

AFA Monitoring Report: July – December 2013

March 2014



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Introduction

FMA's overarching focus is on raising standards of good conduct, ethics and integrity amongst financial market participants. We expect participants to operate above the bare minimum required and senior management within financial services firms to sponsor a culture of integrity and good conduct.

Monitoring market participants is an important activity that helps us deliver one of FMA's key legislative functions, which is to collect and disseminate information or research about matters relating to financial markets.

As part of our ongoing monitoring of Authorised Financial Advisers (AFAs), we review AFA compliance with the conduct and disclosure obligations set out in the Financial Advisers Act 2008 (**FA Act**) and the Code of Professional Conduct for Authorised Financial Advisers (**Code**).

During the period covered by this report, in addition to our 'day to day' monitoring, we focused on three specific themes: Advisers in the Christchurch and Canterbury region, advice provided on UK pension transfers and complaints processes.

Day to day AFA monitoring

During the period of July to December 2013, our monitoring included visiting advisers in Hamilton and Dunedin. These areas were selected because of the high concentration of advisers in both locations. Our initial 32 ABS reviews resulted in six on-site monitoring visits in Hamilton and six in Dunedin.

Key findings and observations from our visits

Disclosure

1. Not all advisers' disclosure documents followed the format prescribed by Regulations 5 and 6 of the Financial Advisers (Disclosure) Regulations 2010 or contained the correct information.
2. In particular, there were a number of instances where AFAs were not detailing a reasonable estimate of client specific fees in their Secondary Disclosure Documents (Regulation 6 of the Financial Advisers (Disclosure) Regulations 2010). Instead, a range of fees were documented.

Code Standard 8

3. We found potential breaches of the Code where advisers made a determination of suitability of investment portfolios for retail clients.
4. In particular, we saw a lack of clarity around how AFAs established an asset allocation for a portfolio based on the output of their client's risk profile questionnaire. There was little or no explanation on how the holdings were selected for the portfolio based on the asset allocation chosen, or why these asset classes and holdings or products, were suitable for the client.
5. We also found potential breaches of Code Standard 8 with regard to the adviser not having an adequate up-to-date understanding of the client's financial situation, financial needs, financial goals or tolerance for risk. This issue was highlighted in our July-September 2012 AFA Monitoring Report.
6. We also found that not all advisers are offering their clients regular reviews and therefore do not necessarily have a current understanding of their clients' financial situation, financial needs, financial goals and tolerance to risk.

Code Standard 9

7. We found that not all AFAs were taking reasonable steps to make sure their clients were aware of the principal risks and benefits of following their advice. Where we did see risks and benefits documented, they tended to be generic rather than the adviser taking into account the specific client. Whilst we do not expect to see every potential risk associated with a recommendation being brought to the client's attention, we expect that advisers should ensure that the key issues relevant to that particular client are outlined.

Code Standard 12

8. In a number of instances, failure to meet Code Standards 8 and 9 may have been due to the AFA not recording information. While we have highlighted that the main issues relate to Code Standards 8 and 9, inadequate record keeping (Code Standard 12) often means the AFA is not able to demonstrate their compliance with the other Code Standards.

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9. Inadequate record keeping has been raised in past monitoring reports; see reports dated July – September 2012 and September 2011 – June 2012. <http://www.fma.govt.nz/news/reports-and-papers/>
 10. All advisers visited have now received feedback from us.

ABS reviews

11. In respect of the ABS reviews conducted, the main issues we identified were:
 - not enough detail provided around how the AFA is compensated (Remuneration and Reward)
 - lack of identification, management and disclosure of potential conflicts of interest of the AFA (Remuneration and Reward)
 - not enough detail specifying any preferential terms the AFA has with any product providers (Products and Services)
 - lack of detail around the percentage of the AFA's clients that are retail clients and the percentage that are wholesale clients (Clients)
 - inadequate disclosure of complaints that have been received in the last 12 months (Complaints)
12. Where we identified issues, we requested that AFAs take the necessary steps to amend their ABSs accordingly and would encourage all AFAs to review these aspects when they next update their ABS.

Thematic reviews

Christchurch and Canterbury region

In August 2013 FMA carried out some proactive surveillance, focused on the Christchurch and Canterbury region. The purpose of this project is to support participants and investors throughout the rebuilding of Christchurch. We reviewed a range of ABSs. A number of these were then selected for a more targeted review on advice practices, which included monitoring visits. We visited four AFAs and also visited other market participants, including RFAs.

FMA will continue to focus on the Christchurch and the Canterbury area during the rebuild process to ensure Cantabrians who are looking to invest their compensation or insurance money are dealt with by market participants ethically and with integrity.

All AFAs visited have now received feedback from us.

Key findings and observations

13. Our field officers actively engaged with various market participants to gain an understanding of their concerns regarding conduct in the region. The feedback we received was generally positive.
14. Overall, the general themes that emerged from our monitoring visits in Canterbury were similar to those found in our 'day to day' monitoring.

UK pension transfers

During the period, FMA conducted a preliminary review into the quality of advice provided by advisers to investors on the subject of transferring UK Pension plans to New Zealand. The purpose of this review was to understand the extent to which AFAs are advising clients on these types of pension transfers including the nature and scope of the advice within the remit of the Code and adviser obligations.

There has been considerable interest in the market on this topic as a result of the introduction of the Taxation (Annual Rates, Foreign Superannuation and Remedial Matters) Bill. We have increased our focus due to the complexity of the subject and the number of retail investors potentially looking to transfer as a result of the proposed tax changes.

Our preliminary review considered the advice given by four advisers and is therefore a small sample which we acknowledge may not be indicative of all advice being provided in this area. However, with the growing awareness of portability of pension funds, the changing tax regime and the results from our initial reviews, FMA will continue to monitor advice on UK pension transfers to ensure that consumers are receiving considered, accurate and where possible, personalised advice. All advisers monitored as part of this project have now received feedback from us.

Key findings and observations

15. We have concerns about instances where advice is being given to clients on a 'No Advice' or 'Class Advice' basis. Due to the complexity of the subject matter we believe that personalised advice is needed. Providing 'Class Advice' on such a complicated topic could prove to be detrimental to the client's financial well-being.
16. In cases where a transfer is recommended by an adviser, FMA expects to see an analysis of the existing UK based scheme, including (but not limited to) a thorough assessment of any guarantees or associated benefits, investment fund options and scheme features, funding and income options, and an impartial comparison of any other features with the proposed New Zealand scheme. We expect advisers to take their client's financial needs and financial goals into account, set out the personalised risks and benefits associated with the transfer and comment on any alternative strategies that have been considered. This is to avoid clients losing benefits that cannot be replicated when transferring to a New Zealand pension scheme.
17. We expect advisers to provide a balanced view of the risks and benefits of transfer rather than focusing on the benefits.
18. Overall, this is a technical area for advisers, which requires specialist UK product knowledge and expertise. We encourage advisers to carefully consider whether they have the necessary competence, knowledge and skills to provide advice (Code Standard 14).

Complaints handling processes

During August and September 2013, FMA undertook a thematic monitoring project focusing on whether AFAs are complying with their obligation to establish and maintain a complaints handling process.

Code Standard 11 sets out the minimum requirements for a complaints handling process. These are:

- all complaints must be acknowledged as soon as is reasonably practical after making the complaint
- a client must be provided with information about an AFA's internal complaints handling process
- a client must be provided with information on how to complain to FMA and a Disputes Resolution Scheme
- an AFA must keep a record of all complaints and action taken to resolve them.

The Code defines a complaint as: 'An expression of dissatisfaction by a client to an AFA about the AFA's financial adviser services provided to the client, other than an expression of dissatisfaction that is trivial or vexatious or that the client indicates is not intended to constitute a complaint for the purposes of the Code.'

The purpose of our complaints review was to:

- give us an overview of the types of complaint handling processes being used
- understand how AFAs determine what constitutes a complaint
- understand how AFAs apply their internal complaints procedures
- enable FMA to determine whether guidance should be issued in this area.



In the first stage of the project, advisers were asked to review their complaints registers and any correspondence relating to complaints. Our review then focused on the following:

- how complaints were being recorded
- the nature of the complaints being recorded
- whether complaints were being acknowledged in a timely manner
- the level of detail recorded for each complaint
- evidence that the complaints process was being used effectively.

We looked at a sample of 19 AFAs. Of those, 10 said they had not received any complaints in the last 12 months. The other nine said they had received between one and four complaints in the past 12 months. All but two cases were resolved using internal processes. At the time of our review, discussion was ongoing regarding the two unresolved cases. All advisers monitored as part of this project have now received feedback from us.

Key findings and observations

19. All the advisers that we reviewed had complied with the minimum requirements regarding setting up an internal complaint handling procedure and a complaints register, as set out in the Code.
20. However, that given the wide ranging definition of a complaint defined in the Code, a number of AFAs monitored had still not recorded any instances in the last 12 months where a client had expressed dissatisfaction about their financial adviser services. In future monitoring, where an AFA has no recorded complaints in the last 12 months, we will probe further to make sure the AFA fully understands the definition of a complaint, and question whether the complaints log is a true reflection of the case.
21. Many of the complaints that we did see recorded lacked detail regarding the nature of the complaint. We expect to see a more thorough and descriptive method used to record this information.
22. There were no emerging themes in terms of the nature of complaints that were documented and the complaints we saw covered a variety of topics.



Ongoing Cases and Future Monitoring

As our findings in this report show, levels of AFA compliance with their obligations are generally good, however we are seeing continuing issues around disclosure and certain Code Standards. For those AFAs who do not meet their compliance obligations, we have a variety of regulatory tools and procedures that can be employed.

Once our monitoring visits have been completed, we write a feedback report for the AFA with highlighted areas for action required. In most cases, AFAs accept our recommendations and comply with our requests for further information or documentation. At this stage, the monitoring visit is concluded, but where serious potential breaches are found, FMA will conduct follow-up monitoring visits to make sure compliance is carried out and monitoring will continue for as long as we feel it is appropriate.

We will also refer matters to the Financial Advisers Disciplinary Committee (FADC) under the FA Act if we believe it is necessary.

Our monitoring activity over the next quarter will be focussed on further visits to those AFAs where we have identified compliance issues. Our focus on AFAs who give advice and deal with pension transfers will continue. The revised Code of Conduct for AFAs is likely to be approved in the next month, and we expect this to be effective from the second half of this year. Our focus will therefore also be on assisting advisers with any transitional compliance issues arising from the new Code. We will work with professional bodies to ensure that AFAs are ready for changes coming later this year through the Financial Markets Conduct Act, such as changes to licensing and the provision of DIMs services, new rules for custody arrangements and changes to disclosure for all financial products. We will communicate information on all relevant changes and implementation dates as soon as these are settled.

Where to go for more information

As a professional adviser, you need to be aware of your obligations under the FA Act and the Code. If you have any questions, please check FMA's website in the first instance for more information to assist with your query.

FMA also has an information line which is open Monday to Friday 8.30am to 5.00pm, phone 0800 434 567 (+64 3 962 2698 for overseas callers).

We recommend that you visit our website on a regular basis to keep up to date with the implementation of the FMC Act. All AFAs should receive periodic AFA updates relating specifically to AFA matters. If you do not currently receive AFA Updates, please contact renee.ji@fma.govt.nz. You can also subscribe to FMA Updates for the latest news.

Your professional body, employer or QFE may be able to help you or you may need to seek legal advice.

The following websites also provide useful information for financial advisers:

www.financialadvisercode.govt.nz – Code of Professional Conduct for AFAs

www.afacompetence.org.nz – The Skills Organisations information on competence standards and assessment

www.fspr.govt.nz – The Financial Service Providers Register.

