

The new Code standards: Treat clients fairly, give advice that is suitable and ensure the client understands the financial advice

9 September 2020

Karen Stevens, Insurance & Financial Services Ombudsman
and

Andrew Gunn, Strategic Partnerships Manager IFSO Scheme

Today

Karen Stevens, IFSO

- Case studies and discussion

Andrew Gunn

- Key points of the code and duties
- Evidencing you are compliant
- An example of adviser practice



INSURANCE & FINANCIAL SERVICES
OMBUDSMAN

CS1

Treat clients fairly



INSURANCE & FINANCIAL SERVICES
OMBUDSMAN

Part I

Case study

Case study 137243 (2017)

In July 2012, Glen* met with Todd*, a financial adviser, about reviewing his current insurances. They signed a scope of service agreement which stated that Todd was “*Providing quotations on existing insurance amounts to ascertain if possible to reduce costs*”.

Todd discussed with Glen about the re-underwriting requirement for any new policies. Todd reinforced this in an email to Glen: “*We would only proceed with the change if there have been no changes to health, which could affect the likelihood of a claim*”.

Interim cover with a new insurer (Insurer 2) was issued in late August 2012. The new insurer made an amended offer of terms, imposing an exclusion for “*any mental health disorder*”.

On 1 October 2012, Glen signed the offer of terms for the new cover.

Todd drafted 2 letters to their original insurer (Insurer 1) for Glen and his wife, Donna*, to sign:
Letter A - asking to remove Life, Trauma, TPD and IP cover from the current policy for Glen; health insurance was to remain in place.

Letter B - reducing life and trauma cover for Donna.

Todd said he would forward them to **Insurer 1**.

In July 2016, 4 years later, Glen discovered that he had continued to pay full premiums (>\$114,000) for Life, Trauma, TPD and IP cover to Insurer 1. He said he was confused and didn't differentiate between Insurer 1 and Insurer 2 so hadn't noticed the payments were still coming out.

Insurer 1 had no record of letter A, but noted that letter B was received on 4 October 2012. The insurer said it would backdate the cancellation, if Todd could provide emails to prove letter A had been sent and received – he could not.

How did Todd respond?

Todd realised that letter A had the wrong policy number on it.



Todd notified his PI insurer of the potential claim. Todd's PI insurer appointed a lawyer to act for Todd. The lawyer advised that the PI insurer was likely to accept the liability claim.

With his PI insurer's approval, Todd offered Glen and Donna \$85,000 in full and final settlement, on the basis that Glen had contributed to his loss by failing to notice the monthly amount had not reduced and did not read the renewal notices sent by Insurer 1. Todd stated "*Had you done so, you would have been made aware of the overpayments*".

Glen and Donna did not accept the offer and wanted Todd to pay the full amount of the overpaid premiums.

Three Aspects of Fairness: The Fairness Triangle

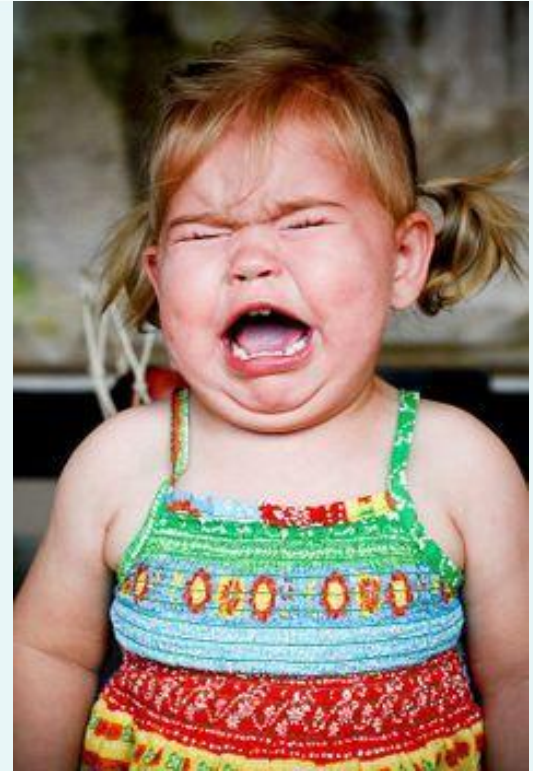


Developed by

Perspectives

What was fair for:

1. Glen and Donna (clients)
2. Todd (adviser)
3. Insurer 1
4. Insurer 2
5. Todd's PI insurer



IT'S NOT FAIR!

IFSO Scheme

The case manager reviewed the file and found that Glen had been sent renewal notices each year for the old insurance, so should have noticed that the cover had not been reduced.

As such, although Todd's actions caused a loss, Glen's inaction contributed to the amount of the loss.

Todd offered a settlement of 75% of the loss and Glen accepted the offer.

Reflections

“Fairness is in the eye of the beholder”

1. What factors do you take into account when determining what is fair for your clients?
2. What is your “fairness infrastructure”?
3. How will you demonstrate you always treat clients fairly and act in their interests?

Financial Advice Providers and Financial Advisers have responsibilities and obligations under the Financial Markets Conduct Act and Code of Professional Conduct for Financial Advice Services when providing regulated financial advice.

If a client's complaint is referred to a Disputes Resolution Scheme or you are subject to an FMA monitoring visit. Advisers will need to provide **evidence** demonstrating why their advice is suitable, fair and understood.

How do you meet your legal duties and your ethical behaviour, conduct and client care standards under the Code?



INSURANCE & FINANCIAL SERVICES
OMBUDSMAN



Part II

The code and treating clients fairly

Treat clients fairly

Relevant Duties FMC Act⁺

431K Duty to give priority to client's interests

431J Duty to ensure the client understands nature and scope of advice

Code standard 1 – Treat clients fairly

⁺ Financial Markets Conduct Act (as amended by FSLA Act)

431J Duty to ensure client understands the nature and scope of advice

“A person must not give regulated financial advice to a retail client unless the person has taken reasonable steps to ensure that the client understands the nature and scope of the advice being given, including any limitations on the nature and scope of the advice.”

Code of Professional Conduct – Code Standard 1

“What is fair depends on the particular circumstances, including the nature and scope of the financial advice”

Code of Professional Conduct – CS1

“Treating clients fairly should include:

- *treating clients with **respect***
- ***listening** to clients, **considering** their views and **responding** to their concerns and preferences*
- ***communicating** with clients in a timely, clear and effective manner*
- ***not taking advantage** of clients’ lack of financial knowledge or other vulnerabilities*
- ***not applying undue pressure** on clients”*

Code of Professional Conduct – CS1 however...



Treating clients fairly does not mean that clients are not responsible for their own decisions or that they are not exposed to risk.



INSURANCE & FINANCIAL SERVICES
OMBUDSMAN

CS3

Give financial advice that is suitable



INSURANCE & FINANCIAL SERVICES
OMBUDSMAN

Part I

Case study

Case Study – Suitability of advice

In 2009, Bob met with Tai, an adviser. Bob told Tai he was a conservative investor and wanted an investment which was a “*tortoise*”, rather than a “*hare*”. As a result, Bob invested \$55,000 and agreed to make monthly contributions of \$100 to a personal superannuation plan offered by Global.

After one year, Bob received an annual statement showing that all contributions had been invested in international equities and the value of the investment had reduced by approximately 13%. Bob contacted Tai, saying he was concerned about the fund, but was encouraged to continue the plan.

In 2012, after discovering his concerns could be pursued through other channels, Bob made a complaint to Global (a complaint could not be made about Tai, because his advice was given before advisers had to belong to a dispute resolution scheme).

In 2013, with the matter still not resolved, Bob made a complaint about Global to the IFSO Scheme. Bob said the “*investment was not prudently placed*”.

In July 2013, Global contacted the IFSO Scheme and said it wanted to review its position, because it had received additional information about Tai.

This resulted in Global making Bob a “without prejudice” offer of about \$50,000.

Bob did not accept the offer and made a counter-offer of \$60,000, based on his understanding of returns offered by different funds.

Global did not agree to this and the matter was referred back to the IFSO Scheme.

IFSO Scheme

There was a lot of conflicting information about what had been discussed between Bob and Tai, before the plan was established.

Bob said:

- the investment was going to be in a diversified fund
- he would not have proceeded, if he had known the money was to be invested in international equities
- Bob could not remember being given an Investment Statement.

Tai said:

- the investment was based on Bob's overall portfolio and "*the higher risk portion of a diversified portfolio*"
- Bob knew the money was to be invested in international equities
- Bob was given an Investment Statement and had the opportunity to read it before signing the application.

In recommending the international equities fund, Tai significantly increased the risk component of Bob's investments.

What was Tai's advice process?

- Tai had relied on undated handwritten notes prepared by someone else.
- Tai did not appear to have attempted to update, or verify, the information.
- There was no evidence to show that Tai had completed a needs analysis/risk profile for Bob. Had he done so, it would have established a \$50,000 investment, which was mentioned in the handwritten notes, did not exist.
- Bob and Tai agreed that, when it was signed, the application had not been fully completed. (Details of required investment fund/s had not been included.)

Did Tai act with reasonable care and skill and give advice to Bob that was suitable?



However, by signing the application, Bob agreed all information which had to be completed, was completed before the application was signed, and he acknowledged he had received and read an Investment Statement.

Bob did not appear to understand what he was investing in. The only document he received from Global with this information was a membership certificate showing the international equities fund had been selected.

The Case Manager believed Tai had not acted with “*reasonable care and skill*” required by the Consumer Guarantees Act and his agreement with Global and, as a result, Bob should receive more than the current value of the plan. However, Bob had to bear some responsibility for not ensuring he understood which investment fund was being used before the application was signed and for not making sure an Investment Statement was received.

The Case Manager concluded that an appropriate solution would be for Bob to receive a refund of the contributions paid, totalling \$58,133, without interest.

What can we learn from this?

- Advisers currently have a general duty to use reasonable care and skill when they are providing financial advice under the Consumer Guarantees Act 1993, the Financial Advisers Act 2008 and under the common law.
- When the new Code is introduced in March 2021, there will be added duties, including under Code Standard 3, to give advice that is suitable. You need to know what the duties are and ensure you can meet them.
- In the case study, the adviser breached his duty and clearly did not give advice that was suitable. It was easy to see he did not have good processes.

How do you know that you comply with your duty of reasonable care and skill?

Are your processes good enough now and for when the new Code comes in?



Part II

The code and give advice that is suitable

Advice that is suitable

Relevant Duties FMC Act⁺

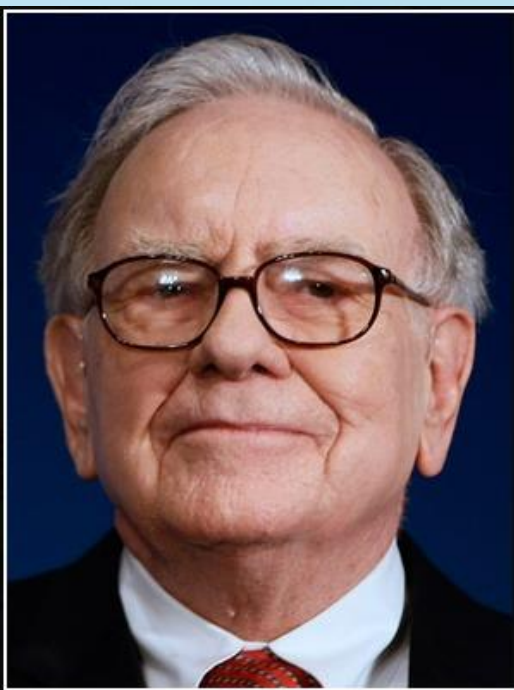
431K Duty to give priority to client's interests

431J Duty to ensure the client understands nature and scope of advice

431L Duty to exercise care, diligence and skill

Code standard 3 – Give financial advice that is suitable

⁺ Financial Markets Conduct Act (as amended by FSLA Act)



Risk comes from not knowing what
you're doing.

— *Warren Buffett* —

AZ QUOTES



431L Duty to exercise care, diligence and skill

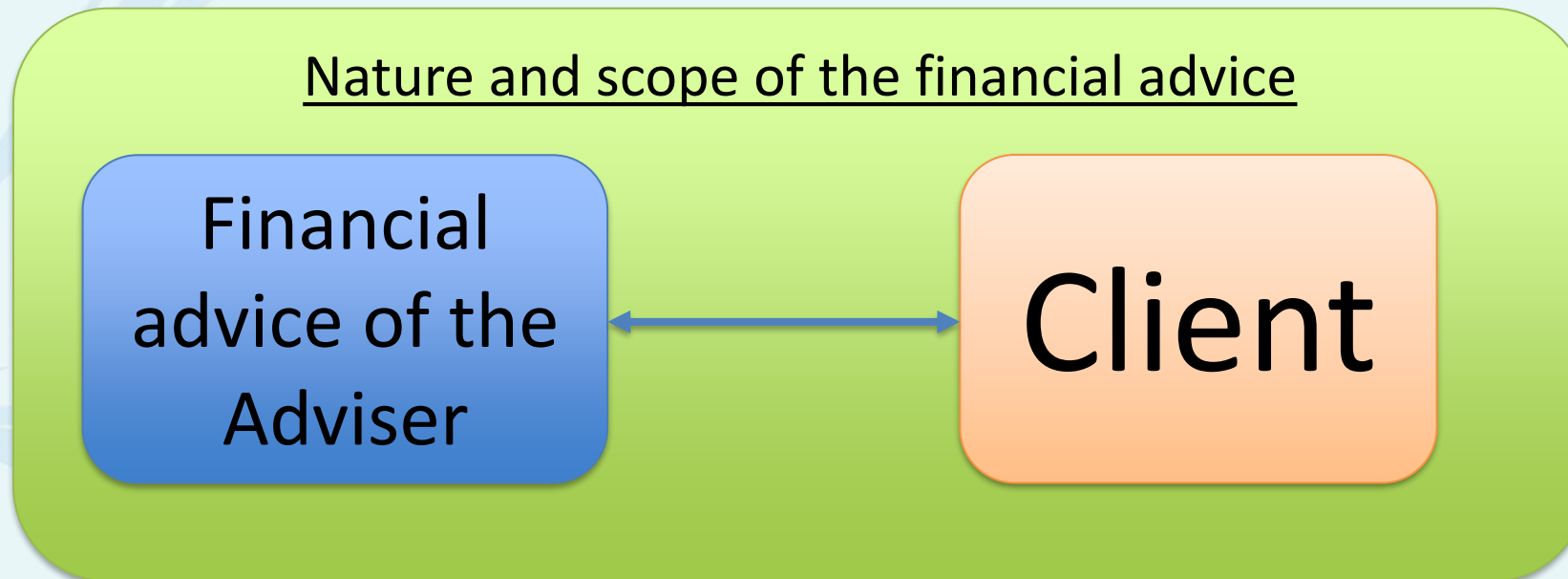
*“A person who gives regulated financial advice to a client must exercise the care, diligence and skill that a **prudent person** engaged in the occupation of giving regulated financial advice would exercise in the **same circumstances**.”*

The common definition of “prudent” is *“acting with, or showing care and thought for the future*

“Skill” is defined in Part 2 of the Code - the minimum standards of competence, knowledge and skill plus skills such as professional skills (e.g. soft skills, analytic skills, synthesise solutions) and technical abilities.

Code Standard 3

“A person who gives financial advice must ensure that the financial advice is suitable for the client, having regard to the nature and scope of the financial advice”.



Code Standard 3 (grounds and commentary circumstances)

*“Ensuring that the financial advice is suitable for the client should include having **reasonable grounds** for the financial advice.*

*Reasonable grounds means those grounds that a **prudent person** engaged in the occupation of giving financial advice would consider appropriate in the same **circumstances**, such as those in relation to:”*

“Circumstances” could be personal circumstances: family needs, risks facing the client, dependents, personal relationships, wealth aspirations, attitude to financial security and equity losses, vulnerabilities, debt capacity; or external circumstances, such as a severe drop in equities and economy seen in the GFC, housing market, inflationary outlook, negative impacts of a pandemic.



Code standard 3 (commentary)

“Reasonable grounds for the financial advice ... consider appropriate in the same circumstances ... such as those in relation to:

- *any strategy supporting the financial advice*
- *any assumptions underlying the financial advice*
- *any financial advice product covered by the financial advice*
- *the client’s circumstances that are relevant to the financial advice, such as their financial situation, needs, goals, and risk tolerance”.*

Nature and scope of the financial advice

Financial Advice

Strategy, assumptions, products, and a detailed analysis of client's circumstances depending on scope advice



Client

Circumstance relevant to advice such as financial situation, needs, goals, and risk tolerance



Code standard 3 (commentary - analysis)

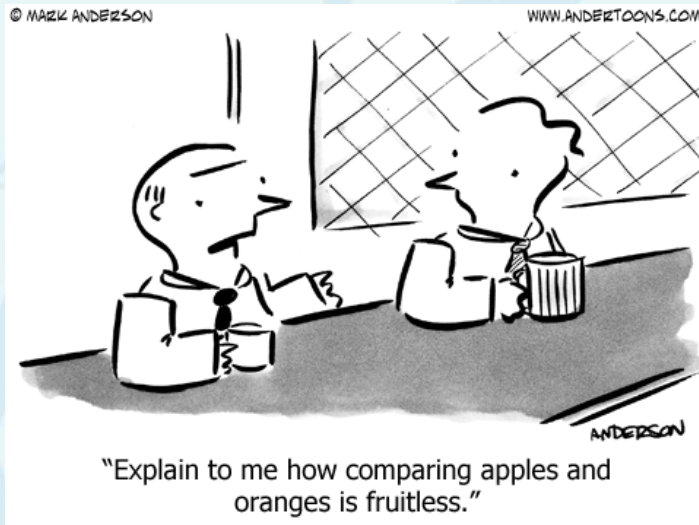
“Depending on the nature and scope of the financial advice, a detailed analysis of the client’s circumstances may be required or it may be reasonable to make assumptions about the client’s circumstances based in particular characteristics of the client.”

Under Duty 431J – you need to be very careful to ensure the client understands the limitation to your scope of service, and its risks of these to your client.

If you don't have a detailed analysis – remember the “reasonable grounds” test still applies - what the “prudent” adviser in your circumstances would have done.

Code standard 3 (commentary - product comparison)

“If the financial advice includes a comparison between two or more financial advice products, the financial advice should be based on an assessment of each product.”



If an adviser recommends (that it is in a client's best interests) to replace a product – then this comparison requires the financial advice be based on an assessment of each product (current and proposed replacement product).



INSURANCE & FINANCIAL SERVICES
OMBUDSMAN

CS4

**Ensure client understands
the financial advice**



INSURANCE & FINANCIAL SERVICES
OMBUDSMAN

Part I

Case study

Case study 00209180 (2020)

In 2003, Mr and Mrs D (Mr F's parents) invested a large sum of money into an insurer's investment fund, with the help of a financial adviser, Mr R.

In 2018, when Mr F reviewed the investment, he complained that Mr and Mrs D had:

- been charged an adviser's fee, but did not receive any advice
- told Mr R they wanted regular reviews, but this did not occur
- been told in a 2003 meeting by Mr R that he would provide regular reviews of their investment.

Mr F asked the insurer to refund all the adviser fees paid since 2003.

The insurer said it sent quarterly reports to Mr and Mrs D which had included the adviser's details, if they had wanted a review.

Mr F said the adviser had not placed Mr and Mrs D's interests above his own.

IFSO Scheme

The insurer - provided Mr and Mrs D with statements every 6 months, advising them to contact the adviser for a review if they needed one, and provided his telephone number.

Mr R - said he did not recall agreeing to provide regular reviews. Instead, he advised Mr and Mrs D about the half-yearly statements and told them if they needed a review, they should contact him directly.

Mr F - believed Mr and Mrs D suffered loss as a direct consequence of the lack of regular reviews, but he could not prove it.

Mr and Mrs D were required to pay the annual management fee to the insurer; it was not a fee for advice. While the insurer expected advisers to make arrangements with their clients about reviews, a failure to provide that service was not a breach of contract between Mr R and Mr and Mrs D; it was a failure of Mr R's obligations to the insurer.

The insurer was not required to refund the fees Mr and Mrs D had paid to it, or to pay Mr F compensation.

Part II

**The code and ensuring the client
understands the financial advice**


Code standard 4 – ensure that the client understands the financial advice

“Section 431J .. Provides that.. reasonable steps to ensure the client understands the nature and scope.. And limitations on the nature and scope”

“Understanding the advice includes the clients having sufficient comprehension of the content, risks and consequences of the financial advice”



INSURANCE & FINANCIAL SERVICES
OMBUDSMAN



Part III

An example of adviser practice



An example of adviser practice

Out with the old, in with the new policy

Macy has many new clients who already have insurance cover. When Macy finds these policies are with insurers she does not have agencies for, she works to get cover with her insurers - as long as she can secure cover with no exclusions or the same exclusions and goes through with the clients the importance of non-disclosure.

Macy isn't trained in other insurance policies, so does not feel qualified or able to compare those existing policies. Macy always points out the real benefits of choosing to go with her insurer and why this is in her clients' interests.

The IFSO Scheme's approach

- What **is fair**?
- What are the **reasonable steps to place the client into a suitable product**, in these circumstances?
- What are reasonable steps to ensure the **client understands** the advice, **risks and consequences** – and valid assumptions?
- What reasonable steps would a prudent adviser take regarding the nature and scope of this advice?
- Does Macy prioritise the client's interests over hers (if there is a material conflict)?

Questions

Is a policy comparison between the existing policies and proposed policies a “reasonable step” in these circumstances (that is: no or the same exclusions)?

What about a software tool to compare the two policies? Would a prudent adviser be expected to do this?

Is it “reasonable” to go through the key benefits of the existing policy cover?

What is fair? Is there a need to check with the client any preferences between old and new?
Respond to their preferences?

What is an appropriate scope of advice?

If “product replacement” is the advice, but there is no product comparison is done, how would a prudent adviser ensure their client’s understanding of the risks and consequences of the advice?

Are other options ever considered? (old policy remains, top-ups?)

What’s in the client’s best interests?



Insurance & Financial Services Ombudsman Scheme

We resolve complaints about insurance and
financial services.

COVID-19 response: The IFSO Scheme team is working remotely and
we welcome your contact during this time.

Our service is free and independent.

Call us on 0800 888 202

[Make a Complaint](#)

[membership@ifso.n](mailto:membership@ifso.nz)

z

Call us 0800 888 202