

Consultation paper: Personalised DIMS under the Financial Advisers Act 2008

Draft eligibility criteria and new standard conditions for AFAs authorised to provide a Personalised Discretionary Investment Management Service (Personalised DIMS)

19 November 2014

The Financial Markets (Repeals and Amendments) Act 2013 introduces amendments to the Financial Advisers Act 2008 (the FA Act). This means for a person to be authorised to provide a Personalised DIMS they must meet the prescribed eligibility criteria.

These criteria are set out in the Financial Advisers (Personalised DIMS) Regulations 2014. To be eligible you must be capable of effectively performing the Personalised DIMS. The FMA will assess capability against minimum standards.

Advisers who provide Personalised DIMS will also be expected to ensure ongoing compliance with additional Standard Conditions which reflect the minimum standards.

This paper outlines the proposed minimum standards the FMA will use to assess eligibility to provide Personalised DIMS. The paper also outlines the proposed additional standard conditions. We invite you to review these and share your feedback with us.

Submissions close on Tuesday 9th December at 5pm. The form at the back provides more details.

A. What is a Personalised DIMS?

1. A Discretionary Investment Management Service (DIMS) is an arrangement where you are authorised by your client to make buy-sell decisions about their investment portfolio. This is often without needing to refer to them about every transaction or investment decision. A service may still be a DIMS if your client has the right to be consulted on, or to countermand your decisions.
2. The definition of Personalised DIMS is set out in section 15 of the FA Act:

“A Personalised DIMS is a service provided to a named client or a client who is otherwise readily identifiable by the financial adviser exercising the investment authority under that service; and

the investment strategy implemented in or to be applied under the investment authority has been designed to take account of the client’s particular financial situation and goals or any one or more of them (rather than merely being customised from an investment strategy that applies to a class of clients, for example, by selecting options or by making minor changes to the class strategy or authority).”
3. This definition of Personalised DIMS focuses on the design of the **investment strategy**, not the design of the investment portfolio. An investment strategy is the way you decide what investment decisions to implement for a particular client.
4. We understand most AFAs currently use model portfolios and/or model asset allocations as a core part of their investment strategy. This means most DIMS are not Personalised DIMS. For further explanation of the definition of Personalised DIMS see [Understanding the regulation of DIMS frequently asked questions](#).
5. Any DIMS that is not a Personalised DIMS is a class DIMS.

B. Will you need to be authorised?

6. You only need to be authorised or licensed to provide Personalised DIMS to retail clients – not for wholesale clients.
7. If you are a Financial Markets Conduct Act (FMC Act) DIMS licensee or an employee of an FMC Act DIMS licensee you do not need to be authorised to provide Personalised DIMS under the FA Act.
8. Please note the Personalised DIMS under the FA Act must be a truly personalised service designed to suit the individual investor. However, if the service is customised from an

investment strategy that applies to a class of clients – for example, if you select options from a model portfolio, or make minor changes to the class strategy or authority, is not considered ‘personalised’.

| At a glance | | |
|---------------------------------------|---|--|
| Can I provide.... | Under FA Act? | Under FMC Act? |
| Personalised DIMS for retail clients? | YES – if you are an AFA and the service is within the scope of your authorisation under FA Act and you meet the eligibility criteria | YES – with a DIMS licence |
| Class DIMS for retail clients? | NO | YES – with a DIMS licence |
| Any DIMS for wholesale clients? | YES – if you are an AFA, QFE adviser, registered person or an exempt provider | YES – a licence is not compulsory |

C. Minimum standards – four key areas

9. We propose that to show you are capable of effectively performing the Personalised DIMS you must meet a range of minimum standards. We propose that advisers will need to meet minimum standards in four key areas:
 - Capability – your skill and experience
 - Operational infrastructure – your client services, investment activities and business operations
 - Financial resources – financial resources and professional indemnity insurance
 - Governance – governance and compliance culture.
10. These standards are outlined in Part 2 of this consultation paper. These proposed standards do not cover all your obligations under the FA Act or regulations.
11. If you are not authorised to provide DIMS at 30 November 2014 you will need to meet the minimum standards at the time that you are authorised for Personalised DIMS and on an on-going basis.
12. If you are authorised to provide DIMS at 30 November 2014 you will need to meet the minimum standards when the eligibility criteria takes effect and on an ongoing basis.
13. There is flexibility in how each AFA meets the minimum standards. Your approach needs to be appropriate for the size and nature of your business. The systems and controls expected in a single-adviser business will be simpler than those expected in a larger or more complex business. In addition some minimum standards may be met through adherence to the Code of Professional Conduct for Authorised Financial Advisers (the Code).

14. This consultation document does not provide detailed commentary on the expectations of an AFA under the minimum standards – this will be detailed in the updated AFA Application Guide and the ABS Guide. However, the principles discussed in the FMA’s Quick guide to licence applications for small businesses providing DIMS provide a useful guide as to how the standards might apply to an AFA business.
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D. Standard conditions

15. We propose two new standard conditions that reflect conditions imposed on all FMC Act DIMS licensees in relation to Outsourcing and Financial Resources (see Part 3). These will only be applicable to those providing Personalised DIMS under the FA Act.
 16. We also note for consultation a process for future amendment(s) to the Standard Conditions to remove references to repealed legislation.
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E. Timing and requirements

New or existing AFAs not currently authorised for DIMS

17. The eligibility criteria for new or existing AFAs applying to be authorised to provide Personalised DIMS takes effect from 1 December 2014.
18. If you meet the eligibility criteria you will be issued with an authorisation for the provision of Personalised DIMS. New AFAs will be charged the application fee and existing AFAs who are not currently authorised for DIMS will be charged a variation fee in order to vary their financial adviser scope (FAS scope).

Existing AFAs authorised for DIMS

19. For existing AFAs who are authorised to provide DIMS as at 1 December 2014 the eligibility criteria will take effect from 1 June 2015.
20. If you wish to provide Personalised DIMS under the FA Act after 1 June 2015 you will need to provide us with an updated Adviser Business Statement (ABS) and completed additional information form by 31 May 2015.
21. We will assess if you meet the eligibility criteria based on your ABS and form. If we require further information from you to be satisfied you are capable of effectively performing the service we will talk with you directly to facilitate this. Providing us with your updated ABS

will also allow you to rely on certain transition exemptions set out in the Financial Advisers (Personalised DIMS) Regulations 2014.

22. If you meet the new eligibility criteria you will be issued a new authorisation certificate which authorises you for Personalised DIMS. This authorisation will have the same expiry date as your existing authorisation.
 23. If you do not provide us with an updated ABS by 31 May 2014 and have not cancelled your authorisation for DIMS you cannot rely on the transitional provisions provided for in the Financial Advisers (Personalised DIMS) Regulations 2014.
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F. For your information

Terms

- AFA Authorised financial adviser
- DIMS Discretionary investment management service
- FA Act Financial Advisers Act 2008
- FMC Act Financial Markets Conduct Act 2013

Please note

The purpose of this paper is to give you a chance to review and comment on the proposed minimum standards and additional Standard Conditions for AFAs providing Personalised DIMS that will come into effect under the FA Act. The ABS Guide and AFA Authorisation Guide will be amended following this consultation.

Part 2. Minimum standards

A. Capability

You and anyone you are relying on to provide a DIMS must have the right skills and experience, to manage the service properly and effectively.

Minimum standards

1. You and your team (collectively) must have an appropriate breadth and depth of relevant financial services know-how, whether gained here or overseas, to effectively provide the DIMS.
 2. You must have the competence, knowledge and skill relating to any aspect of the provision of DIMS that you will personally perform.
 3. Your business has access to any necessary expert professional advice (for example legal or tax advice) either through internal appointments or external consultants.
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B. Operational infrastructure

**New clients | Investment objectives & authority | Investment selection | Monitoring & reporting | Material issues & complaints | Custody | Outsourcing | Resources
Staff & supervision | IT systems | Records | Termination of service**

New clients

Your procedures for bringing new clients on board must ensure they get sufficient information to make informed decisions about the financial services offered – and that these services are not inappropriately marketed.

Minimum standards

1. You maintain adequate and effective systems to bring clients on board, with processes and controls to ensure the requirements of the FA Act and the FMC Act are met.
2. You have effective procedures to identify if a client is a retail or wholesale client ([sections 5B](#) and [5C](#) of the FA Act) and to ensure they are informed about their status.
3. You and any staff involved in bringing clients on board are aware of the obligations under the FA Act, and are adequately trained in the systems and processes for bringing clients on board.

Client objectives and investment authority

A client should be given sufficient information to enable them to fully understand the scope of any investment authority they grant.

The investment authority should be appropriate for the relevant investment objectives.

Minimum standards

1. You have effective procedures in place to record the client's objectives and investment authority.
2. You keep a written copy of your client's investment authority, and that authority meets the requirements of Section 43 (as enacted at 1 December 2014) of the FA Act.
3. You ensure the proposed investment authority is appropriate for the client's investment objectives.
4. You ensure any 3rd party whom you use is adequately trained in your DIMS systems and processes.

Selecting investments

You must exercise a professional standard of skill and care when selecting investments.

Minimum standards

1. You have effective procedures to collect all relevant investment information about all forms of proposed investments. This includes information about any proposed investments that are exempt from the disclosure obligations in [Part 3](#) of the FMC Act, to fulfil your obligations pursuant to code standard 6.
2. You have adequate and effective processes to select assets/instruments to comply with the investment authority – including an investment strategy, supported by up-to-date research and analysis.
3. You have sufficient relevant skills, experience and training so you meet the professional standard of care.
4. You 'stress test' your investment strategies as appropriate to the particular investment strategy.
5. You maintain efficient procedures to identify transactions involving related party benefit and deal with them appropriately.
6. You maintain efficient procedures to identify conflicts (or potential conflicts) of interest and deal with them appropriately.

Investment monitoring and client reports

Your systems and processes must enable you to monitor investment portfolios and take appropriate action when necessary.

Minimum standards

1. Your portfolio monitoring systems and processes enable you to measure and report performance against the client's investment objectives – and the client agreement sets out the frequency and methodology for reporting to them.
2. You regularly require your clients get updated financial advice or reconsider their investment objectives (as appropriate). You review your client's circumstances and the portfolio allocations at least annually.
3. Your systems, controls and procedures ensure:
 - your investment strategy is developed and amended when appropriate
 - corporate actions relating to investments (such as rights entitlements, dividend payments or stock splits) are appropriately dealt with in the best interests of your client
 - no one can conduct unauthorised trading in relation to your client's property.
4. You have adequate and effective systems and procedures to:
 - identify and report (to your client and the FMA if required) breaches of the investment authority
 - analyse and follow up any breaches
 - identify any trends in breaches, and introduce measures to prevent reoccurrence.

Material issues and complaints

You have effective processes and procedures to identify and deal with material issues in your business.

Minimum standards

1. You maintain effective methods for identifying and reporting to the FMA changes to your financial service which may impact your authorisation or any serious breach of the FA Act, regulations, Code or authorisation.
2. You monitor complaints to ensure they are dealt with fairly and in the best interests of the investor.
3. You have systems and procedures to identify trends in complaints – and you investigate and address any issues identified.

Custody

Client money and property must be held by an appropriate independent party.

Minimum standards

1. You do not hold any client money or client property yourself.
2. Any custodian you use is independent.
3. Any custodian used is an appropriate entity to hold and safeguard money and property.
4. You keep your due diligence on any custodian up-to-date.

Outsourcing (*excluding custody*)

You must ensure outsourced functions are adequate, effective and comply with your authorisation obligations.

Minimum standards

1. You have appropriate processes to ensure, before you outsource a function, that the provider is an appropriate entity and capable of effectively performing the outsourced function to an acceptable service level.
2. You have a proper legal arrangement with the provider, including provisions that enable you to effectively monitor their performance and take appropriate action for non-performance.
3. Records and information the provider holds will be available for inspection by the FMA on request.
4. You regularly review the outsource arrangement (at a frequency appropriate to the risk involved).
5. Your performance monitoring programme includes:
 - checks that the provider's performance meets required standards
 - triggers for identifying non-performance
 - a plan for steps you will take in the event of non-performance.

Staffing and supervision

You must have adequate and effective arrangements to manage and supervise any staff you are relying on to provide the DIMS. Staff need to be suitable for their roles and act professionally.

Minimum standards

Your arrangements ensure:

1. Any staff have the right skills and experience for their roles, and a clear job description that sets out their responsibilities (including authorisation/delegation levels).

2. Roles are designed to support key controls (for example by segregating duties between roles).
3. Enough time is allowed for key processes including compliance activities.
4. Staff are appropriately trained, managed and supervised – you address poor performance and recognise professional conduct.
5. You have appropriate supervisory arrangements, including:
 - Sufficient resources are allocated to supervision
 - Supervisory staff have the right knowledge and experience (including understanding the functions of the roles they supervise)
 - Supervisory staff have the support and authority they need to do the role effectively.
6. Any issues identified by supervisory staff are acted on appropriately.

Note 1: Minimum standards 5 and 6 would not apply where staff numbers are limited.

IT systems and business continuity

Your IT systems used to deliver the Personalised DIMS must be secure and reliable. Your arrangements ensure they perform efficiently and the associated risks are managed.

Minimum standards

1. Your IT systems include necessary functionality to provide the service, and perform the intended processes effectively.
2. You have effective safeguards and controls over the IT systems (and the underlying processes) whether they are built into, or external to, the system. These include processes:
 - to ensure data and system security – and prevent errors or system failure
 - that takes into account risk from human error, technical failure and malicious conduct.
3. You maintain an appropriate (and tested) business continuity plan – including procedures for data backup and disaster recovery.
4. You have proper legal arrangements with any third-party software providers, including licences for software and contracts for any required maintenance and support.

Records

You must maintain adequate records and provide information to the FMA in a timely manner.

Minimum standards

1. You have systems and procedures to maintain proper records.
2. You retain these records for at least seven years – and they are available for inspection by the FMA on request.

Termination of service

You must act in the best interests of your client when their client agreement ends.

Minimum standards

1. Your client agreement allows the client to terminate the service without penalty – and take control of the assets, or realise their value, within a reasonable period.
 2. Your client agreement explains clearly:
 - How assets will be dealt with when the service is terminated
 - Any risks associated with the assets that could arise when the service is terminated.
 3. You have effective procedures to deal with any assets that can't be transferred directly to the client or transferred to another service when the service is terminated.
 4. You have effective procedures to ensure the orderly termination or transfer of client services if your business ceases.
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C. Financial resources

Financial resources | Professional indemnity insurance

Financial resources

You must, at all times, have adequate financial resources to effectively perform the service.

Minimum standards

1. You have a sufficiently strong balance sheet.
2. You are able to pay your debts as they become due in the normal course of business.
3. You maintain an appropriate level of liquid assets at all times to cover reasonably expected contingencies in your business.
4. You have adequate and effective systems, policies, procedures and controls to:
 - monitor your financial resource levels
 - consistently calculate an appropriate level of liquid assets to hold for your business
 - assess the risk of your financial resources not being adequate to continue to provide the service, or a serious financial problem occurring.

Note 1: Under minimum standard 1 we generally require positive net tangible assets. Further information about net tangible assets is set out in the standard condition for financial resources.

Professional indemnity insurance

You must maintain an appropriate level of professional indemnity insurance cover for your business.

Minimum standards

1. You maintain an appropriate level of professional indemnity insurance to cover risks related to your service (if cover is available).
 2. Your level of professional indemnity insurance cover is adequate and appropriate for the nature, scale and complexity of your business – there is no set minimum cover, it depends on your business.
 3. You have sufficient resources to meet any policy excess.
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C. Governance

Governance | Culture | Compliance

Governance

You must have a framework for ensuring compliance with your DIMS obligations – and ensuring you have in place appropriate risk management processes.

Minimum standards

1. You have a clear governance framework covering all key aspects of your DIMS compliance obligations and key risks of providing the DIMS.

Culture

You have governance and compliance arrangements that promote a culture of compliance, and ensure appropriate risk management and fair treatment of investors.

Minimum standards

1. You have a good compliance culture, supported by systems, policies, procedures and controls.
2. We expect a good compliance culture to include the following:
 - you clearly communicate your conduct expectations to any staff involved in providing your DIMS, for example through the Code of Conduct for Authorised Financial Advisers

- you allocate adequate time and resources for training, supervision and compliance activities
- you willingly engage with relevant regulators in an open and honest manner, and are responsive to any regulatory concerns they may raise.

Compliance

You must have adequate and effective arrangements for challenging and testing your own compliance, the compliance framework and the outcomes.

Minimum standards

1. Compliance assurance – you have adequate and effective arrangements to challenge and test the design and operation of your processes and controls, and the adequacy of your governance and management information. This is your compliance assurance programme.
2. Your compliance assurance programme goes beyond day to day controls for key processes, by including more in-depth testing of processes and controls including:
 - the testing (and the design of it) is done independently of those involved in day to day processes and oversight – for example testing is done by a separate compliance or internal audit function, or by an external organisation
 - you allocate sufficient, appropriate resources to planning and carrying out the programme, and ensure those involved have the skill and experience to carry out the work.

Part 3. Authorisation conditions

A. Standard conditions

Additional conditions will be inserted into the existing Standard Conditions for AFAs. These additional conditions will only apply to AFAs providing Personalised DIMS.

1. Outsourcing

Standard condition:

If you outsource a process/system (or any other authorisation obligation) you must be satisfied that the provider is capable of performing the service to the standard required to enable you to meet your authorisation obligations. You must have a legally binding agreement with the provider. You must also ensure that records pertaining to the DIMS are available for inspection when requested by the FMA.

2. Financial resources

Standard condition:

You must calculate your **net tangible assets (NTA)** at least monthly, including as at your balance date each year. If your calculation shows that you did not have positive net tangible assets at any time, you must notify the FMA and provide an explanation, unless:

- a. you have previously notified the FMA that you have negative net tangible assets and explained:
 - i. the circumstances that cause you to have negative NTA, including the nature of any significant intangible assets or related party receivables, and
 - ii. whether you consider having negative NTA adversely impacts on your ability to provide DIMS effectively on an ongoing basis and why, and
- b. the FMA has advised in writing that you do not need to provide further notifications about having negative NTA arising from those circumstances, and
- c. there has been no material change from the position and circumstances described to the FMA in your most recent previous notification.

You must also engage a qualified auditor and enter into agreed procedures to review the calculation of your NTA as at your balance date each year. The auditor's report must include a statement that, as at your balance date, in the auditor's opinion, you calculated your net tangible assets correctly.

Net tangible assets (NTA)

For the purposes of this Standard Condition (*Financial Resources*) **Net tangible assets (NTA)** has the following meaning:

1. NTA shall mean the AFA's **adjusted assets** minus **adjusted liabilities**.
2. **Adjusted assets** means, in relation to an AFA, the value of total assets as they would appear on a balance sheet at the time of calculation that has been prepared under NZ GAAP, minus any **excluded assets**.
3. **Excluded assets** means:
 - a) the value of any intangible assets (i.e. non-monetary assets without physical substance), plus
 - b) the value of any **associated party receivables** except **permitted associated party receivables**.
4. **Associated party receivables** means any receivables, or other obligations, owed to the market services licensee by any person who:
 - a) is an associated person (as defined in NZ IAS Investments in associates) of the AFA; or
 - b) was or, if the FMC Act had been in force at the time, would have been an associated person (as defined in the FMC Act) of the market services licensee at the time the liability was incurred or the investment was made.
5. **Permitted associated party receivables** means an associated party receivable to the extent that:
 - a) it is **adequately secured**; or
 - b) is owed by a registered bank regulated by the Reserve Bank of New Zealand or an Australian Authorised Deposit-taking Institutions (ADI) authorised under the Australian Banking Act 1959; or
 - c) the following conditions all apply:
 - i. it is receivable as a result of a transaction entered into by the AFA in the ordinary course of its business on its standard commercial terms applicable to persons that are not associated with the market services licensee on an arm's length basis;
 - ii. the value of the receivable (before any discount is applied) is not more than 20% of the assets less liabilities as they would appear on the AFA's balance sheet at the time of calculation.
6. **Adequately secured** means, in relation to an associated party receivable, that receivable is:
 - a) secured by an enforceable security interest over financial products if:
 - (i) the financial products are regularly traded on an **acceptable financial product market** or are interests in a registered scheme for which withdrawal prices are regularly quoted by the manager of the scheme, and the AFA believes on reasonable grounds that withdrawal may be effected within 5 business days; and
 - (ii) the market value of these financial products is at least 120% of the amount owing, or at least 109% of the amount owing if the financial products are debt securities; or

- b) secured by a registered first mortgage over real estate that has a fair market valuation of at least 120% of the amount owing.
7. **Acceptable financial product market** means any registered market registered market within the meaning of section 2(1) of the Securities Markets Act 1988 or any licensed market within the meaning of section 6 of the Financial Markets Conduct Act 2013 and each of American Stock Exchange, Australian Securities Exchange, Borsa Italiana, Bursa Malaysia Main Board and Bursa Malaysia Second Board, Euronext Amsterdam, Euronext Paris, Frankfurt Stock Exchange, Hong Kong Stock Exchange, JSE, London Stock Exchange, NASDAQ Stock Market, New York Stock Exchange, Singapore Exchange, SWX Swiss Exchange, Tokyo Stock Exchange and Toronto Stock Exchange.
8. **Adjusted liabilities** means, in relation to an AFA, the amount of total liabilities as they would appear on a balance sheet at the time of calculation that has been prepared on the same basis as NZ GAAP,
- a) minus the amount of any liability under any subordinated debt, where the obligation to repay the debt is subordinate to all other claims, demands, rights and causes of action of all unsubordinated creditors and the debt is not repayable within one year;
 - b) plus the maximum potential liability under any guarantee provided by the AFA.

B. Specific conditions

We may also set extra authorisation conditions for individual AFAs on a case-by-case basis, for example:

1. **Limits**

If you request a limit on your authorised activity, or can only demonstrate the capacity to provide an effective service within certain parameters, we may set limits on your licence.

2. **Employment**

If we approve your authorisation based on your reliance on your employer's systems, we will specify that your authorisation is only valid while you are an employee of that employer. There may also be other conditions based on the particular relationship.

C. Future variation of standard conditions

Standard Condition 3 identifies various pieces of legislation by name. Some of those pieces of legislation are to be repealed in the future.

We will progressively remove reference to legislation as it is repealed.

The next step

How do I make a submission?

Please use the form on the next page – this gives the details of what you need to do. Forms must be submitted electronically in both PDF and word formats and emailed to consultation@fma.govt.nz – please put ‘Feedback Personalised DIMS minimum standards and Standard Conditions’ in the subject line.

Alternatively, you can make an online submission on our engagement site www.talktous.fma.govt.nz. You need to register to be able to use the site.

Submissions close on Tuesday 9th December at 5pm.

Where can I get more information?

You’ll find more information about the changes on our website www.fma.govt.nz, or at the Ministry of Business Innovation and Employment site www.mbie.govt.nz.

If you have questions about the consultation process, please get in touch on 0800 434 567.

Feedback: Personalised DIMS minimum standards and Standard Conditions

Please submit this feedback form electronically in both PDF and MS Word formats and email it to us at consultation@fma.govt.nz with 'Feedback Personalised DIMS minimum standards and Standard Conditions' in the subject line. Thank you. **Submissions close on Tuesday 9 December 2014.**

Date: _____ Number of pages: _____

Name of submitter: _____

Company or entity: _____

Organisation type: _____

Contact name (if different): _____

Contact email and Phone: _____

| Part# | Section# | Paragraph# | Comment | Recommendation |
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*You don't need to quote from the consultation document if you use part & paragraph numbers.
You may attach extra pages - please label each page with your name & organisation.*

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Feedback summary – if you wish to highlight anything in particular

Please note: Feedback received is subject to the Official Information Act 1982. We may make submissions available on our website, compile a summary of submissions, or draw attention to individual submissions in internal or external reports. If you want us to withhold any commercially sensitive or proprietary information in your submission, please clearly state this and note the specific section. We will consider your request in line with our obligations under the Official Information Act.

Thank you for your feedback – we appreciate your time and input.