

# QFE Annual Report Feedback



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## Introduction

One of FMA's primary roles as regulator is to assist and monitor compliance, enforce the law and help set expectations for our stakeholders and the market. Since our establishment in 2011, one of our strategic outcomes as set out in our Statement of Intent is to 'Increase levels of compliance of market participants'. (See FMA's Outcome Framework 2013-2016).

For many market participants, and specifically for Qualifying Financial Entities (QFEs), regulation is new. Also, QFE advisers are not subject to the Code of Professional Conduct as Authorised Financial Advisers are. However, QFEs are responsible for ensuring the professionalism of their advisers and providing adequate consumer protection for their retail customers.

Each year a QFE is required to produce and provide to FMA an annual report and Adviser Business Statement (ABS). This is an important part of the QFE regulatory framework. This feedback summarises key issues and themes that have emerged from FMA's review of QFE's annual reports and ABSs.

Overall, we consider there is room for improvement around the quality and standard of QFE annual reports. We ask that QFEs, and those who assist QFEs with their compliance responsibilities, consider this feedback report and what it means for their compliance arrangements.

## Overview

QFEs must provide an annual report to FMA within five months following the end of their financial year.<sup>1</sup>

The quality of annual reports received by FMA since licencing has been variable. In some cases the information contained in the reports was unclear, or lacked concrete data.

Additionally, several reports did not meet the requirements of the Financial Advisers Act (2008) (FAA) or the Reporting and Notifications Standard Conditions for QFEs. For example some were signed under a delegated authority and others did not include material changes that had been notified to FMA during the course of the year. Both of these examples are discussed further in this report.

This feedback also summarises the areas where, in future, FMA will expect an improvement in annual reports. It provides information about definitions and the material required under Section 77 of the FAA and the Reporting and Notifications Standard Conditions for QFEs.

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<sup>1</sup> Section 77 (1) Financial Advisers Act 2008

## Using this feedback

You should use this feedback in conjunction with the compliance principles in the QFE Adviser Business Statement Guide, and the QFE Feedback Summary Report (August 2011) both of which are available on our website.

FMA provided QFEs with individual feedback on their first annual report. It is not intended going forward that FMA will give feedback on every annual report.

## Key Findings: Annual Reports

### Key points:

- Definition of a Principal Officer
- Breaches

### 1. Principal Officer

Section 77(3) of the FAA requires that an annual report must be signed by either –

- a) a principal officer of the QFE; or
- b) a principal officer of a partner entity of the QFE.

A *'principal officer'* is a defined term in the FAA. It means a director or a person who occupies a position equivalent to that of a director (such as a trustee or partner).

Someone signing under the delegated authority of the board (other than a director) does not meet the requirement that the annual report must be signed by a director or person who occupies a position equivalent to that of a director. For example, FMA has received annual reports signed by Chief Executives and other individuals who have signed under a power of attorney. Neither of these examples fulfils the requirement that a principal officer sign the annual report.


In future, FMA will reject annual reports that are not signed by a principal officer as defined by the FAA.

### 2. Breaches

Section 77(1)(c) requires that a QFE report to FMA if it is aware of any breach of a financial adviser obligation by an employee, agent, or nominated representative of the QFE or of a member of the QFE group, stating the name of that person and the nature of that person's breach or breaches.

#### a) Annual reports where no breaches are reported

There is no materiality threshold for reporting breaches in QFE annual reports. **All** breaches, no matter how minimal, must be reported.



FMA has received annual reports where no breaches are reported. These reports raise an immediate concern to FMA as to whether that entity's governance and compliance arrangements are capable of detecting breaches.

To enable accurate breach reporting, a QFE must have a clear process for determining when an incident is a breach.

FMA relies on open and transparent reporting and utilises information in this section of the annual report to assess the adequacy of the QFE's monitoring and to identify trends within industry sectors.

We encourage those QFEs who have reported no breaches in their previous annual reports to re-evaluate their process for determining whether an incident is a breach. Those QFEs that report no breaches can expect monitoring from FMA as to their internal breach reporting processes.

**(b) When there are no breaches to declare**

Some QFEs have interpreted Section 77(1)(c) of the FAA to not expressly require the annual report to state that the QFE is not aware of any breach of a financial adviser obligation by an employee, agent, or nominated representative of the QFE or of a member of the QFE group in circumstances where no breaches are noted.

FMA considers it to be best practice to expressly include a statement that the QFE is not aware of any breaches in those situations where no breaches are being notified to FMA to clearly demonstrate that the person signing the annual report is aware of all the matters the report covers.

**(c) Notified breaches**

Even if a breach has been notified to FMA during the course of the reporting year, the name of the person and the nature of the person's breach or breaches are nevertheless required to be included in the annual report.

**(d) Timing of breaches reported**

A QFE should report all breaches it has become aware of during the reporting period, including any breaches that occurred before the start of the reporting period but which were not identified until during the reporting period.

## Key Findings: Adviser Business Statements

### Key points:

QFEs must maintain and keep current, a written ABS, in accordance with the current QFE ABS Guide.

- The QFE must ensure that this accurately reflects:
  - The financial adviser services of the QFE, the QFE Group and its nominated representatives; and
  - The governance and compliance arrangements of the QFE over these services
- Nominated representatives and the QFE's responsibilities

The ABS is a document that contains both the summary of the financial services provided by the QFE, QFE Group and its nominated representatives and the governance and compliance arrangements of the QFE over those services.

This document must be current and should be seen as a living document that serves a valuable internal purpose. It should not be seen as a chore to produce and chiefly for an external purpose, but rather as a benefit to the organisation documenting its arrangements that deliver FAA compliance.

### 3. Updating your ABS

QFEs have often informally advised FMA about changes to their systems and structures. This information has not necessarily been material or required to be notified – the entity has taken an approach of open transparent interaction with FMA. FMA supports this interaction and would prefer to have matters over reported rather than under reported. However, it is important that this information is included within the ABS of the entity.

FMA prefers QFEs submit a tracked change version of the ABS so that we can clearly identify the changes made. We also note the annual report should identify the areas in the ABS where changes have been made. This should be done with specificity if marked up copies of the ABS are not provided. However, FMA understands that a QFE may over time wish to substantially alter the form of its ABS. FMA is happy to discuss any such proposed changes.

### 4. Maintaining your ABS

Similarly, where a QFE has made notification to FMA about changes in its governance and compliance arrangements, or the financial adviser services of the QFE, it is expected that these will be incorporated into the ABS at the time those changes are notified to FMA.

An ABS with minor alterations that don't reflect previously notified changes indicate the record keeping of that QFE may be sub optimal and may raise concerns about its wider compliance framework.

## 5. Actions following breaches

FMA is interested in both the nature of any breaches and the steps a QFE takes in response to them. This includes how the individual breaches are rectified and whether the breach has resulted in the QFE amending its governance and compliance arrangements. FMA would expect to see both general and specific remediation measures reflected in a QFE's ABS.

## 6. Nominated Representatives

### Nominated Representatives – notification requirements

Section 74 of the FAA provides that the nomination of a nominated representative is terminated if the entity that nominated the individual gives written notice to the individual and to FMA.

The definition of “*nominated representative*” provides that an individual continues to be a nominated representative until nomination is terminated under section 74.

In reviewing ABSs it is clear that some QFEs' nominated representative numbers have fluctuated during the reporting period.

The QFE must notify FMA during that reporting period of any termination of nominated representatives for the termination to be effective.

Whilst there is no specific time period within which this notification must be made, if no notification is made to FMA, the QFE will continue to be liable for any financial adviser service that individual may provide.

### Nominated Representative termination due to misconduct


Should a nominated representative be terminated due to misconduct the Reporting and Notification Standard Conditions for QFEs applies. N1.2 requires that the QFE must notify FMA of this termination within ten business days of the QFE providing notice to the nominated representative where the termination is a result of misconduct or formal disciplinary action being taken (in relation to their financial adviser activities). An explanation of the circumstances and any steps being taken to ensure consumer protection is also required to be provided to FMA at the same time.

### Nominated Representatives who are Authorised Financial Advisers

A QFE's ABS is expected to include details about its AFAs, including the types of products on which they provide advice, including investment planning services and discretionary investment management services.

A number of QFEs' AFAs are registered on the Financial Service Providers Register as providing certain services but upon enquiry, FMA found many were not providing the service for which they were registered.





Although an AFA's registration details on the FSPR are the responsibility of the AFA, we encourage QFEs to ensure that AFAs who are nominated representatives of the QFE are appropriately registered for the services they provide and that this information is updated in their ABS.

### **On-going obligations of QFEs with regard to Nominated Representatives**

Some entities appear to have considered that they have a limited responsibility for nominated representatives, due to the particular nominated representative's AFA status.

Section 76(1)(a) of the FAA requires that a QFE must ensure compliance with the terms and conditions of the grant of QFE status by each employee and nominated representative of the QFE.

Therefore, notwithstanding that a nominated representative or employee may also be an AFA who has individual responsibilities under the Code of Professional Conduct for AFAs, the QFE is nevertheless directly accountable for the conduct of these persons.

A QFE must take full responsibility for all of the financial adviser services provided by nominated representatives. A QFE should take this into account in considering any nomination of an adviser particularly if it is contemplated that the adviser may provide services other than on behalf of the QFE, for example on their own behalf or for third parties as the QFE will also be responsible for this.

## **Key Findings: Compliance arrangements**

### **Key points:**

- Compliance assurance
- Suitability of advice
- Supervision


In August 2011, FMA released a QFE feedback summary. In this we outlined areas where QFEs would be expected to provide greater clarity and focus when explaining their capacity to us.

This section expands further on the information contained in that QFE feedback summary document.

### **1. Compliance assurance**

Many QFEs have attempted to demonstrate the compliance controls and monitoring that are in place to oversee their financial adviser obligations. Provision of the following information would help to demonstrate the capacity of the QFE in this area:

- a. Details explaining how the QFE tests the systems and processes used to ensure that the QFE and its advisers meet their on-going obligations. This could be addressed by providing information which indicates how the QFE ensures that processes are followed, as well as the adequacy of those




processes, i.e. the QFE's approach to testing and challenging the financial adviser framework. It would also assist if the QFE indicated how it ensures that existing processes were properly designed to monitor the outcomes.

- b. FMA expects the monitoring of advisers in most cases to be delegated to a senior executive, who reports to the board. It would be helpful to describe the scope and nature of the reports provided to the Board and how the Board ensures that the QFE's obligations are met, as legal responsibility for compliance rests with the board. The board or governing body, need to be able to understand how the processes and controls, along with the compliance assurance and governance framework, support adviser professionalism and ensure compliance.
- c. Some entities' compliance assurance included checklists which addressed the tasks that were being carried out, but did not extend to checking the suitability of the advice provided. It would be helpful to identify how suitability of advice is trained for, recorded, supervised and challenged as well as a description on the frequency and coverage of these activities.

## **2. Suitability of advice**

Suitability of advice is where a QFE explains how it knows that its advisers are consistently providing suitable opinions or services. The following information would help demonstrate the capacity of the QFE in this area:


- a. Where a QFE outlines what factual information is provided about products, it also needs to describe where in the process opinions or recommendations are made and consequently the basis for any financial advice provided. FMA is interested in the processes that support the making of recommendations and giving of opinions as well as how a QFE trains advisers to provide these on a consistent basis.
- b. In a call centre environment, where the advisers follow a scripted sales process and the system has a built in advice recommendation, it is helpful to outline where the discretion occurs when assessing suitability. Where adviser discretion exists, FMA would expect details about processes that assist advisers to identify suitable outcomes.
- c. In circumstances where a QFE utilises software programs to support adviser services, the QFE needs to be clear what systems and controls are in place, within that software program, and external to it. This is to ensure that advisers provide advice that is suitable to a customer's circumstances, requirements and attitude to risk. This is especially relevant when the tool generates a recommendation for a client's circumstances. In this scenario, the QFE should explain what elements of the recommendation are generated by the tool and how this impacts upon the role and responsibility of the adviser. It may also be appropriate to provide other information, such as the factors that the tool analyses to formulate a recommendation.

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- d. In events where an affordability analysis or credit risk assessment is carried out, the QFE should illustrate how it ensures the recommendations made are suitable, as well as affordable. A wider description of what information is collected from the customer, to support the suitability analysis, may be helpful in addressing this. FMA are particularly interested in how advice is documented beyond the credit risk assessment.
  - e. Details explaining how the QFE tests the systems and processes used to ensure that the QFE and its advisers meet their on-going obligations. This could be addressed by providing information that indicates how the QFE ensures its processes are adhered to, as well as the adequacy of those processes, i.e. how are they tested and challenged?

### **3. Supervision**

FMA is looking to see how QFEs demonstrate their ability to supervise advisers so they behave appropriately, provide suitable advice and comply with the QFE's processes. The following information would help demonstrate the capacity of the QFE in this area:

- a. Entities have described their supervision as being met through delegated authority policies, internal compliance audits, and a control assurance program. These descriptions often mean different things to different entities, so it is helpful to describe what they mean to the QFE and how they relate to advice within the organisation.
- b. Descriptions of the supervision process should include an outline of the processes and procedures supervisors follow to ensure that appropriate advice is provided which delivers the right outcomes for customers. It would assist FMA's understanding to describe how this is supported, for example what checks and processes do the supervisors have to follow?
- c. In some instances QFEs outlined that advisers are observed periodically through the year. To support this, we would expect to see further information about how the QFE supervises the advice provided on a day-to-day basis.
- d. When supervision is based on remote checking of cases, and face to face supervisory checks are infrequent, the description should be clear on what checks are carried out to ensure that the advice is consistently suitable and complies with the QFE's processes.
- e. For larger organisations, where supervisors are spread over a wide geographical area, it is helpful to describe how the QFE calibrates its supervision nationally and how trends and issues can be identified and addressed.

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- f. For organisations who advise on a large cross section of products, it is helpful to outline within the supervisory scope what differences occur between the different product groups.
  - g. Specific information about frequency of activity should be provided.

## Conclusion

As our monitoring progresses, FMA will provide on-going feedback.

