1 of the Bill, we wish to comment on the terms that have been suggested for different types of adviser under the regime. Our view is that a consumer will not adequately understand the difference between a financial adviser (FA) and a financial advice representative (FAR). We acknowledge that both types of adviser will be providing advice and will have the same obligations under the Code but feel that there should be a clearer distinction made between the roles. Since the FAR will be advising on a FAP's product, we suggest incorporating the FAP's name into the FAR term. Perhaps, ABC Bank Advice Representative?

Some industry participants have suggested that there should be just one category of adviser, with differences being dealt with via disclosure, but we feel this would detract from the more highly qualified and specialist status that would be associated with a FA.

Regarding the question about whether the FA/ FAR (or future term) should be a designation or a job title, our view is that making it a designation would be acceptable if the revised disclosure requirements make it clear, probably by using prescriptive wording, what type of advice the client is receiving and from whom. An accurate and concise description of the scope of the advice, including what is within, and outside of, the scope, would also assist here.

Whilst we agree that the Code should apply to all advisers and we understand why FAs should be individually registered, we think there should be an element of accountability assigned to a FAR to acknowledge their part in the provision of the advice on behalf of the FAP. This, in our view, should be a lower level of accountability reflecting that a FAR is not as qualified or specialised as a FA.

We also submit that the regime should allow a FAP to have a defence if it can demonstrate it took all reasonable steps to ensure that its FAs/FARs complied with their legislative obligations. Whilst we agree that a FAP should have adequate controls, procedures and policies in place that support a positive culture of compliance, it is inevitable that there will be cases where individual, rogue actions are contrary to the conduct required encouraged and embodied by an organisation. This should be acknowledged.

Part 2 of the Bill sets out licensing requirements

Question 4

Do you have any feedback on the drafting of Part 2 of the Bill?

We have concerns over the concept of a wholesale service being 'tainted' by a retail client, and the practicalities of the level of demarcation that is proposed as being required. We think this will raise issues for smaller, diverse client base businesses such as ours.

We regard ourselves as having a diverse client base because we have different types of clients, broadly:

- Institutional-type clients who are clearly wholesale investors. In our experience, these clients do not expect or wish to receive a retail-type advice service, with the associated disclosures, scope, written advice and other retail client protection requirements. However, they still wish to be able to access some of the 'retail' funds we manage.

- Wholesale Eligible Clients, being retail clients who have completed safe harbour certificates in order to be classified as wholesale investors under section 36 of the Financial Markets Conduct Act 2013 in order to access specific wholesale offers.

- Retail clients.

We submit that in our experience the Wholesale Eligible Client group would benefit from continuing to be treated as retail in order to receive the relevant consumer protections that are available to retail clients. This is particularly the case in relation to those who meet the eligibility criteria based solely on their accumulated wealth over a life time, rather than their level of financial sophistication. It is for this reason that Milford Private Wealth AFAs currently offer Wholesale Eligible Clients the same service as is offered to retail investors under the Private Wealth Service – providing personalised written advice, full disclosure, definition of scope and the nature of the service and reporting. The current Milford operating model also recognises that some Wholesale Eligible Clients (i) do not need personalised advice because they regard themselves as financially sophisticated enough to make their own investment decisions, or (ii) do not wish to pay for personalised advice, and those clients are able to access class advice through the Milford Premier Service.

For organisations with a diverse client base, as currently drafted we think Part 2 raises the following issues:

1) We have questions about what is intended by the defined term 'service'. Does provision of the 'service' include the initial interaction with a client, is it restricted to the advice process (in which case when is that initiated?), and does it also include the end product/s that the client invests into?

   If the term 'service' is intended to include the end product then Milford would have to create new products to accommodate those wholesale clients currently invested in retail funds. This would create significant issues for us, both in terms of client disruption and effort and additional cost to Milford (and potentially our clients).

2) We also question what the impact would be if, during the provision of the service, it was determined that a retail client had been inadvertently incorrectly assessed as wholesale?

3) We think there is also a potential ambiguity in the provisions. A financial advice service will be a retail service if the service is provided to any retail clients. However, financial advice is typically personalised in nature, and therefore different advice is provided to different investors depending on their

circumstances. In our view, it is not clear in what circumstances a financial advice service provided to different clients will be on sufficiently similar terms to call it a single 'service' that can be tainted by a retail investor's involvement. The similar provisions work for financial products or DIMS, because they are given on nearly identical terms, but we are not sure it works as well for financial advice. Clarification of what 'service' is intended to mean in this context would be required to answer this question too.

This response also covers the question raised in question 14 of the consultation paper.

Part 3 of the Bill sets out additional regulation of financial advice

Question 5

Do you agree that the duty to put the client's interest first should apply both in giving the advice and doing anything in relation to the giving of advice? Does this make it clear that the duty does not only apply in the moment of giving advice?

We are supportive of the obligation applying during the advice process (which we believe includes the assessment of whether an individual requires advice in the first place) and in the ongoing relationship, but do not believe it should be applied further than that. In our view, applying this duty to 'doing anything in relation to the giving of advice' requires qualification. It would be useful to understand the intended parameters of this concept.

We agree with others in the industry that to try and legislate what is essentially a distilled, but in some senses restricted, version of Code Standard 1 could negatively affect the Code and in particular that Code Standard. This is because as drafted it appears to legislate a specific theme and aspects of the essence of Code Standard 1, but not others. Our view is that currently section 431H of the draft Bill is too focused on conflicted behaviour, but we see Code Standard 1 as a more holistic, principles-based concept that is broader than has been drafted. It is the over-arching approach that affects all aspects of an AFA's dealings with their clients.

While we are in agreement that putting the client's interests first is paramount, and this is why it is being legislated, we feel there is a potential that it may unintentionally stifle future development or refinement of these key points. We would like to see the Code deal with, and develop, the intricacies of specific themes. In particular, we would like the Code to deal with what is intended to be covered, and what is not, by the phrase 'materially influence the advice.'

We are also of the view that a FAP should have a defence available to allow them to argue they had taken all reasonable steps to ensure that they, or their FARs, had complied with the duty of putting the client's interests first.

Question 6

Do you have any comments on the proposed wording of the duty that a provider must not give a representative any kind of inappropriate

payment or incentive? What impacts (both positive and negative) could this duty have?

We are in agreement that purely volume based sales incentives do not encourage good conduct or consistently good outcomes for clients. However, it is not clear from the drafting what is intended to be included in the realm of inappropriateness. We believe the qualifying description of 'inappropriate' in 431O(2) is subjective and so would need to be supported by guidance, or expanded on in the Code. A defence should be available if the FAP implements appropriate incentive policies, procedures and controls but the FAR actively disregards them.

Question 7

Do you support extending the client-first duty to providers who do not provide a retail service (i.e. those who only advise wholesale clients)? Why or why not?

We fully support the obligation to put a retail client's interests first and act with integrity, as set out in Code Standard 1. We also agree with treating Wholesale Eligible Clients (i.e. retail clients that have completed a safe harbour certificate solely to access a wholesale offer) as retail clients.

We do not support extending the client-first duty to institutional-type wholesale clients. In many cases, this will be contrary to the expectation of the relationship, for example in dealing with institutional clients, a wholesale client's intermediary or consultant, or counter parties in a dealing room transaction. Our view is that contractual protections are sufficient for these types of wholesale client.

Part 5 of the Bill makes miscellaneous amendments to the FMC Act

Question 11 and 12

Should financial advisers have direct civil liability for breaches of their obligations, if the financial advice provider has met its obligations to support its advisers? Why or why not?

Yes we believe that FAs should have direct civil liability in these instances. This is because the FA will have obtained professional qualifications that set them apart from FARs.

Should the regime allow financial advice providers to run a defence that they met their obligations to have in place processes, and provide resources to enable their advisers to comply with their duties?

Yes.

Schedule 2 of the Bill creates a new schedule to the FMC Act with detail about the regulation of financial advice

Question 24

Should the FMC Act definition of 'wholesale' be adopted as the definition of wholesale client for the purposes of financial advice? Why or why not?

We agree that the FMCA definition of a wholesale client should be adopted for the purposes of financial advice as this makes sense to align the two for simplicity and because (generally) the criteria to qualify as a wholesale investor under FMCA captures the right types of client who could generally forgo retail client protections.

However, as previously outlined, we think there is currently a group of wholesale investors, Wholesale Eligible Clients, who are able to be classified as wholesale simply by them having significant overall asset positions and then there are more institutional-type wholesale clients. We believe their needs, requirements and expectations are often very different. When dealing with the group we have termed Wholesale Eligible Clients, we would like to see FAPs being able to make an assessment in conjunction with the client of the financial sophistication of that client to determine whether their status noting the existence of the opting out provision.

We do not agree that an entity with net assets or turnover exceeding $1m should also be included in the definition of a wholesale client as we would argue this financial benchmark is far too low to capture clients who truly fit the intention of a wholesale client. The threshold should be more focused on the sophistication of the investor, so that removing retail protections potentially leads to poor client outcomes.

Proposed transitional arrangements

Question 34

Do you support the idea of a staged transition? Why or why not?

We are broadly supportive of a staged transition conceptually, but do not think the consultation paper contains sufficient clarity on some aspects of what is anticipated. However, it is not clear to us whether a FAP that was not a QFE under the old regime will also be able to operate with FARs and FAs during the transitional period and prior to being fully licensed.[1]

If not, then non-QFE providers may determine it is necessary, in order to maintain a level playing field, to become licensed as a QFE before 28 February 2019. This would be a major undertaking, with considerable costs involved and regulator time to review the application. We question whether this is the intended consequence.

[1] For example, page 44 states that: 'Firms with transitional licences which were formally QFEs will be able to engage financial advisers and financial advice representatives.'

Possible complementary options

Question 43

Do you support the option of a competency assessment process for existing AFAs and RFAs? Why or why not?

Whilst we are supportive of both competency options, our preference is that any measure of competency should include comparable overseas as well as domestic financial advice experience.

We also think that competency assessments should be included in the Code of Conduct, rather than being set in legislation.

We fully support any actions or initiatives that promote improved competency and an actively engaged and experienced financial advice profession in New Zealand. Our view is that these twin strands are essential for a continued focus on positive customer outcomes and also the development of the profession as a whole.

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