

April 2015

Authorised Financial Advisers in NZ

A snapshot of the industry from AFA information
returns 1 July 2013 – 30 June 2014

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Executive summary

Purpose of this report

Until now, only limited data has been available to the public about the shape and practices of the financial advice industry. Although some information has been collected through the Financial Service Providers Register (FSPR), this has been little more than demographic data and contact details for individuals.

New reporting requirements for Authorised Financial Advisers (AFAs) require them to submit an annual AFA Information Return to the FMA. This report summarises the most relevant information from the first year's filing of returns, and provides some insight into the state of the industry for the first time.

There are estimated to be more than 20,000 advisers in New Zealand, most of whom do not have to register individually as they are linked to a Qualifying Financial Entity (generally large organisations such as banks, fund managers and brokers). Of those who do have to register, more than 6000 do not have to be authorised by the FMA as they deal with simple products. Around 1800 are AFAs, who are authorised by the FMA to give advice on more complex products and services, and are expected to comply with higher competence and conduct standards.

We expect this report will be informative for AFAs, enabling them to better understand their own sector – including data about their own characteristics, those of their clients, their business practices, and the wider market for financial products and services. It will also ensure a better understanding of the sector by the public and market commentators.

Because this is the first time this information has been compiled, we are unable to compare it with previous data. However, it has provided a very useful baseline that will enable us to map emerging trends in subsequent years. The next returns are due by 30 September and will help give a fuller picture of how the industry is evolving.

Key findings

In 2014, the FMA developed seven strategic priorities to guide our operations over the next three years. These priorities include a focus on conflicted conduct, sales and advice, and investor decision-making. We have already identified in our *Strategic Risk Outlook* some specific areas of interest. This report also highlights some of these areas.

Experience and availability of AFAs

- There were about 1900 AFAs licensed in New Zealand in June 2014. Around 11% of these were authorised, but were not providing advice to clients.
- Around 15% of AFAs have been providing financial advice for less than four years. As more experienced AFAs leave the industry, it will be important to see a steady stream of new entrants to maintain the availability and quality of advice. Demographic data collated from the FSFR shows the average age of AFAs is 50. This report shows nearly a third of AFAs have more than 20 years' experience, and more than half have more than 10 years' experience.
- Around one-third of AFAs are either employed by, or linked to, a Qualifying Financial Entity (QFE). There are more than 50 organisations currently registered as QFEs, including banks, fund managers and brokers.

Complaints

- More than 90% of active AFAs have not recorded any complaints over the past year. Less than 2% have recorded more than four complaints. While this appears encouraging, we would like to better understand in subsequent reports how AFAs are managing complaints.

Clients

- Of the AFAs who are providing advice, and manage their own set client base, the average number of clients is 250.
- Of AFAs who are managing their clients' investments, 29% indicated they had fewer than 50 clients of their own. Just over 12% indicated they had more than 500 of their own clients. We would like to better understand in subsequent reports how these AFAs are managing such a large client base.
- Around 5% of AFAs dealt with more than 150 new clients during the year. A small number of these had more than 300 new clients.
- While a substantial percentage (23%) of AFAs have some exposure to wholesale clients, this exposure is generally small. The categorisation between retail and wholesale clients is important, as wholesale clients are exempt from certain requirements and protections that apply to retail clients (including minimum standards of client care, and access to a dispute resolution scheme). We would be concerned if retail clients were being inappropriately categorised as wholesale clients, or vice versa.

Payments

- Around 13% of AFAs are closely aligned to one product provider for remuneration. We have previously signalled our concern about distribution models that exacerbate conflicts of interest. We have indicated that we will look at remuneration arrangements that can lead to conflicted advice or sales, and whether firms have in place appropriate safeguards to prevent mis-selling. It is vital that AFAs are providing timely, clear, concise and effective disclosure to their clients.
- The main method of remuneration for AFAs is commission (45%), followed by bonuses (40%), and fixed fees or hourly rates (36%). We would like to

better understand in subsequent reports how AFAs are remunerated, particularly for fixed fees, as this total appears too high. There is ongoing debate about methods of remuneration for AFAs in both New Zealand and Australia. We have previously stated that distribution models such as volume-based incentives, up-front commissions and trail commissions should not encourage conflicts of interest between AFAs and their clients. We have also signalled that with managed funds, we will focus on fee-driven behaviour that is likely to result in unfair investor or market outcomes.

- A significant proportion of AFAs provide financial advice to their clients about acquiring 'alternative' products, including below-investment-grade bonds (29%) and private equity (14%). This may be driven by a desire to chase higher returns in a low-rate market, and it is therefore vital that clients are informed about the balance between risk and reward for such investments.

KiwiSaver

- Two-thirds of AFAs provided advice to their clients about KiwiSaver during the year, which is encouraging as KiwiSaver is an important investment for many New Zealanders. However, many clients received advice about a narrow range of schemes. Nearly half of AFAs provided advice about joining or transferring to just one KiwiSaver scheme during the year. Only 5% provided advice about more than five KiwiSaver schemes. The FMA is planning to better understand how financial advice about KiwiSaver is being delivered. We will produce a report later this year which explores some of these issues.
- While many AFAs provided advice to clients about transferring between KiwiSaver schemes, most were for a small number of clients (fewer than 10). From a regulatory perspective, we expect KiwiSaver members to receive appropriate advice and support when they transfer, and we will continue to monitor this issue.

Insurance

- Many AFAs (40%) are providing advice to their clients about insurance. A small number of AFAs (less than 2%) are providing a high volume of financial advice about insurance product replacement. We have previously signalled that we are concerned about the potential mis-selling of insurance products, including selling products that do not meet the customers' needs, or churning of customers (rapid turnover of insurance business that is not in the customer's interest).

UK pensions

- A fifth of AFAs are providing advice about UK pension transfers. The FMA has recently warned people to be cautious of potentially misleading and deceptive advertising about transferring UK pension schemes to New Zealand. We have been monitoring promotional materials and advertisements that encourage people to transfer their UK pension schemes. Some material appears designed to alarm people about changes to the tax treatment of their UK pension scheme in New Zealand, and the accessibility of their UK pension scheme.

Compliance rate

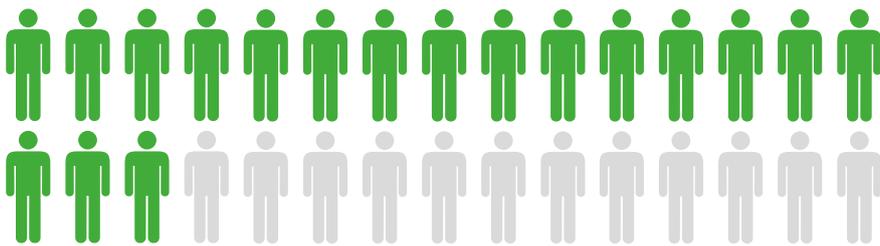
There were 1,901 AFAs licensed at 30 June 2014, of whom 60 have since deregistered. We received 1,784 returns, which is a compliance rate of 97%. Filing is mandatory so we are following up with those who did not submit a return, and will consider enforcement action for ongoing non-compliance.

Acknowledgements

We want to thank the AFAs who took the time to submit their return. We also want to thank the professional bodies and adviser associations for their support, and for encouraging their members to participate.

Snapshot of AFAs in June 2014

1,900 APPROXIMATE NUMBER OF AUTHORISED FINANCIAL ADVISERS IN NEW ZEALAND



59%

had at least 10 years' experience



recorded no complaints

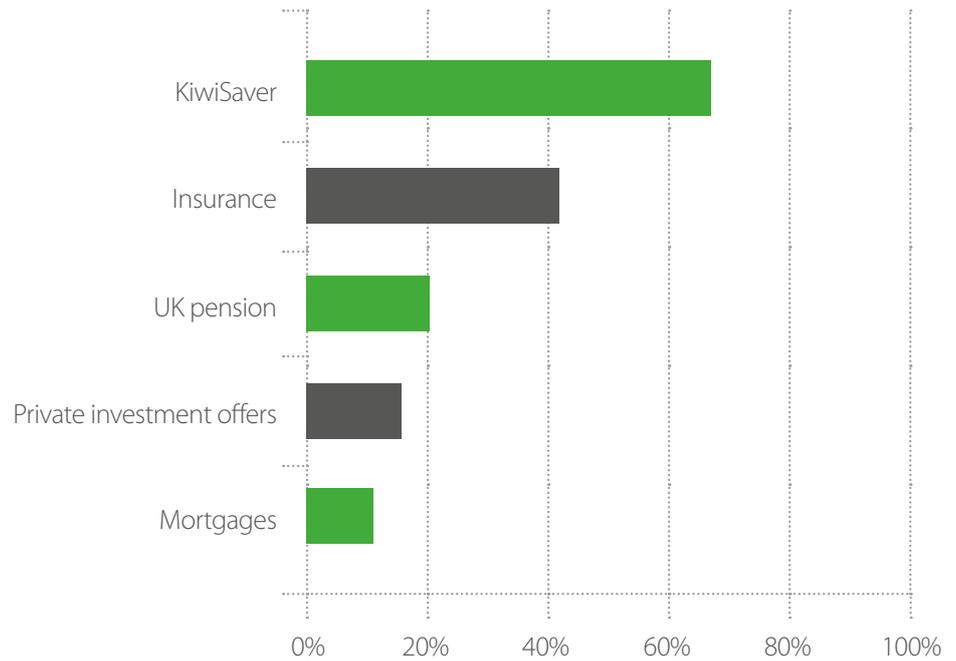


had fewer than 100 clients of their own



were part of a Qualifying Financial Entity

Type of services provided by AFAs



45%

received commission

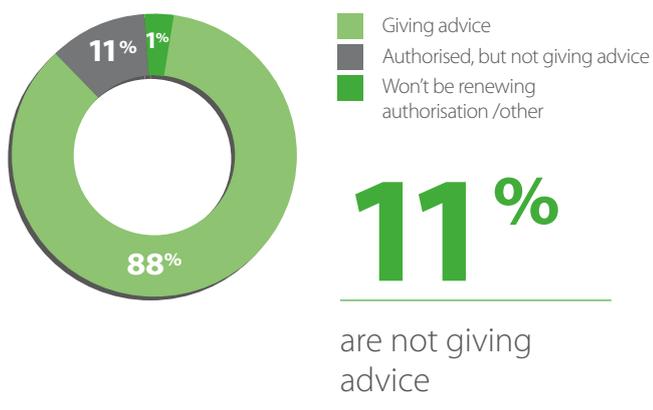
40%

received a bonus

Profile of AFAs

AFAs providing advice

"What is the primary purpose for you holding an active AFA authorisation?"



	% of AFAs
To provide financial adviser services	87.9
I choose to keep an active authorisation but do not provide financial adviser services to clients	11.2
I previously advised clients but no longer do and I will not seek reauthorisation/ other	0.9
Number of respondents	1,784

Business models

"What situation best describes your AFA employment status?"

	% of AFAs
Employee of a QFE	27.2
Employed by an entity which is not a QFE	23.2
Shareholder/director of an advisory firm with more than one adviser	22.0
Employed by an NZX participant firm	19.1
Sole adviser practice	15.3
Nominated representative of a QFE	8.9
Sole practitioner	8.3
Other	4.9
Number of respondents (multiple responses allowed)	1,784

Experience

"How many years in total have you been providing financial adviser services in New Zealand on category 1 products?"

	% of AFAs
0-3 years	15.3
4-10 years	25.8
11-19 years	27.9
20 years+	31.0
Number of respondents	1,455

Complaints

"In the past 12 months, how many complaints have been recorded about your financial adviser services?"

	% of AFAs
0	90.1
1-3	8.3
4-6	1.3
7+	0.3
Number of respondents	1,607

Compliance support

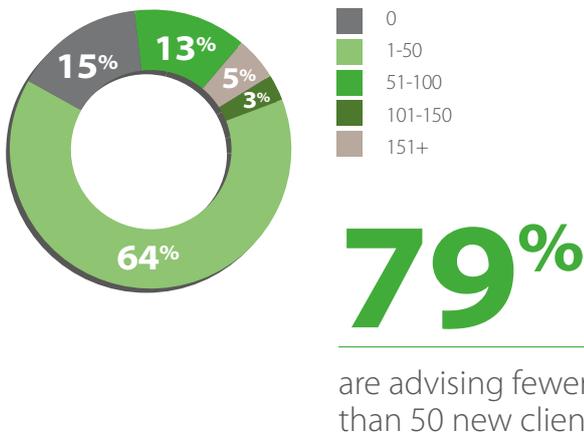
"Do you receive ongoing compliance support?"

	% of AFAs
Yes, ongoing compliance support from a supervisor	31.5
Yes, ongoing compliance support from AFAs in my firm	30.3
Yes, other	75.1
No	6.8
Number of respondents (multiple responses allowed)	1,067

Profile of clients

New clients

"In the past 12 months, in respect of category 1 products, how many new clients did you personally provide financial adviser services to?"



	% of AFAs
0	15.1
1-50	64.0
51-100	12.7
101-150	3.2
151+	4.9
Number of respondents	1,455

Number of clients

AFAs were asked about the number of retail clients that are solely their own.

	% of AFAs
0-50	29.7
51-100	15.1
101-150	13.8
151-200	8.3
201-300	9.2
301-500	11.2
501+	12.7
Number of respondents	863

Retail and wholesale

AFA's were asked whether they have wholesale clients:

	% of AFA's
Yes	23.0
No	77.0
Number of respondents	1,463

"What is the business split between retail and wholesale clients?"

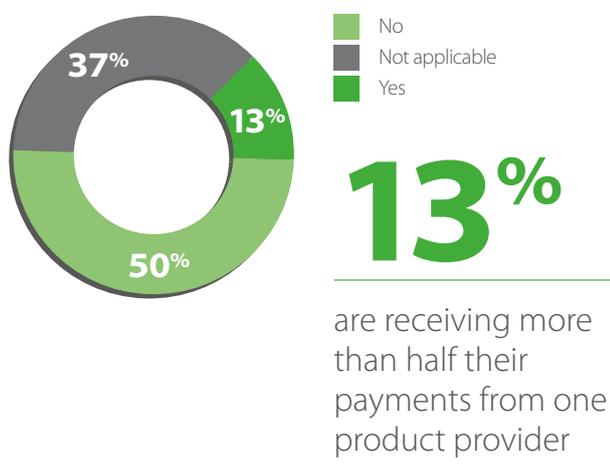
	% of AFA's
Retail	96.2
Wholesale	3.8
Number of respondents	1,391

Payments and products

Source of payments

"In the last 12 months, did you generate more than 50% of your commission or production bonuses relating to investment products from one product provider in delivering financial adviser services?"

(For the purposes of this question, 'you' included the AFA and their business if they were a sole practitioner, sole adviser practice, or a shareholder/director of an advisory firm with more than one adviser).



	% of AFAs
No	49.5
Not applicable, I don't receive commission or a production bonus	37.1
Yes	13.4
Number of respondents	1,455

Range of products

"In the past 12 months, did you provide financial advice to clients to acquire any of the following products?"

	% of AFAs
Managed funds	83.2
Retirement savings/superannuation	64.1
Below-investment-grade bonds	28.9
Private equity	14.4
Capital-guaranteed investments	9.8
Hedge funds	8.7
Warrants	7.1
Structured debt issues	6.2
Property investment schemes	5.8
Commodity trading	3.8
Derivatives or futures contracts	2.5
Other complex products	2.8
None of the above	9.2
Number of respondents (multiple responses allowed)	1,343

Types of payment

"What payment types apply to your financial adviser services?"

	% of AFAs
I receive commission for my services	44.8
I receive bonuses based on a mix of measures, including compliance and quality	39.5
Customers pay a fixed fee* or an hourly rate	35.9
I receive bonuses based on volume and set targets	20.0
None of the above	14.0
Number of respondents (multiple responses allowed)	1,607

*This definition requires clarification in subsequent years, as it may be have been interpreted differently by different AFAs

Extra services

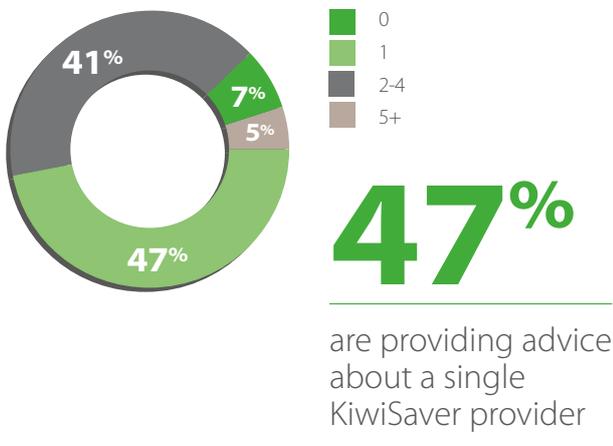
"Do you personally provide any of the following services?"

	% of AFAs
Trustee services	10.9
Advice on borrowing to invest	8.4
Taxation services	4.1
Direct property investment advice	3.4
Foreign exchange trading	3.0
Accounting services	2.2
Legal services	0.2
None of the above	77.4
Number of respondents (multiple responses allowed)	1,607

KiwiSaver, insurance and UK pensions

KiwiSaver advice

"In the past 12 months, how many different KiwiSaver schemes have you provided financial advice about joining, whether it was financial advice to join a KiwiSaver scheme or transfer to another KiwiSaver scheme?"



	% of AFAs
0	6.9
1	47.2
2-4	41.2
5+	4.7
Number of respondents	1,044

Types of services

"In the past 12 months, have you provided a financial adviser service, whether personalised or class, in relation to any of the following?"

	% of AFAs
KiwiSaver	67.0
Insurance	41.3
UK pension transfers	20.3
Private investment offers	16.1
Mortgages	13.6
Other offshore pension transfers	11.1

Number of respondents (multiple responses allowed) **1,607**

For 'QFE' and 'non-QFE' AFAs providing advice, the breakdown of financial adviser services is presented below:

	QFE (%)	Non-QFE (%)
Mortgages	17.2	10.7
Insurance	30.6	46.6
KiwiSaver	56.7	68.9
Investments	76.8	87.1

Number of respondents (multiple responses allowed) **534** **1,058**

KiwiSaver transfers

"In the past 12 months, how many clients have you provided financial adviser services to, about transferring between KiwiSaver schemes?"

	% of AFAs
0	30.9
1-10	52.1
11-25	11.3
26-50	3.3
51+	2.4
Number of respondents	1,044

Decumulation

"When clients become eligible to make retirement withdrawals from KiwiSaver, have you recommended that they withdraw funds for investment into other category 1 products?"

	% of AFAs
Yes	20.8
No	53.2
Not applicable	26.1
Number of respondents	1,044

Insurance product replacement

"In the past 12 months, how many of your clients have you provided financial advice to about insurance product replacement?"

	% of AFAs
0	18.0
1-10	46.5
11-25	20.4
26-50	10.9
51-100	2.9
101+	1.4
Number of respondents	1,122

Insurance persistency ratios

"In the past 12 months, was your persistency ratio with any one insurance product provider, for category 2 products, below 80% for more than 3 months?"

	% of AFAs
Yes	1.7
No	83.8
I don't know	14.5
Number of respondents	1,122

Appendix 1

How we collected this information

This report covers the period from 1 July 2013 to 30 June 2014. It was collated from the answers to 40 questions, which were available to AFAs on our website to complete online. The submission period opened on 18 August 2014 and closed on 30 September 2014.

How we will use this information

The FMA will use the information collected in the returns to:

- understand the services offered by AFAs and the business models used
- report aggregate information back to the financial adviser industry (through this report)
- inform our risk-based approach to monitoring and surveillance of AFAs and to allocate our resources effectively
- identify any significant issues that need following up
- inform any changes to oversight of financial advice, including regulatory settings, licensing criteria, standard conditions, and reporting obligations
- check the scope of financial advice activities AFAs are undertaking versus what they are licensed to provide
- prioritise our work and develop future thematic reviews
- contribute to future reviews of legislation (eg, the Ministry of Business Innovation and Employment five-year review of the Financial Advisers Act 2008).

Notes regarding the data

- **Self-reported responses:** The Information Return data is the self-reported responses of individual AFAs.
- **Number of responses:** Not all AFAs were required to answer each question – only the questions that were applicable to their circumstances.
- **Multiple responses:** Where multiple responses are possible the percentage of responses will total more than 100%.
- **Use of best estimates:** The FMA accepts that AFAs may have given best estimate answers where questions have not been asked before and AFAs were not aware that they would need to collect data to answer the question. In future reporting periods it is expected that AFAs will implement systems to collect the data required by the Information Return.
- **Change of employer:** If an AFA changed employer during the period, they were asked to complete the Information Return with regard to their current employer.

For more information

Please refer to the FMA website, www.fma.govt.nz, to see questions and answers about the Information Return process. More information is also available in the Regulatory Reporting Guide for AFAs, and our Regulatory Impact Statement, which are also available on our website.

Glossary

Accumulation	Saving
AFA	Authorised Financial Adviser
Business split	The percentage of individuals or entities (not percentage of revenue, or funds under advice, or some other measure).
Category 1 products	Includes equity securities, debt securities, managed investment products, derivatives, DIMS, and investment-linked insurance contracts.
Category 2 products	Includes bank term deposits, Bonus Bonds, call building society shares, call credit union shares, call debt securities, shares in a co-operative company, units in a cash or term portfolio investment entity, consumer credit contracts, insurance contracts (non-investment linked), and life insurance policies.
Complaint	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 of Professional Conduct for AFAs.
Decumulation	Withdrawal of savings
DIMS	Discretionary Investment Management Services
Financial advice	A person gives financial advice if that person makes a recommendation or gives an opinion in relation to acquiring or disposing of (including refraining from acquiring or disposing of) a financial product.
FMA	Financial Markets Authority
Investment planning service	When an adviser designs or offers to design a plan for an individual that is based on an analysis of an individual's current and future overall financial situation and identifies their investment goals, and includes recommendations or opinions to realise those goals.

New client	Each new client is counted separately (eg, if an AFA provides services for each person in a couple, their jointly held portfolio, and a trust of which the clients are trustees, then this is counted as four clients).
Non-QFE	Non-Qualifying Financial Entity
NZX	The registered securities exchange in New Zealand.
Persistency ratio	The percentage of an insurance company's already written policies remaining in force without lapsing or being replaced by policies of other insurers.
PIR	Prescribed Investor Rate (also known as 'PIE tax rate').
QFE	A Qualifying Financial Entity (QFE) is a business that takes responsibility for the financial advice provided by its employees and contractors, without those people having to register individually.
Retail client	A client of an AFA who is not a wholesale client.
Sole practitioner	An AFA who works for him/herself, rather than for a company.
Sole adviser practice	Where there is only one AFA, and he/she is the sole director (or one of two directors) and the only senior manager.
Trustee services	Excludes any situation where the AFA is a trustee for a client that is a relative.
Taxation services	Does not include any assistance the AFA may provide a client relating to the client's PIR.
Wholesale client	A client whose principal business is the investment of money or habitually invests money; with net assets exceeding \$1 million or turnover exceeding \$1 million; and who has certified in writing that they have sufficient knowledge, skills or experience in financial matters to assess the value and risks of financial products and the merits of those services.

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