Code Working Group

Consultation Response

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Code Working Group Consultation Paper Response

Introduction

On 12 March the Code Working Group published a consultation paper on the Code of Professional Conduct for Financial Advice Services. The new Code is required in order to implement the Financial Services Legislation Amendment Bill should it become law, due to changes in that law allowing licensing of advice providers, including digital advice providers, and the requirement for all advice providers and advisers to meet common standards.

The Code Working Group proposals are a framework for developing a Code, rather than a draft of the actual Code. The framework has much to commend it. Structural features worth taking into account that deserve recognition include:

1. that advice companies require different rules to advisers working within them
2. that, since digital advice is now permitted, digital-human hybrid services could be recognised as meeting the requirements of the Code in aggregate
3. that different types of responsibilities, some ethical, some operational, and so on would apply, and apply differently to the advice business and advisers.
4. that a test for suitability of the Code could be to support Good Advice Outcomes.

Although the name might change, and my suggestion is for it to change to "Good advice Experience" the description of how this test applies may be useful, now that putting the interests of the client first is to be included in the law via the requirement to give priority to the client's interests, rather than as the first principle of the Code

As I wrote on first reading of the consultation paper, the Code Working Group are to be congratulated for this work. This is a strong framework, and although I have some serious misgivings about competence requirements in particular, if submissions are heard and responded to, there is no reason that the outcome should not be good. That should be recognised even as I move to list areas of concern about specific aspects of the proposals.

Overview areas of concern

The main areas of concern, as I see it, are broadly:

- Competence requirements
- Requirements for hybrids of systems and human advisers
- Ethical standards
- Other consultation document issues and comments

Competence Requirements

Starting with competence requirements:

Section 11, there is a statement that compliance costs are to be minimised, and that this is contradicted by the somewhat arbitrary decision to require a Bachelor's degree in addition to specific financial planning knowledge.

Section 22, the two different types of financial advice are described, (and later, examples are given that include insurance advice, but more on that below), but I highlight at this point that no definition is offered. A good definition is available, that used in the CFP qualification. If that definition is adopted then a very large proportion of current insurance advice would be caught as financial planning, and subject to the competence requirements.

Section 24, is where the requirement for a Bachelor's degree is introduced, in conjunction with a level six qualification for existing advisers to transition. The degree is specific as being at NZ level 7 or higher, and must major in either finance, management, accounting, business, commerce, economics, or financial planning.

There are several problems with this requirement. But it is important to dispel any lingering hopes that it doesn't apply to insurance. **Section 45,** later in the document makes it explicit that insurance is included. Also, to check, I have spoken with Angus Dale-Jones. He confirmed that it was intended to include most insurance in this definition. His view was that only transition is problematic, and that equivalence with Australia was one of the concerns of the CWG. I disagree, and feel that it will severely limit the ability of the industry to recruit advisers, and will probably lead to a substantial reduction in the availability of good insurance advice.

Some question on competence requirements:

1. What specific market failures in the advice market for insurance are there that can only be met by requiring a Bachelor's degree to fix?

2. Why would a person who holds a level five qualification and obtains authorisation just before November 2018 be entitled to have this requirement waived when another person, who has a level five qualification but has not obtained an authorisation be denied the waiver? The only quantifiable difference between an Authorised adviser and a Registered adviser is, in effect, monitoring. So, if an RFA can meet the same standard, or a QFE adviser, then they should be granted the same waiver.

3. Even if there are market failures that can be specifically addressed by an increase in competence, knowledge, and skill, are these to be found in the specific degrees listed?

4. Even if those competence, knowledge, and skills are to be found in those degrees, is the degree the most efficient way to acquire them – given the stated aim of minimising compliance costs?

5. If a level six qualification may be suitable to provide those competence, knowledge, and skill to current RFAs moving to the new regime why would it be inadequate to provide them to new advisers entering the regime?

6. What thought has been given to existing insurance advisers that would find the cost of a level six qualification (in time, effort, or money) too great, and therefore the reduction in access to financial advice, and the impact on consumers that will result?

To underline the problems of basing the recognition of prior learning on regulatory status, take these individuals, identically qualified, but each with a different form of regulatory supervision:

- An AFA, with a level five certificate, authorised in 2017, and practicing according to the AFA Code.

- An RFA, with a level five certificate, registered, practicing several years, providing insurance planning services, according to the AFA Code.
- A nominated representative in a QFE, with a level five certificate, practicing several years, according to the AFA Code.

Each of these people has the exact same qualification. Two have much more experience.

- Yet the first may be required to do no further study, their 'prior learning' being recognised simply by virtue of having been Authorised.
- The RFA would have to undertake a level six qualification in order to stay in business, at substantial cost (money and time) in order to continue to offer the same insurance planning services that they were offering before, without harm, to consumers.
- The nominated rep, however, is in the worst situation. They would have to rely on their employer becoming a FAP in order to stay in the industry, or complete a Bachelor's degree, plus a level six qualification.

These cases are not merely hypotheses – they are real, the last person attended the recent workshop on CWG proposals and belongs to a QFE that will not become a FAP. Hence, this person will be faced with leaving the industry, unless we find a mechanism to recognise their valid prior learning, and perhaps broaden the criteria for future recruitment.

Future recruitment is a significant issue because only about 20% of adults have a Bachelor's degree or level seven qualification. Of these, less than a third are in the broad categories specified by the CWG. Considering the group that could offer insurance planning after only studying a level five certificate. If the CWG holds firm on the requirement as drafted, that reduces the proportion of the adult population from which we can recruit, down to about one in twelve. If the CWG recognises any Bachelor's degree, as it is contemplating, proportion eligible falls to about one in five. Still quite limiting.

Suggestions for revising competence requirements to enhance consumer access and equity

Fortunately, these problems are relatively easy to fix, some suggestions include:

For existing advisers:

- Having a test (years of experience, plus a portfolio test, based on quality of financial plans prepared)
- Plus, recognising 'any degree' as sufficient evidence of the level of thinking, plus a level five qualification
- Having the same test apply equally to AFAs, and RFAs
- Extending eligibility for the tests to nominated representatives of QFEs to provide them with a pathway to Financial Adviser Status that does not require a multi-year qualification.

For new advisers from the date of implementation:

- Clarifying which ***current*** level seven qualifications could be used, and if none exist (as may be the case if the Massey Diploma is no longer considered suitably specific) then delaying this requirement until such level seven qualifications do exist.

Without some greater flexibility, there are some odd incentives in play during the interim: for example, my friend in the QFE should seek authorisation immediately, and thereby go from having a

requirement for a level seven qualification to none, simply by filling in a form, and paying a fee. This regulatory supervision 'arbitrage' alone confirms that the requirements are not yet calibrated correctly.

An alternative form of relief, although not one which I prefer, is to further restrict the definition of financial planning, so that the group of advisers caught by these competence requirements falls. In some respects I feel that this runs counter to the intention of the law change, and reinstates a form of differentiation between advisers that is not easy for consumers to understand. Consumers are unlikely to refer to the finer points of what constitutes 'financial advice' before seeking it.

Requirements for Hybrids of systems and human financial advisers

The other big gap is what the CWG hasn't explained – how they intend to recognise the systems / skills of the business as a contribution to the overall human/systems hybrid advice delivery.

The Code Committee is silent on how systems and processes may be recognised to meet Code obligations – so far, they have only recognised the principle.

There is a risk that this is as far as they will go. The Code Committee is not an operational organisation. It is designed to develop the Code, and so they may leave it to the regulator to manage what systems get treated as sufficient to relieve the requirements for individual competence. That being the case FAPs that wish to have systems and processes recognised as helping them meet the Code, and therefore may be permitted to have staff with less formal training, will be dealing with the FMA in their licence applications.

You may expect that a small FAP that only hires FAs will have an easier licence process (for a given set of services) than a similar business that is applying on the basis of systems plus less qualified nominated representatives. This step up, for businesses wishing to have their systems recognised, will come in several ways: cost of the systems, cost of the application, but most of all cost of the engagement capability with the FMA. Few businesses will manage it in the short-run. Unlike the majority of commenters at Goodreturns, I see these systems solutions as vital in helping insurance advice businesses get efficient enough to survive in the new environment.

Suggestions for requirements of FAPs delivering advice through hybrid systems

Recognise that the requirements these businesses have to meet are Code requirements – no more, and no less. Consumer access, and long run innovation, are supported by these businesses being subject to the same rules.

Ethical Standards

Section 92 suggests there are many good sources for ethical guidance – a quick review of the literature suggests that these can vary widely. Accepting the intention to have the business think more about these, the Code Working Group presumably accepts that the results may vary widely.

Section 100 does not make it clear whether anonymised data is exempt from these provisions. If it is not, then it will not be possible to meet the stated objective of supporting digital advice. I propose that anonymised client data should be available for the following purposes:

1. Analysing typical client and advice situations, so that an adviser business can answer when asked "what do most clients like me choose to do?"
2. Using advice situations and outcomes from previous clients for training purposes and for peer review of advisers
3. Creating databases that may be subject to AI or machine learning to develop new advice-giving systems and processes
4. Allowing clients to enter into specific transactions that allow them to trade away privacy for lower cost / free services as is common in many social platforms

Other Consultation Document Issues:

Section 88 raises a genuinely difficult question – what to do when a company performs well but a wilful individual decides to act in a way contrary to the Code. This is worth working on. It will determine how much liability a financial advice provider has under the Code and how much confidence a consumer can derive from them. I suggest the weight of financial liability must fall on the company

Section 114 needs to address small advice providers that may not have a separate in-house compliance function.

Section 130, where the CWG lists additional matters that could be addressed via standards, the CWG should make it clear what it has in mind when referring to trail commission at this point. Is this a disclosure issue or something else? It is not possible to provide effective feedback on this issue until it is clear, and consultation should be permitted on the issue when it has been made clear.

Section 134, emerging data science allows us to make surprisingly broad and strong recommendations based on narrow sets of data. It would be well not to be too prescriptive about how much data is collected, but allow the test of good advice experience to determine the extent and quality of these data.

Section 151, possibly conflicts with the duties under section 100.

Conclusion

Assuming the CWG has the flexibility that they profess, and most of these issues can be dealt with, then this is a good consultation document. But there is a significant risk – that the current proposals for competence would see a substantial reduction in advice availability to consumers.

S 9 (2) (a)