

LBA

SUBMISSION ON  
PROPOSED MINIMUM STANDARDS OF ETHICAL  
BEHAVIOUR AND CLIENT CARE FOR AUTHORISED  
FINANCIAL ADVISERS

Submission to: Code Committee For Financial Advisers

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## **INTRODUCTION**

The LBA thanks the Code Committee for the opportunity to comment on the proposed minimum standards of ethical behaviour and client care for authorised financial advisers. We would also like to thank the committee for taking the time over the past few months to include us in their consultation with interested parties. We feel we have achieved a great deal in these discussions and look forward to the final draft of the code.

## **BACKGROUND**

The LBA commenced as an Incorporated Society in September 1994. The aim of the Association was to support Independent Life Insurance Brokers who were not aligned or tied to any one product provider. The Association introduced a Code of Ethics, and established a formal Disciplinary Committee to handle complaints from members of the public. The code of ethics includes the following clauses:

- Always place the best interest of the clients above your own direct or indirect interest.
- Maintain the highest standard of professional competence and give the best advice possible to clients by seeking to maintain and improve professional knowledge, skills and competence.
- Hold in strictest confidence, and consider as privileged, all business and personal information pertaining to a clients affairs.
- Make full and adequate disclosure of all facts necessary to enable clients to make informed decisions.

We are pleased to see that the principles of ethical behaviour and client care put forward by the committee mirrors those of our association. Our association has a robust disciplinary process and over the years complaints from the public have involved less than 1% of membership per year.

## **GENERAL COMMENT**

Before discussing the questions 1-38 posed by the committee we would like to address the issues surrounding commission payments, independence and objectivity. There has been media frenzy in the past few months around banning all commission payments to investment advisers. This has led to other forms of commission payments also being called into question, such as life insurance commissions.

The requirements of Advisor Disclosure Statements under the Securities Markets Act 1988 as amended and with effect from 29 February 2008, requires disclosure of commission payments, fees and any other remuneration, pecuniary or not. This disclosure relates to investment products only. Any ban on this type of remuneration and a complete switch to fee based advice will most likely result in the following:

- Only the wealthy will seek advice
- Adviser numbers would reduce dramatically
- Institutions would become both product provider and adviser
- Reduced opportunities for members of the public to get good advice

When we look at our membership, most are risk writers who receive commission for the sale of life insurance products. Any outright ban on these commissions would reduce the public to purchasing life insurance from bank tellers or even worse, kiosks at the Warehouse.

Insurance companies accept that the most successful distribution method for the sale of large volumes of life insurance is through intermediaries. This may not be the most economic method but is certainly the most effective. If you can accept that in the area of life insurance, commissions are here to stay then it is imperative that we have strong legislation in the area of objectivity, client care and product suitability. In looking at the proposed code, I believe there are many safeguards in this area and will comment directly to those questions.

This leads into the area of commission disclosure of life insurance commissions.

## **COMMISSION DISCLOSURE (Life)**

In proposed standard 4, you have asked about commissions being banned but nowhere in the consultation paper do you mention disclosure of commissions. It is obvious from the consultation meetings I have been part of that it is your intention to have a mandatory requirement to disclose commissions in some way. I ask that you seriously consider the following argument before taking this step.

Currently it is reported that up to 58% of all new life insurance premiums are sold through banks. This includes the bank insurance companies or the insurance companies aligned to banks. The sales pitch presently goes something like “we don’t get paid commission so we have your interests at heart”. The following example will show you that this may not be true, and in order to make sure we have a level playing field, we must insist on the banks disclosing how much commission they or their associated companies receive as a result of a sale.

The two companies presently paying the highest commission for life insurance, ING and Sovereign (Up to 220% & 230% respectively) charge the following premiums for a 45yr Male Smoker, \$500,000 yearly renewable life cover:

ING	\$143.76 month
Sovereign	\$138.38 month

The banks, which we are led to believe do not pay commission, charge the following:

BNZ	\$133.82 month
Westpac	\$143.32 month

You will note there is very little difference in these premiums but in terms of advice, I suggest the quality of advice received from a non aligned AFA will be far superior to that received from bank staff. There is a great risk that by making commission disclosure mandatory you will be telling the public they will receive better value for money by dealing with the banks. As I have shown above, this may not be the case.

We are happy to see the disclosure of commissions as a proportion of the annual premium as long as bank insurance commission provisions are shown. We also ask that tied in with disclosure of commission is a qualifying statement “Commissions are not fully earned until 24 months premiums have been received by the insurer.” The time period of 24 months can be adjusted if the period of responsibility differs in any way.

## **CONSULTATION QUESTIONS**

**Q.1** As stated, these principles sit well with our association and are appropriate.

**Q.2** Likewise, client care principles are appropriate.

**Q.3.** Proposed standard 1: We feel this standard needs to apply to all AFA's involved in the area of investment advice. We especially feel that having employees accountable will lead to them putting pressure on their employers to enhance their product offering to better meet client's needs. This can only be a good outcome for clients. There is no room for anyone not placing the interests of client's first.

In the area of risk advice, advisers are required to pass any material fact that they are aware of to the insurer. In these cases, it may not be in the client's best interest but is certainly in the interest of a third party, the insurer.

**Q.4** We don't believe client's need to sign an express consent regarding independence or objectivity. We do feel that they should sign an acknowledgement of receipt of an Adviser Disclosure Statement. This would cover any question of independence.

**Q.5** We don't believe there needs to be any further safeguards. Current legislation already covers this under Securities Markets Act, Fair Trading Act & Consumers Guarantees Act.

**Q.6** This is an area that has been a major problem in risk advice. We have a large number of advisers in the marketplace who call themselves 'Independent Advisers' yet in reality place most of their business with one company. There is nothing wrong with this as generally the clients are better served as the adviser has formed some very strong relationships with underwriters, claims staff and administrators. This benefits the client when there is any grey area surrounding the claims process or where premium loadings or exclusions are being negotiated.

Independence should be reserved for those who charge fees only and don't receive any reward or remuneration from the product provider.

Non aligned should be reserved for those who have no formal requirements to place a percentage of their business with a provider. It must also be shown that they do not place more than say 60% with any one supplier and use at least three product suppliers.

Aligned would be those advisers who are required contractually to place a majority of their business with a provider or fail to meet the threshold of a non aligned adviser.

**Q.7** We agree with the proposed standards 2-4 but would like to point out that it is possible to be objective, without being independent.

**Q.8** We have addressed the question of life commissions on page 4. With regard commission payments on investment products, there needs to be a shift in consumer

financial literacy before they will start accepting they need to pay a fee to obtain advice. We will have less investment advisers dealing with only wealthy clients and the bulk of the population will be left to flounder if we ban commissions. It may be that commissions in the future be set across the board so that whatever recommendation the adviser makes, omission was the same and enough to run a profitable business. Any ongoing renewal commission would be paid if the adviser completed an annual review with the client.

**Q.9** In all occupations there are gifts or incentives designed to capture new business. Doctors receive gifts from pharmaceutical company reps, builders get to travel to Bledisloe Cup rugby games in Australia through the building supply merchants etc. The fact is these gifts can seriously affect a person's objectivity. In the case of small insignificant amounts (under \$100) we don't feel it necessary to disclose as long as they are irregular and not tied to any production targets. Such gifts should not effect and advisers independent status. All other, larger, incentives should be disclosed and are already required to be disclosed under other legislation. These incentives or rewards would affect their independent status.

**Q.10** An adviser should not be deemed independent if he or she is required to place **all** their business through the one platform. We have seen how damaging this can be as evidenced in the cases of Vestar and Money Managers as well as others. Independent advisers should be permitted to use platform investments if they feel their client is best served by such vehicles as long as it is only one of many areas they can place client's investments in.

**Q.11** The present definition regarding an AFA's family member should be expanded to include 'any persons or entities associated with his or her spouse, civil union partner, de facto partner, child, parent or grand parent'.

**Q.12** Agree

**Q.13** We are neutral on this as we believe other legislation covers this area.

**Q.14** Nothing that stands out.

**Q.15** We feel that present laws covering libel, slander and defamation covers these situations along with our association's code of ethics.

**Q.16** No guidance required as there are already laws in place.

**Q.17** Yes.

**Q.18** Proposed standard 10. Yes this will ensure the client does not have unrealistic expectations of the process.

**Q.19** Trail commissions, renewal commissions on investment products should only be paid if the client is being serviced on a regular basis. In the case of risk commission

however, there are contractual arrangements between insurers and advisers that can't be broken. An example is the taking of level commissions over the lifetime of the policy. Advisers may insure a client who moves to the other end of the country and enlists the services of another broker. The new broker may be actively involved with the client yet the introducing broker should still be entitled to receive the ongoing renewal commission, as they sacrificed the full upfront commission they would have been entitled to receive.

**Q.20** No. An adviser needs to make the call as to the appropriate course of action. Some clients are more than happy to proceed without formal written terms of engagement. We will end up with no trees left if we aren't careful.

**Q.21(a)** We believe an AFA should always carry out a suitability analysis when providing risk recommendations. This helps decide which company would be the best fit and which product would provide the best outcome.

**(b)** If an AFA is in an advising outside his or her area of expertise then they will, by default, be unable to carry out a suitability analysis. The AFA should be required to disengage at this point and not continue with the client.

**Q.22** Covered in Q21(b), an AFA should not be permitted to continue their engagement with the client at this point and should have foster relationships with other AFA's who are proficient in those areas.

**Q.23** Agree. Nothing else springs to mind.

**Q.24** Without plucking any number out of the sky, it would be useful if the requirements were similar to financial records under the income Tax Act which I believe is seven years? Electronic records or manual records would be the same.

**Q.25** These are appropriate although some advisers have clients throughout the country who they have never met face to face. These clients are adequately serviced through electronic means and by mail.

**Q.26** We feel all recommendations relating to risk and investment should be in writing unless the advice is purely the selection of a product provider relating to a specific need, e.g. mortgage protection.

**Q.27** Why would a client want to waive the requirement to have advice in writing? Only a lazy AFA would suggest such a course of action. We call them cowboys and I thought the regulations were designed to get rid of them.

**Q.28** We feel it will be difficult for sole practitioners to have an internal disputes resolution procedure and feel they would have to involve a third party. Disputes regarding internal processes and procedures would be the most difficult to solve. Disputes regarding product or outcomes could easily be solved by involving the product provider. As far as providing the client with full details of the dispute resolution body

they belong too, this is already a requirement of the Adviser Disclosure Statement and there is no need to have any further requirement.

**Q.29** Yes.

**Q.30** We feel a period of 3 years should be suffice although, if they are recorded in a register, then they could be kept for several years.

**Q.31** We feel the standards appropriate but have reservations regarding the reporting of illegal conduct. Will AFA's be protected under the 'whistle blower' legislation or does that only protect employees?

**Q.32** Can't think of any exceptions.

**Q.33** Same as Q 24, seven years.

**Q.34** Yes without question.

**Q.35** These are appropriate and nothing else springs to mind.

**Q.36** Nothing at this point in time

**Q.37** No

**Q.38** No