

Interim AFA Monitoring Report

September 2011 - June 2012



FINANCIAL MARKETS AUTHORITY

TE MANA TATAI HOKOHOKO - NEW ZEALAND

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FMA’s monitoring programme enables us to observe and record how AFAs are complying with their legal obligations. It also involves giving feedback about our observations to AFAs to enable them to make any necessary improvements to their processes.

Reporting of outcomes enables the gathered information to be used by all stakeholders to identify issues and share learning for the benefit of the wider advisory community.

Introduction

The Financial Advisers Act 2008 came into full effect on 1 July 2011. After a 'settling in' period, FMA reviewed a number of Authorised Financial Adviser (AFA) Adviser Business Statements, then selected a subset of this group for monitoring visits. FMA was conscious AFAs were anxious to learn from those visits and published 'monitoring tips and hints' on its website following the initial visits. FMA also participated in a series of meetings, industry presentations and webinars to share the results.

In February, FMA began a second series of visits taking in more regional centres as well as ensuring it visited AFAs offering different financial advice services (see table below) and under different remuneration and employment arrangements. No QFE AFAs were visited in these monitoring rounds. Further information about how FMA selects AFAs for monitoring visits is available on our website.

In total, FMA has now visited 34 AFAs over five locations:

- Wellington and Lower Hutt Sept 2011
- Palmerston North Sept 2011
- Tauranga in February / March 2012
- Invercargill in April 2012
- Queenstown in April / May 2012

While only a small proportion of the total AFA population, the results provide indicative areas for improvement that are likely to be helpful for all AFAs.

This interim report shares the results of these early visits and comments on the implications for all AFAs. We encourage all AFAs to read this report and consider whether the observations might also apply to their client advice processes. If so they should make the necessary improvements.

A further report will be published after September 2012, after completion of the next AFA monitoring round, and a full year of monitoring.

Table 1: AFA licence types

Type of service	Number of AFAs
Investment Planning Service and Discretionary Investment Management Service	5
Financial Advice	1
Financial Advice and Discretionary Investment Management Service	2
Financial Advice and Investment Planning Service	11
Financial Advice, Investment Planning Service, and Discretionary Investment Management Service	15
TOTAL	34

Figure 1: Remuneration and employment arrangements

- 26 AFAs were self-employed and 8 AFAs were employees
- 14 AFAs were remunerated from salaries only and 20 were remunerated based on receipt of fees and commissions
- 34 provided advice to retail clients, 16 also provided advice to wholesale clients
- 33 provided category 1 and 2 advice, with 1 adviser providing category 2 advice only
- Of the 26 AFAs that are self-employed:
 - 10 were contracted to an organisation that provides compliance support as part of its service
 - 2 appeared to have no external compliance support in place
 - 14 received compliance support externally

Summary of findings

Prior to each visit, FMA reviewed AFA Adviser Business Statements. During the visit we examined 3-6 client files and also interviewed AFAs. In total 146 files have been examined.

General comments on findings

The monitoring team is encouraged by the standard of ethical behaviour, based on these first visits, and equally encouraged that AFAs are generally meeting our expectations in relation to the minimum standard of client care. AFAs visited received FMA staff positively and were fully engaged in the process of the monitoring review.

We expect that many of the AFAs visited earlier in the review period will have proactively reviewed their professional development plan as a result of the feedback they received, and identified specific actions to address any concerns. It is pleasing that AFAs have amended their Adviser Business Statements based on FMA feedback. In addition to this, an AFA's willingness to seek further expert compliance support when needed is also applauded.

The primary opportunities for improvement are the need for better record keeping and the steps taken by the adviser to ensure that the personalised service is suitable for the client.

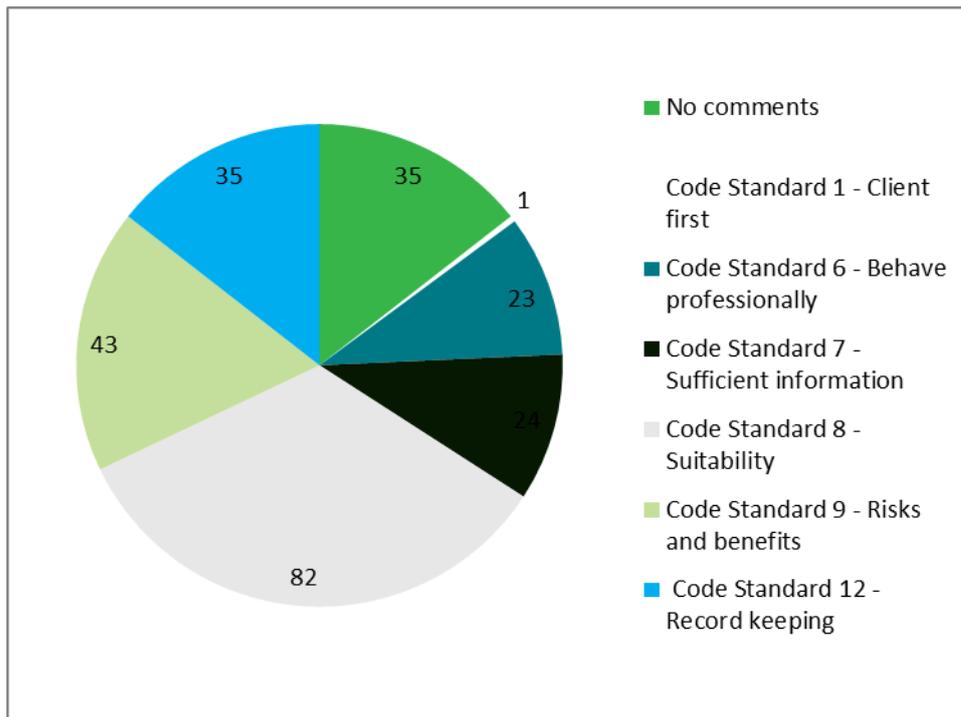
We would also like AFAs to review their documentation regarding the nature and scope of the adviser service being provided to their clients to ensure it is more clearly defined for the client. And at the same time we would like to see more emphasis on ensuring that the client's goals and objectives are properly quantified in dollars and time in plan documentation.

Findings in relation to Code Compliance

Of the total of 146 files examined, 35 files fully met our expectations. We made no comment on these files.

On other files our findings ranged from minor compliance matters for improvement through to more serious concerns requiring significant follow-up. We have made comments about one or more Code Standards as summarised in Figure 2. Note, feedback on results from the most recent visits is still ongoing as at the date of this report. In earlier visits, AFAs were able to provide a satisfactory explanation subsequent to the monitoring visit. Accordingly these remain interim results and the exact number of concerns about each Code Standard is likely to change.

Figure 2: Interim findings in relation to Code Compliance as at July 2012



Further information including examples of the types of comments FMA has made about certain Code Standards is provided later in this report.

Findings in relation to disclosure

12 AFAs had issues in relation to compliance with the Financial Advisers (Disclosure) Regulations 2010. Due to the prescriptive nature of these regulations, some of these related to minor technical non-compliance issues. Further detail is provided later in this report.

Implications for AFAs

AFAs involved in the monitoring visits

The monitoring team has provided detailed feedback to each of the AFAs involved, identifying the specific findings in relation to their own files. In the majority of cases we believe the AFAs visited will be able to improve their compliance with Code Standards and disclosure regulations.

In some cases, we advised AFAs to review their business processes and documents in the highlighted areas and make appropriate adjustments to both current files and to future financial adviser services. No follow-up from FMA was required.

In other cases, AFAs have been asked to provide further clarification to us on the issues raised or to re-submit files once areas of concern have been addressed.

We are still actively working with a small number of AFAs to address more serious concerns. This work has involved follow-up visits and requests to re-submit a larger number of files.

All AFAs - Code Compliance

AFA compliance with these particular Code Standards will continue to be a focus for the monitoring team along with general compliance with the Financial Advisers Act.

Particular attention may be given to:

- The types of interactions an AFA has with clients, and the extent to which this is properly documented through plans, letters and file notes etc
- The process followed by the AFA to establish the risk a client is willing and able to take, and making a suitable investment selection
- A review of the AFA's professional development plan to ensure compliance with Code of Professional Conduct – minimum standards for continuing professional training
- Compliance with the Financial Advisers (Disclosure) Regulations 2010

It is important that AFAs retain all records to demonstrate their compliance with their obligations.

The monitoring team will also be looking for clarity in relation to the nature and scope of the AFAs service being provided to each client, and the record of client information obtained relevant to the scope of the service being provided.

All AFAs - Compliance assistance

The monitoring team was occasionally asked by AFAs to comment on various aspects of process where the AFA was uncertain if these processes were compliant. We recommend that if in any doubt, AFAs should seek input from their compliance specialists prior to a FMA visit and take any corrective action as necessary. We remind AFAs that breaches of the Code or the Financial Advisers Act may result in disciplinary action.

AFAs selected for future monitoring visits

During our review of these first monitoring visits, we asked for feedback from a selection of AFAs. These comments were helpful, and it is our intention to continue to seek and encourage feedback at the conclusion of the each monitoring round to enable us to continue to improve our monitoring process.

A number of AFAs spoke about their nervousness before the monitoring visit, but also noted the approachability of the FMA representatives which helped to ease the situation.

Any AFA involved in a monitoring visit needs to be ready to explain his or her advice process and show the key documentation used. They may also be asked to explain the advice process followed in each of the 3 – 6 client files reviewed. The reviewers are interested in any relevant background of the client, the process followed and finally the outcomes achieved for the client.

Whenever possible, AFAs will be given the opportunity to address any specific concerns the reviewers may have on the day, before receiving a feedback letter. This will help to clear up any misunderstanding as soon as possible.

Findings in relation to Code Standards

The Code of Professional Conduct for Authorised Financial Advisers sets out the minimum standards of professional conduct for AFAs.

During its monitoring visits, FMA assesses how well the adviser demonstrates they are meeting those minimum standards.

In these first monitoring visits, the most common initial concerns and/or findings related to compliance with Code Standards 6,7, 8, 9 and 12 and in particular with Code Standard 8.

We have included some sample initial concerns/findings, which have been summarised below, to indicate the types of matters that arose during these visits.

Code Standard 6

Code Standard 6: *An Authorised Financial Adviser must behave professionally in all dealings with a client, and communicate clearly, concisely, and effectively*

Sample of initial concerns/findings:

- References to the source of research and product analysis was not held on file
- Use of technical jargon that may not be understood by the client
- Apparent conflicting statements made in the documented advice

Code Standard 7

Code Standard 7: *An Authorised Financial Adviser must ensure each retail client has sufficient information to enable the client to make an informed decision about whether to use the Authorised Financial Adviser's financial adviser services and/or to follow any financial advice provided by the Authorised Financial Adviser.*

Sample of initial concerns/findings:

- The scope of the adviser service and any limitations were unclear
- The scope of service described did not match the service provided
- The information gathered from the client did not reflect the scope of service

Code Standard 8

Code Standard 8: *When providing a personalised service to a retail client an Authorised Financial Adviser must take reasonable steps to ensure that the personalised service is suitable for the client*

Sample of initial concerns/findings:

- Gaps in client files
- There was insufficient information to demonstrate that the adviser had an up to date understanding of the client's circumstances. For example, specific retirement needs or goals of the client had not been stated
- It was unclear how the AFA's recommendations tied back to the client objectives
- We had concerns over instructions to opt out of Code Standard 8, and the extent to which they client may have been influenced. For example, we had concerns about the nature of the AFA service provided to the clients

Note, in a number of instances we had concerns relating to some aspect of the process followed by the AFA when providing advice that was suitable to the client's specific circumstances and needs. This does not necessarily mean that the financial advice given was unsuitable.

Code Standard 9

Code Standard 9: *When an Authorised Financial Adviser provides a personalised service to a retail client that is an investment planning service or that relates to a category 1 product, the Authorised Financial Adviser must provide a written explanation to the client of the basis on which those services are provided. The Authorised Financial Adviser must also take reasonable steps to ensure the client is aware of the principal benefits and risks involved in following any financial advice provided as part of that service, having regard to the characteristics of the personalised service*

Sample of initial concerns/findings:

- It is unclear whether the client was made aware of the AFA's rationale for switching investment funds
- Lack of explanation concerning assumptions made when providing the client with projection calculations
- Lack of evidence on file to demonstrate that a client was made aware of the principal risks and benefits of a particular investment product

- For annual reviews, it was unclear what process was followed to determine whether portfolio investments remained appropriate to the life cycle of the client, with consideration given to the benefits, risks, common terms and conditions of the different investment funds

Code Standard 12

Code Standard 12: *An Authorised Financial Adviser must record in writing adequate information about any personalised services provided to a retail client.*

Sample of initial concerns/findings:

- No written records of why client has not followed the AFA's advice
- 'Authority to proceed' form, used as part of the AFA's process, was not held on particular client files
- There were insufficient details on file to demonstrate that adequate information was recorded about the personalised service provided
- Use of standard form/templates that don't reflect the scope of service actually provided

Note, in a number of instances failure to meet Code Standard 8 was due to poor record keeping. While we have highlighted that most issues relate to Code Standards 6, 7, 8 and 9, poor record keeping (12) is often behind the initial failures.

Findings in relation to disclosure

Disclosure must be made before the advice or service is provided, or if that is not practicable, as soon as practicable after the service is provided (Financial Advisers Act 2008 section 22(1)).

Disclosure obligations are set out in the Financial Advisers (Disclosure) Regulations 2010.

Sample of initial concerns/findings:

- No evidence that primary or secondary disclosure statements had been provided to the client
- In the secondary disclosure statements there was no information about the fees for the advice provided to the client
- Disclosure documents did not match the prescribed wording in the Disclosure Regulations