

What should you expect from a financial adviser?

In the wake of finance company failures and the Global Financial Crisis (GFC) many people have rightly been questioning the value of the financial advice they have received. There has also been plenty of finger pointing from within the advisory community – some of it informed, and much of it not. In this article Simon Hassan, an experienced adviser and a Fellow and former President of the Institute of Financial Advisers, gives some straightforward answers to the important question "What should you expect from a financial adviser?"

In recent times tens of thousands of New Zealanders have lost more than half a billion dollars in finance company failures. Many have lost a lifetime's careful savings - a nest egg accumulated over years of careful budgeting and doing without.

Some did not seek advice, and entrusted their life's savings to a shoddy company on the basis only of a newspaper ad featuring a credible looking name and a high interest rate. Others paid for professional advice - and lost money all the same.

Following the finance company collapses, the GFC from 2008 on saw a real drop in investment values here and around the world. This has also caused investors to question the value of the advice they received and in many cases to flee to "safe" investments.

There is risk in all investments

We must be clear from the start that all investments carry a degree of risk, and that some risks cannot be predicted or guarded against. To use an extreme example, few if any investors considering an investment in central New York before September 2001 would have considered the possibility that the Twin Towers could be destroyed by two passenger planes.

Few investors would be concerned about risks of this type. But the fact remains that making any investment involves taking some risks.

Risks can be managed

However many investment risks can be avoided, managed or reduced by commonsense strategies like doing your homework (professionals call this research), and by not putting all your eggs in one basket (professionals call this diversification). Managed this way, risk can be positive for an investor - because in the end a well chosen diversified mix including 'risky' investments usually does better than a portfolio restricted solely to 'safer' investments.

Given the complexity and the risks involved, it is not surprising that many people look for professional advice on their investments. If you have paid for advice (either directly - through fees, or indirectly - through commissions from a product provider), or if you are considering getting advice about your investments, how should you choose your adviser, and what should you expect?

What does the law say?

Until 2010 there was very little regulation affecting New Zealand financial advisers. Fortunately, with the implementation of the Financial Advisers Act, that has changed.

All advisers now have to be registered, with their names on a public record, the Financial Services Providers Register (you can see this at www.fspr.govt.nz). They have to belong to an approved Disputes Resolution Schemes. They must not mislead or deceive, they must provide meet a reasonable standard of care, and provide certain disclosures.

In addition to being registered, financial advisers who give provide advice on more complex products including all forms of investment must be authorised. These advisers are called Authorised Financial

Advisers, or AFAs). AFAs have to meet a number of additional requirements, including minimum levels of initial and ongoing education, criminal and police checks, and testimonials

AFAs also have to meet tough disclosure rules. In the first instance, they have to give prospective clients a 'Primary Disclosure Statement. This contains important information to help you decide whether or not to use their services. It includes how they get paid; non-financial benefits they may receive from other organisations; and criminal convictions, and adverse findings in any court on their professional role.

When providing a particular financial service, an AFA must also give you a Secondary Disclosure Statement that with it. This details the amount of any direct cost to you, when it must be paid, and the how much your adviser will be paid as a result (other than by salary) including any remuneration from the providers of financial products.

Finally, AFAs also have to adhere to a government-approved 19-point Code of Professional Conduct (the Code). This sets out important obligations to:

- put your interests first
- ensure that any personalised service is suitable to you
- ensure that you are made aware of the main benefits and risks of following their advice

The Code requires AFAs to demonstrate an appropriate level of knowledge, competence and skill when providing financial services, and have a professional development plan covering gaps in their knowledge and how they plan to address these.

Will the new law protect you?

It's still too early to tell, but the rules provide a real basis for ensuring that advisers – especially AFAs – act professionally. It's all about consumer confidence. Not in the markets, which are outside an adviser's control, but in their chosen adviser.

A major gap relates to "category 2" products such as insurance, where the requirements are much lower – including no obligation (unless your advisers is an AFA) to put your interests first, or adhere to the other requirements in the no Code.

And regulation never means the end of problems. Laws don't change human nature. Lawyers and accountants have been regulated for years, and yet members of those professions are regularly exposed as crooks. Financial advisers are regulated in Australia, but that hasn't stopped ordinary folk across the ditch being preyed upon by financial sharks. And the new rules don't provide enough protection for those receiving advice on insurance, mortgages and similar products unless their advisers are AFAs (there are still fewer than 2,000 AFAs).

But regulation will mean that unprincipled and incompetent advisers, particularly investment and financial planning advisers, can be taken out of business, and face real financial penalties.

And many advisers belong to the Institute of Financial Advisers which (according to CEO Peter Lee) sets standards higher than are required by those the law, requiring **all** financial adviser members to meet these: AFA or not.

The Institute of Financial Advisers

Peter Lee says the Institute, with 1,000 practitioner members, is the only internationally-recognised professional body for financial advisers in New Zealand. The primary reason the Institute exists is to set and enforce professional standards for advisers - in the interests of Kiwi consumers.

According to Lee the Institute is committed to helping create an environment in which Kiwis can have confidence about the financial advice they receive. It is keen to help educate the public about financial decision making and is involved with a number of financial literacy projects around New Zealand.

Lee says the Institute required members to disclose remuneration and conflicts, submit to rigorous, independent complaints and disciplinary processes, and follow a code of ethics and practice standards long before regulation. Among other things the Institute requires all practitioner members to

- Act in the interests of their clients (this is a higher standard than the law only applies this requirement to AFAs applying a much lower 'act with integrity' rule to other financial advisers),
- Undertake an average of 30 hours a year of ongoing education,
- Ensure that advice has a reasonable basis,
- Follow practice standards that exceed the legal requirements (eg: in money handling), and
- Ensure that their remuneration is fair and reasonable.

Under current law membership of the Institute is voluntary - and perhaps not surprisingly most financial advisers choose not to belong. Membership imposes obligations - it is a "business risk". Some prefer not to join to avoid the risks. Others don't want the cost (membership costs \$780 a year). Others, often those later in their careers don't want to face the hurdle of getting qualified.

Ask your adviser if they belong to the Institute

Of course the Institute can only regulate its members. But a simple question any investor should ask an adviser is whether they belong. You can check this out - or find a member near you - by going to the Institute's website www.ifa.org.nz, or by calling its national office on 0800 404 422 during business hours. You can also contact the Institute with questions, or to lay a complaint about a member.

New Zealand was the last OECD country to regulate financial advisers. It's a great pity that successive governments have taken so long to get to that point - something the IFA has wanted for years. And it's a crying shame that the finance company collapses and the GFC came along before the reforms were in place.

Lee says the Institute is working with Government, the Ministry of Economic Development, the Financial Markets Authority and other professional bodies to ensure that the new environment can deliver to expectations.

Some investment basics

Plenty of experts have commented on the finance company collapses and later crises criticising those who lost money and/or their advisers. But very few have been prepared to give clear guidelines on what investors should have done. More on that later, but first here are some investment basics.

As I said earlier the golden rule of investing is to diversify - spread things around. Generally a portfolio should consist of a mix of 'risky' assets like shares and 'safer' assets like bank deposits. More in risky assets if you have a long time frame and/or no immediate need for investment income. More in safer assets if you need an income and/or if your investment is short term.

A common mistake made by investors and advisers alike is to look for higher returns from interest-bearing assets rather than from traditional sources of investment risk, like property and shares. Unlike shares and property, interest-bearing investments only have 'downside' risk. They either pay you what they promised or (if things go wrong) less than that.

Shares and property both have 'upside' as well as 'downside' risk. When the share market turns down (as it often has - both here and overseas - especially in recent years) someone with a well chosen mix of shares usually only has to wait to see values come back up. With a diversified portfolio of well chosen 'risky' assets time is your friend.

'High interest' usually also means 'high risk', and often when an interest-bearing investment gets into trouble the only question that remains is how much of each dollar you will eventually get back. Time can become your enemy. The longer a fixed-term investment is from maturity the greater the chance of things going wrong.

There are no hard and fast rules, and it can depend on a variety of factors like those in the bullet list below. But if you had \$200,000 to invest for 10 years or more, and a balanced portfolio was right for you, then about half of the total might go into interest-bearing investments of one sort or other. Of this, only a small part - if any – should be to higher-interest (read 'higher-risk') deposits: say no more than \$10,000 (or 20% of the overall portfolio) in total.

And no matter what, unless you want to gamble, you shouldn't put all your money with one or just a small number of high-risk (read 'high-interest') providers.

What should you expect from a competent financial adviser?

Before giving you any advice they should take the time to learn about your situation, needs and attitudes. In your initial discussions they would have learned key things about you:

- Your time horizon (how long you were planning to invest for)
- How much income if any you will need
- Details of your wider situation, especially of any debt
- Details of other resources, and especially of any other investments
- Your experience and sophistication as an investor
- How you feel about investment risk (your risk appetite), and
- How much risk you can afford to take (your risk capacity).

Their advice would take account of all these things. It should also conform to the core principles explained above, including the needs to:

- **Diversify** (even at the most basic level we all know it's foolish to put all your eggs in one basket),
- Match your personal **time frame** and those of your investments (eg: you shouldn't invest short-term money in a long-term investment), and
- Have a 'reasonable basis' (eg: advice to use – or get out of – a particular investment should be supported by an external research report, or some other robust evidence of its suitability).

And on top of that, even it is wasn't the law, a competent adviser who is also a professional would be sure to give you all relevant details about things that might have influenced their advice - including:

- The remuneration (fees and or commissions) or other rewards (including 'soft dollar' incentives like trips) they will get if you follow their advice, and from whom,
- Any relationship or constraint that could have affected their advice, and of course
- Full details of any conflict of interests (such as if the investment recommended was going to pay them or their employer twice what another similar investment would pay).

What can you do if you get poor advice?

The new regime has provided you with a number of options.

- Firstly, if your financial adviser is an AFA they have to have an internal complaints process. So your first step would be to contact your adviser or their firm.
- All advisers (AFA or not) have to belong to a Disputes Resolution Service (DRS), so you can approach your adviser's DRS. How to do this must be detailed in their Disclosure Statement This is listed on the Financial Services Provider Register. Decisions made by the DRS are binding on the adviser – but not on you unless you have agreed to that.
- You can also complain directly to the Financial Markets Authority, who can investigate your complaint and decide what if any action to take. The FMA has a Disciplinary Committee to deal with breaches of the Code by AFAs.
- And you can still take civil (court) action to recover monies.

Finally, if your adviser was a member of the Institute of Financial Advisers at the time; and being paid to give you advice (rather than just to process a transaction on your instructions for example); and if any of the key elements listed above was missing from the process they went through with you - then Peter Lee advises that you could also lay a complaint with the Institute (www.ifa.org.nz). According to

Lee the Institute does not protect members who have breached its rules. It has a robust process with independently chaired Professional Conduct and Disciplinary committees.

We deserve to live in a society where people can be confident in relying on those they go to for advice about investments and other financial decisions. The new law will help, but may not be enough. As an extra protection you should consider dealing with a member of the Institute of Financial Advisers.

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