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QFE ADVISER BUSINESS STATEMENT GUIDE

SECURITIES COMMISSION
NEW ZEALAND

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INTRODUCTION

The Financial Advisers Act (the Act) comes fully into force on 1 July 2011. It sets new professional standards for financial advisers and gives the Securities Commission power to regulate people and entities who give financial advice. The Commission will also regulate some businesses that employ or engage financial advisers, and these businesses will be known as Qualifying Financial Entities (QFEs).

What is this guide for?

It's to help you decide if you want your business to become a QFE and, if so, how to go about applying for QFE status by preparing an Adviser Business Statement (ABS) which a QFE will need on an ongoing basis.

This second edition of the QFE Adviser Business Statement Guide reflects changes made to the Act on 30 June 2010 and how the ABS should address these (see page 9). It covers partner entities, nominated representatives and associated entities. In addition to reading this guide you should consider sections 63 to 76 of the amended Act which apply to QFEs.

Authorised financial advisers will also have to prepare an ABS, but this guide is just for entities. Advisers should refer to the Commission's separate AFA Adviser Business Statement Guide. This can be downloaded at the Commission's website www.seccom.govt.nz/afa

We welcome any suggestions for later versions of this guide.

BECOMING A QFE

What is a QFE?

The aim of the Act is to encourage public confidence in the professionalism and integrity of financial advisers. It therefore focuses on the professionalism of individuals. As an efficient way of achieving this objective, financial adviser businesses that have many advisers may choose to become a Qualifying Financial Entity (QFE). A QFE takes on responsibility for ensuring the professionalism of its advisers.

To become a QFE, an entity must satisfy the Commission that it has the capacity to:

- Take responsibility for its financial advisers' conduct – we call this "frontline compliance responsibility" because the Commission will then rely on the QFE to ensure its advisers comply with the Act.
- Maintain policies and procedures to ensure adequate consumer protection for retail clients.
- Comply with the terms and conditions of its QFE status and its other obligations under the Act (related to its financial adviser services).

As long as a business that engages advisers invests in appropriate compliance infrastructure, processes and people, and creates a consumer protection culture, becoming a QFE can offer efficiency and cost-reduction advantages. The business and its advisers will benefit from streamlined registration, disclosure, disputes resolution arrangements and regulatory monitoring.

However, a QFE will derive no streamlining relief from conduct obligations. QFE and non-QFE advisers doing similar work must adhere to similar standards of professionalism and competence.

Does my business have to become a QFE?

No, it doesn't. Financial adviser businesses may choose whether or not to apply for QFE status. Any entity may choose to become a QFE based on its own assessment of the benefits and responsibilities. We expect that most advisory businesses will not become QFEs.

An entity that is not a QFE can continue to conduct its financial adviser business, employ advisers and offer services to advisers. Its financial advisers will need to be individually registered and may also need to be authorised, depending on the financial adviser services that they provide. A business which is not a QFE can help its advisers comply with their obligations under the Act.

What’s for and against becoming a QFE?

You will have to weigh the streamlining benefits against the responsibilities and costs.

As a QFE, your business will have to ensure it fulfils all of its commitments under the Act, and its terms and conditions. Failing to do so may result in one of a range of regulatory actions by the Commission.

QFE benefits vary depending on the product category on which advice is given, whether the product is issued or promoted by the QFE group or a third party, and whether your business is providing an investment planning service.

Benefits are limited for QFEs engaging only Authorised Financial Advisers (ie, those advising on category one products issued by third parties or providing investment planning services). The Act requires these advisers to be individually registered and authorised even if they work for a QFE.

On the other hand, QFE status may substantially benefit businesses engaging many advisers who do not have to be individually authorised. Not only do these advisers not need individual registration, their QFE’s disclosure statement can cover them rather than each adviser having to supply a separate statement.

For corporate groups, the Act allows flexibility in QFE structure, the advisers that a QFE can take responsibility for and the products or services that its advisers can provide without being individually registered and authorised. The choice of which entity or entities should be a QFE depends on where effective control over compliance is located. In applying for QFE status, we will expect an entity to demonstrate that it has effective control over its advisers and – in respect of category 1 products – significant control over the issuing or promotion of these products.

A QFE can nominate any individual adviser as its nominated representative and will take responsibility for advisers in any associated entities. The QFE will have frontline compliance responsibility for these advisers and demonstrate that it has effective control over their conduct.

For information about fees and levies for AFAs and QFEs, see ‘What does authorisation cost?’ in the Frequently Asked Questions on the Commission’s website at www.seccom.govt.nz

How does my business become a QFE?

To become a QFE a business must:

	REQUIRED BY
Prepare and submit the ABS to the Commission for review	Preferably by 1 October 2010 Accepted until 1 December
Address any queries arising from the Commission's ABS review	As required
Get written confirmation from the Commission that enquiries are concluded before applying for QFE status	28 February 2011
Register online at the Financial Services Providers Register www.fspr.govt.nz and formally apply for QFE status. (Fees are payable and a short questionnaire must be completed.)	31 March 2011

The Commission will check that your ABS includes the expected information. In addition to any queries, Commission staff may interview senior management, eg, the director of the financial adviser force, and conduct on-site visits.

What is an ABS?

All businesses applying for QFE status must prepare an Adviser Business Statement (ABS). This describes your adviser business (Part 1) and the governance and compliance arrangements that ensure that the business and its advisers operate professionally (Part 2).

Your ABS will be the Commission's key source of information, allowing us to assess your entity's capacity to take responsibility for the conduct of its financial advisers, whether it can be granted QFE status, what terms and conditions to impose on the QFE, and how to structure its ongoing monitoring.

In particular, your ABS will:

- Describe how your business takes frontline compliance responsibility for its advisers' professional conduct and competence and ensures retail clients receive adequate consumer protection.
- Compare (in Part 2) your own conduct and compliance standards for QFE advisers on category 1 products with those of the AFA Code of Professional Conduct ('the Code'), and, if they are not the same, explain why not. The Act allows a QFE to set its own standards of adviser conduct and competence. Using the Code as a benchmark allows the Commission to ensure that advisers in QFEs meet similar standards of professionalism

to other advisers and to assess an entity's capacity to take responsibility for its advisers' conduct.

- Be a "living document" – QFE status will oblige you to keep the ABS up to date and reflect changes as your business evolves.
- Be approved and maintained by the relevant governing body – usually your board of directors.
- Remain an internal document – you do not need to make it public unless you choose to.

How do I prepare an ABS?

The ABS requirements have been designed so you can structure and write your ABS in a form that suits your own business needs. This flexibility means that the ABS can serve not only as a QFE compliance document, but also may be used to assist with your internal governance and management processes, if you want it to. By documenting your business model, and governance and compliance arrangements, the ABS will ensure that your business can comply with the Act and that your advisers can operate professionally in an appropriately controlled environment.

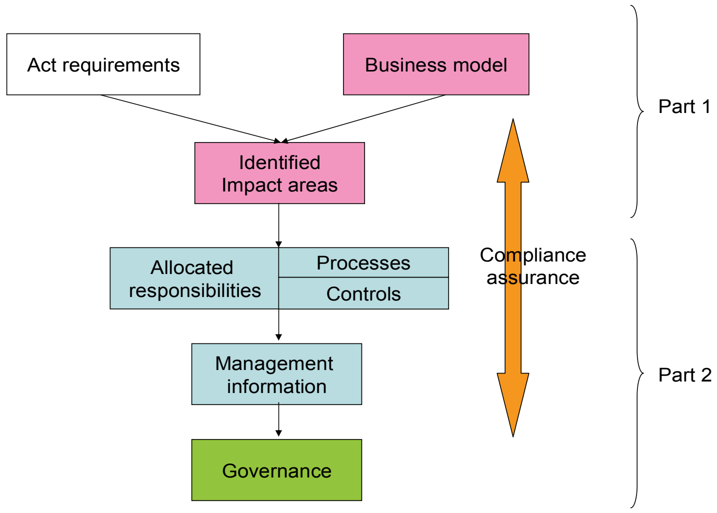
The length and complexity of an ABS will vary according to your business and the extent to which your policies and procedures are already documented elsewhere. It should be comprehensive enough to help your governing body review and oversee its adviser business. Note that detailed procedures should be covered in separate manuals, which the ABS can cross-reference.

You may divide your ABS into sections representing your business's operational structure, but the sections or the whole document must clearly identify two parts:

- **Part 1 describes your adviser business** and, at least, must contain the information detailed in *Preparing Part 1 of Your ABS*. It provides context for Part 2.
- **Part 2 describes your governance and compliance arrangements.** It must explain how your business will take frontline compliance responsibility for the professional conduct and competence of all its advisers in all of their adviser services. It must explain how consumer protection is addressed. *Preparing Part 2 of Your ABS* sets out key principles you must address.

You should ensure that your ABS conveys your business culture, particularly how you ensure professionalism and consumer protection are embedded in governance and adviser activities. It must articulate how you propose maintaining capacity for adviser frontline compliance responsibility.

Diagram: Preparing an ABS



It's important that Part 2 sets out how you propose checking, eg, through management information, supervision and audit, that your business and its advisers are operating according to your policies and procedures and conforming to the standards set out in your ABS.

You can prepare and submit your ABS before all of your processes and controls are fully implemented, provided that this is clear in your document.

How should my ABS address changes to the Act?

Requirements for applications

The Act (s65(3)) requires an application for QFE status to set out the procedures that the applicant has for:

- training employees and nominated representatives
- setting standards for employees and nominated representatives
- monitoring those standards.

A QFE must also have procedures to ensure adequate consumer protection for retail clients (s66(1c)). Where an applicant's QFE advisers will provide services relating to category 1 products, the protection must be assessed against the standard provided by AFAs (s66(2)), taking into account the scope of services provided.

Applicants should address these requirements within the relevant sections in Part 2 of the ABS document. Entities whose QFE advisers will sell category 1 products must include an 'if not, why not' analysis against the Code (see page

23). Entities are expected to maintain appropriate procedures in these areas on an ongoing basis.

Responsibility of a QFE for its advisers

A QFE is responsible for ensuring the compliance of:

- the QFE group, its employees and nominated representatives (including AFAs) with the QFE's terms and conditions (s76(1b))
- its QFE advisers with their financial adviser obligations (including nominated representatives) (s76(1c and d)).

A QFE must ensure that employees and nominated representatives who need to be authorised are AFAs (s76e). Primary responsibility for compliance with the minimum standards of professional conduct in the Code and the AFA's individual terms and conditions lies with the AFA. However, the QFE must have procedures for training its AFAs, setting appropriate standards for them and monitoring compliance with those standards (s65(3)). It must also ensure that retail clients serviced by its AFAs receive adequate consumer protection (s66(1)c(iii)).

Class and wholesale services

The Act now allows entities to provide class services to retail clients and to provide financial adviser services to wholesale clients. The Act requires the Commission to consider a potential QFE's capacity to comply with its obligations under the Act (other than in respect of broker services). Key obligations include the following requirements:

- to exercise care, diligence and skill in providing the service (s33)
- not to engage in misleading or deceptive conduct or advertising (s34-35)
- for wholesale services, to only accept certificates from eligible investors if there is no reason to believe that the certificate is incorrect and the client has been advised of the consequences (s5E).

The ABS should therefore address any class and wholesale services provided.

ABS for partner entities

The Act allows a number of entities to become a QFE together. These partner entities have joint responsibility for the QFE's obligations and liabilities.

Partner entities should prepare one ABS document to demonstrate that they jointly have the capacity to take responsibility for the financial advisers of the QFE.

The structure of the ABS should suit the business and governance needs of the partner entities. For example, it can include separate sections for each partner entity or address topics once in a common section.

Nominated representatives and associated entities

The ABS should address the whole business that the QFE will be responsible for, including that of nominated representatives and advisers in associated entities.

A QFE may nominate individuals as nominated representatives. The QFE takes responsibility for its nominated representatives. An adviser may not be the nominated representative of two or more entities unless the entities are related. The Adviser section in Part 1 of the ABS can propose an efficient mechanism for nominating and recording nominated representatives. The Commission will consider including this in the QFE's terms and conditions. A QFE must be able to provide the Commission with a list of its nominated representatives whenever reasonably required and periodically as set out in its terms and conditions. The QFE must also notify the Commission if it terminates an adviser's nominated representative status.

A prospective QFE may apply to have associated entities. A QFE takes responsibility for any advisers in an associated entity and its advisers are able to provide advice or a discretionary investment management service in relation to any category 1 products of the associated entity without being individually registered and authorised. The prospective QFE should include a list of any proposed associated entities with the relevant information in the Structure section under Part 1 of the ABS.

The Commission's consideration of each associated entity will include:

- the entity's financial service provider status (s67(4))
- the 'closeness' of the responsibility for the advice and for the product – how the prospective QFE's relationship with the associated entity allows the QFE to take responsibility for the advice. The application must state how each entity is connected to the QFE
- the impact of including the entity's products within the QFE group, eg, on the number of QFE advisers
- the QFE's capacity to be responsible for the advisers in the entity.

The Commission may publish guidance on its expectations for associated entities.

QFE group name

If a QFE will consist of partner entities or will include associated entities, the Structure section in Part 1 of the ABS must suggest a name for the QFE group for approval by the Commission. Transparency to consumers is a key consideration. In general, the Commission expects the QFE group name to be:

- the name of the QFE (or one of the partner entities) legal entity followed by ‘QFE Group’, eg, ABC Limited QFE Group or
- a trading name already used by the QFE or a substantial portion of the QFE group, followed by ‘QFE Group’.

How will QFEs be regulated?

The Commission will use a range of information – including the ABS, periodic reports and notifications from QFEs about their activities, market intelligence and complaints – to focus its monitoring on QFEs at higher risk of serious non-compliance with the Act.

The ABS review and licensing process is important, but we will place emphasis on our ongoing regulatory relationship with QFEs. We will determine the extent of ongoing QFE regulation and monitoring by taking account of:

- what the ABS says about organisational culture and the QFE’s approach to professionalism
- the thoroughness of its approach to compliance procedures
- the nature, scale and extent of the QFE’s business, and the impact in its market
- the degree to which third parties verify, certify or accredit a QFE’s compliance with the procedures and standards fundamental to adviser professionalism.

The Commission will tailor its regulatory approach to each QFE, and the industry as a whole, according to the extent to which the QFE, and the industry, are prepared to voluntarily adopt high standards of professionalism. If QFEs impose rigorous standards on themselves we will be able to scale back the intensity of regulatory monitoring. Your ABS will give your QFE an early opportunity to take the lead by willingly embracing professional standards.

Agreed better-practice benchmarks are important here. We want to work with industry to develop standards that set benchmarks across the national adviser profession. Industry-developed standards and appropriate approaches to ensure conformance with them give industry certainty and consistency, and facilitate the giving of professional advice.

What happens next?

Prospective QFEs should prepare their ABS now. Entities should submit their ABS for review by the Commission by sending both a hard copy and an electronic version to the Securities Commission for the attention of the Financial Advisers team.

You will receive written confirmation when the Commission has sufficient information and its enquiries are complete. You can then go online to make an application for QFE status at www.fspr.govt.nz

You are strongly encouraged to submit your ABS to the Commission for review by 1 October 2010 but we will accept submissions until 1 December 2010. This should allow sufficient time to address any queries that may arise.

You will need to have your QFE status confirmed in time for your advisers to know whether they will need to register individually by 31 March 2011. Acting sooner rather than later will help to ensure that your entity is ready when the Financial Advisers Act comes into force.

Some conduct obligations under the Act will apply to all financial advisers from 1 December 2010. Obligations on a QFE will apply to that entity from the time its QFE status becomes effective (after 1 December 2010), with the exception of disclosure obligations which will apply from 1 July 2011.

Questions and further information

Helpful information about QFEs including a QFE “Get Ready” Checklist can be found on the Commission’s website at www.seccom.govt.nz/qfe. Also see the Frequently Asked Questions on our website.

If you have questions about preparing your QFE ABS, please contact the Securities Commission by emailing QFEenquiries@seccom.govt.nz.

The following sites may provide further useful information:

www.seccom.govt.nz/afa – Securities Commission information for AFAs

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

www.afacompetence.org.nz – ETITO information on competence standards and assessment

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

www.consumeraffairs.govt.nz/for-business – information on dispute resolution schemes

PREPARING PART 1 OF YOUR ABS: YOUR ADVISER BUSINESS

Overview of Part 1

Part 1 must describe your entity's **adviser business** and provide context for Part 2.

Part 1 must address the *principles* and contain the *expected information* outlined in this section.

You may decide on the form and structure of your ABS, but a good ABS will:

- Focus on business relevant to the Act's objectives: sound delivery of financial adviser services, adequate consumer protection and the management of conflicts of interest.
- Focus on personalised services to retail clients, but include any class services and services to wholesale clients.
- Address all financial adviser services for which your entity intends taking responsibility, including the activities of partner and associated entities and nominated representatives.
- Give enough specific information to allow us to assess your entity's potential impact in its markets.
- Give supporting quantitative information to show the relative importance of various business areas.

Complying with the following suggestions will minimise Commission queries:

- Write your ABS in a way that helps your governing body review – and the Commission understand – your business from the perspective of complying with the Act.
- Keep ABS material to a high level, where possible, so it is useful as a governance document.
- Involve your business managers in preparing your ABS. Make sure it's sponsored by senior management and your governing body, and that the latter approves it. Note in your ABS who has approved it.
- Include any changes to the business that are in progress or planned.
- Describe any assumptions your ABS makes where expected changes to the Code, or other law, might create uncertainty.
- If exact quantitative information is unavailable, give the closest information you can. Information should be the latest available (include its date) and, if for a period, should ideally cover a year (state the period it covers). You may use forecast information, particularly if changes are expected.

Pages 15 to 20 provide a guide to the content of Part 1.

Structure

Principle

Your ABS should:

- explain your QFE's structure and key internal and external relationships
- explain any entity-level conflicts of interest.

Expected information

We expect your ABS to address this principle by covering, where relevant:

- whether the QFE expects to appoint nominated representatives, and the nature of any significant groups of nominated representatives (such as where a large number have one employer)
- entity-level arrangements that might give rise to conflicts or pressure on advisers (such as commissions the entity receives from third-party suppliers, fee structures and group relationships).

Expected information for QFE groups

For joint QFEs or QFE groups your ABS should also include, where relevant:

- the name of the partner entities, stating how they meet the 'related bodies corporate' requirement (s64b)
- the name of any proposed associated entity, together with:
    - how the entity is connected to the QFE (s65)
    - whether the entity is registered, entitled to be registered, an affiliated entity or an exempt provider (s67(4))
    - whether the proposed entity provides products and/or employs advisers
    - if the proposed entity employs advisers, whether it expects to be an associated entity of another QFE
    - where the proposed entity is based
- the name proposed for the QFE group (s69, see page 12).

Suggested information

The following may help your ABS explain the QFE's structure:

- describe the entity's organisational structure, including the location of key managers and other roles, and focus on responsibilities for activities covered by the Financial Advisers Act
- describe the relationship between the entity and any group entities and holding companies relevant to its financial adviser service (such as issuers or employers of nominated representatives), plus the regulator of these entities, if any
- describe any outsourcing significant to understanding your financial adviser services (such as call centres).

Products and services

Principle

Your ABS should:

- outline the products and services your adviser business offers, focusing primarily on retail products and services with the greatest consumer risk.

Expected information

We expect your ABS to address this principle by covering, where relevant:

- an analysis of the business between personalised services to retail clients, class services and services to wholesale clients. An analysis of personalised retail services by high-level product types or classes, noting categories 1 and 2 product business separately
- a brief explanation of any unusual or complex retail product types, such as those with embedded derivatives or swaps.

Suggested information

The following may help your ABS describe the QFE's products and services:

- the proportion of the business providing financial adviser services
- the proportion of the business represented by investment planning services and by discretionary investment management services
- the product split by type showing those issued by the entity, partner entities, each proposed associate entity, companies the entity effectively controls, and others
- a description of the type of class services provided
- an outline of any services which are regarded as information or guidance only
- whether the entity and its advisers handle client money or property, and in what circumstances.

Customer types

Principle

Your ABS should:

- outline who the QFE's advisory business customers are, distinguishing between retail and wholesale customers.

Suggested information

The following may help your ABS describe the QFE's customer types:

- the business split between retail and wholesale customers, giving the total number of retail customers for each product group
- any specially targeted customer segments that might need more financial advice or be more vulnerable to poor advice (such as older customers)
- whether the wholesale service includes eligible investors and, if so, the approximate number of these customers and of all wholesale customers.

Advisers

Principle

Your ABS should:

- profile the advisers that the QFE takes responsibility for, documenting the category 1 and/or category 2 product types on which they advise.

Expected information

We expect your ABS to address this principle by covering, where relevant:

- the number of advisers providing services to retail clients who will be a) authorised financial advisers b) advisers in relation to category 1 products who do not have to be authorised, and c) category 2 advisers
- the number of a) employee advisers in the QFE (or each partner entity), b) in each associated entity and c) nominated representatives
- the number of nominated representatives who will also be nominated representatives of another QFE and the name of that related body corporate (s74(2)).

If the entity wishes to propose an efficient way of nominating representatives for the Commission to consider for inclusion in the QFE's terms and conditions (s74(1)(b)):

- the proposed nomination mechanism and the controls operated over it.

Suggested information

The following may help your ABS profile the QFE's advisers:

- the adviser split according to their service or product ranges (such as where an entity has distinct sales forces or advisers operating in different departments and markets; explain which deal with retail customers and whether these adviser groups provide products from one provider, choose from a product panel or have an unrestricted product choice)
- the number of advisers providing investment planning services and the number providing discretionary investment management services
- the national geographical spread of adviser locations
- the method used to ensure that nominated representatives are not also nominated representatives of an unrelated QFE (s74(2)).

Delivery channels for products and services

Principle

Your ABS should:

- show how much advice your entity provides through what channels.

Expected information

We expect your ABS to address this principle by covering, where relevant:

- how advice or services are provided - whether face-to-face, by telephone, post or internet.

Suggested information

The following may help your ABS describe the QFE's business channels:

- the split of volumes/advisers by channel
- the split of services by channel, eg, advice/ discretionary investment management services/ investment planning services.

PREPARING PART 2 OF YOUR ABS: GOVERNANCE AND COMPLIANCE ARRANGEMENTS

An overview of Part 2

Part 2 must describe your entity's **governance and compliance arrangements**. It should explain how the business will:

- take frontline compliance responsibility for advisers' professional conduct and competence, particularly in relation to personalised advice to retail clients
- maintain procedures to ensure that retail clients have adequate consumer protection
- fulfil its obligations under the Act and its terms and conditions.

In addition, Part 2 should specifically set out the procedures that the entity has (s65(3)) for:

- training employees and nominated representatives
- setting standards for employees and nominated representatives
- monitoring those standards.

Part 2 must address the *compliance principles* and include the *expected information* and the '*if not, why not' analysis* set out in this section.

You may decide on the form and structure of your ABS, but a good ABS will:

- Clearly focus on consumer protection and risks for customers in the financial adviser service.
- Clearly address the requirements of the Act. Part 2 highlights some of these obligations, but these are not exhaustive.
- Clearly focus on regulatory risk related to compliance with the Act. Management of other risks is important for businesses but is not necessarily relevant to demonstrating the entity's capacity to be a QFE.
- Give entity specific information rather than generic statements. Use quantitative information, where possible.
- Describe the management information used to monitor the key processes and controls and the management role responsible.
- Recognise any gaps in key processes and controls and explain how these will be dealt with and when.

Complying with the following suggestions will minimise Commission queries:

- Provide an overview of compliance infrastructure, processes and people, and describe any reliance on third parties.
- Focus on personalised services to retail clients, but include any class services and services to wholesale clients.
- Address all financial adviser services for which your entity intends taking responsibility, including the activities of partner and associated entities and nominated representatives.
- Explain how adviser professionalism and consumer protection is embedded in the QFE's overall governance and culture.
- Explain how your arrangements take account of the nature, scale and complexity of your services and your structure (including any QFE group and nominated representatives).
- Set out how you propose to check your business and your advisers are operating according to plan and conforming to the standards set out in your ABS.
- If processes have not been fully implemented yet, your ABS should say so. Distinguish gaps from areas where processes are acceptable, but improvements are being made. Point out where processes are new. One approach is to set out a "Path to Compliance" that indicates how long implementation will take and how you propose to monitor it.
- Describe any assumptions made where there is uncertainty because regulations under the Act or standard terms and conditions for QFE disclosure are not yet finalised.

The “if not, why not” analysis

The Act allows a QFE to set its own standards of conduct and competence for advisers who are ‘QFE advisers’.

For personalised services in relation to category 1 products provided by QFE advisers, the Act also requires the Commission to consider whether clients will receive consumer protection of a similar standard to that provided by advisers who are subject to the Code of Professional Conduct for AFAs, taking into account the QFE advisers’ scope of products.

For such services, Part 2 of your ABS must include a comparison of your business’s conduct and competence requirements with those in the Code and the Act. If they are not the same, it should fully explain the differences, any compensating controls and why you believe that a similar standard of protection is achieved. We refer to this as the ‘if not, why not’ analysis.

For example, an analysis might be considered where:

- your QFE advisers have only one very simple category 1 product available and your standard is tailored accordingly
- your QFE advisers largely provide information and guidance, and any advice is strictly limited and closely scripted.

For advisers on category 2 products, the Act does not refer to any specific standards of competence or conduct (beyond the obligations in the Act). The ABS must still explain how the entity sets standards for these advisers and maintains procedures to ensure adequate consumer protection. The entity must still be able to ensure that its advisers operate with care, diligence and skill.

A good way to do this for advisers on category 2 products may be to use the Code as a benchmark. QFEs might produce an ‘if not, why not’ analysis against the Code, focusing on the principles of the Code standards, rather than the detail of the application provisions. For example, some firms dealing only with category 2 products have indicated that their ABS will include a competence analysis against the standards in the National Certificate in Financial Services (Financial Advice) (Level 5) relevant to their business, or those in National Certificate in Financial Services (Level 4).

The ‘if not, why not’ analysis should clearly address the requirements of the Code. To assist entities, the guide to Part 2 highlights Code standards that may be relevant to each compliance principle. The Code standards are based on the Draft Code dated 19 August 2010.

Pages 24 to 46 provide a guide to the content of Part 2, under these principles.

People, Processes, Professionalism

Principles underpinning QFE governance and compliance arrangements are grouped under these three headings.

People

A QFE must ensure its advisers exercise appropriate care, diligence and skill, and operate according to appropriate conduct and competence standards.

The QFE's governance and compliance arrangements should ensure:

- **Recruitment**: it recruits people with appropriate skills and ethical behaviour
- **Knowledge, skills and competence**: it supports individual advisers to achieve and maintain the right level of knowledge, skills and competence
- **Supervision**: it actively supervises advisers so they behave appropriately, provide suitable advice and comply with QFE processes
- **Performance management**: it identifies advisers who do not meet the required standard and takes appropriate remedial action
- **Reward**: its reward structures and practices drive appropriate adviser behaviours and advice standards.

Processes

A QFE's processes should enhance professionalism, be appropriate to the staff using them, and be well controlled and monitored.

The QFE's governance and compliance arrangements should ensure:

- **Marketing**: it does not mislead or confuse customers or engage in deceptive conduct
- **Information for customers**: it supports its advisers in giving clear, timely information that helps customers make informed decisions
- **Suitability**: its processes help advisers to consistently recommend or guide customers towards suitable products
- **Servicing**: it delivers agreed products or services, and meets reasonable expectations for ongoing services
- **Complaints and compensation**: it has an internal process for addressing customer complaints and helping advisers learn from them
- **Operations**: it has robust compliance arrangements, including those relying on IT systems or outsourcing
- **Record keeping**: it retains appropriate, easily accessible records.

Professionalism

A QFE ensures professionalism by means of an appropriate culture, compliance assurance arrangements and good governance.

The QFE's governance and compliance arrangements should ensure:

- **Governance**: it has a high-level person or body responsible for overseeing adviser professionalism and compliance
- **Culture**: its culture supports advisers' professionalism and compliance and the provision of adequate customer protection
- **Compliance**: it has appropriate arrangements for challenging and testing the adviser compliance framework and its outcomes.

PEOPLE: Recruitment

Compliance principle

The QFE should have governance and compliance arrangements that ensure:

- it recruits people with appropriate ethical behaviours and skills.

Expected information

We expect your ABS to address this principle by covering, where relevant:

- how checks that are part of the recruitment process compare with registration or authorisation standards, as far as these are known.

Guidelines for addressing the principle

- New advisers are assessed against the standard of knowledge, skills and competence required for their proposed roles, and their adviser qualifications are checked.
- Employer, peer or client references are taken for new advisers.

PEOPLE: Knowledge, skills and competence

Compliance principle

The QFE should have governance and compliance arrangements that ensure:

- it supports individual advisers to achieve and maintain the right level of knowledge, skills and competence.

Requirements of the Act and the Code

The following requirements of the Act are relevant to this principle. A QFE must:

- set out in its application the procedures for training and for setting standards for employees and nominated representatives (s65(3))
- ensure its advisers are registered and authorised, as necessary (s76)
- keep an up-to-date list of its Authorised Financial Advisers (s76)
- keep an up-to-date list of its nominated representatives (s76).

Relevant minimum standards are set out in draft Code Standards 6 and 14 to 18.

Expected information

We expect your ABS to address this principle by covering, where relevant:

- an overview of training and standards for each group of adviser roles
- the number of trainees, advisers and supervisors in each role
- an explanation of the approach to product training and any standardised approach to continuing professional development.

Expected information on competence: "if not, why not" analysis

For QFE advisers on category 1 products, your ABS must compare the entity's own competence requirements with those of the Code of Professional Conduct for AFAs. Where these differ, it should fully explain why the entity's requirements are more appropriate.

If your entity has not had enough time to educate advisers to the desired level, your ABS should explain the compensating controls (such as greater supervision) that you have in place, until they reach that competence standard.

Guidelines for addressing the principle

- Every adviser role carries a set standard of skills, knowledge and competence that, where applicable, takes account of the comparison to the Code requirements. Usually, standards will be achieved through a training programme, assessed to ensure it has delivered the required level.
- Individual advisers' training and support needs must be assessed, recorded and addressed, and their progress monitored.
- New advisers must meet a set standard to become fully fledged advisers. The standard takes account of the comparison to the Code requirements, where applicable, and assessment determines whether advisers have reached the required level.
- Advisers are trained and supported to ensure they understand their obligations under the Act.
- Advisers are trained on relevant new products or processes and, in the case of significant changes, assessed to ensure they have achieved the expected standard and learning goals.
- Controls ensure that advisers only provide services within their competence
- Standards are in place for continuing professional development that, where necessary, takes account of the comparison to the Code requirements, and compliance with these standards is monitored.

PEOPLE: Supervision

Compliance principle

The QFE should have governance and compliance arrangements that ensure:

- it actively supervises advisers so they behave appropriately, provide suitable advice and comply with the QFE's processes.

Requirements of the Act and the Code

The following requirements of the Act are relevant to this principle:

- A QFE application must set out its procedures for monitoring the standards set for its advisers (s65(3))

Expected information

We expect your ABS to address this principle by covering, where relevant:

- an explanation of your approach to supervision.

Guidelines for addressing the principle

- Appropriate criteria are in place for acceptance as a supervisor.
- Supervisors have the appropriate level of skills, knowledge and competence for the role and receive initial and ongoing training and support.
- Supervision properly covers the financial adviser service, targets risk areas (eg, particular advisers or products) and is suitably regular.
- Supervision processes are clearly set out, including ways of dealing with particular issues, and supervisors are clear about their role.
- Any supervision result trends are identified and appropriate action taken, such as changes to adviser training.
- Supervisors are also monitored and managed to ensure they exercise care, diligence and skill.

Supervision is a key control over adviser behaviour and ensures they operate in accord with processes. Supervisors themselves (including their recruitment, training and reward) are as important as supervisor processes.

PEOPLE: Performance management

Compliance principle

The QFE should have governance and compliance arrangements that ensure:

- It identifies advisers who do not meet the required standard and takes appropriate remedial action.

Expected information

We expect your ABS to address this principle by covering, where relevant:

- an explanation of your approach to identifying underperforming advisers
- the proportion of advisers who are underperforming in terms of advice quality or compliance
- the approach to investigation of potential breaches of the adviser standards and the actions that may be taken against advisers (for QFE advisers on category 1 products, compare the actions to those that might be taken against an AFA)
- the number of disciplinary cases relating to advice quality or compliance.

Guidelines for addressing the principle

- Advisers who do not meet required standards or deliver the right customer protection or acceptable customer outcomes are identified.
- Customer feedback and complaints information are part of the identification process.
- Reasons for poor performance are considered, a plan and timetable drawn up to address the problem, and adviser progress monitored.
- Appropriate measures are implemented, where necessary, to protect customers from underperforming advisers.
- Disciplinary action is taken on unacceptable behaviour or insufficient progress in reaching an acceptable standard.
- The QFE co-operates with the Commission on any investigation of a complaint about a current or past adviser, and with the Disciplinary Committee on any proceeding and any resulting action the Commission takes.

The focus of the ABS should be on any under-performance by advisers in the areas of professionalism and compliance.

PEOPLE: Reward

Reward covers a range of ways to influence behaviour, including remuneration, monetary and non-monetary incentives, and promotion and preferment.

Compliance principle

The QFE should have governance and compliance arrangements that ensure:

- its reward structures and practices drive appropriate adviser behaviours and advice standards.

Expected information

We expect your ABS to address this principle by covering, where relevant:

- an explanation of how key reward structures address compliance and quality issues
- an explanation of the balance of salary and bonus/commission in retail adviser remuneration – for an average adviser and for the most successful adviser.

Guidelines for addressing the principle

- Reward structures incentivise professionalism.
- Adviser remuneration structures only reward sales/profit-oriented targets when compliance and advice quality requirements are met.
- Advisers do not depend on volume-based bonuses to earn a living wage.
- Non-financial rewards, such as prizes, recognition events and promotions, also require advisers to meet quality and compliance standards.
- Management adheres to the QFE's reward guidelines, eg, bonuses are withheld and quality criteria are not overridden.
- Performance and reward structures for managers of adviser groups include compliance and advice quality measures.

PROCESSES: Marketing

Compliance principle

The QFE should have governance and compliance arrangements that ensure:

- it does not mislead or confuse customers or engage in deceptive conduct.

Requirements of the Act and the Code

The following requirements are relevant to this principle:

- a QFE, a member of a QFE group or an adviser must refrain from advertising a financial adviser service in a misleading, deceptive or confusing way (s35 and s48)
- a QFE, a member of a QFE group or an adviser must refrain from any conduct in relation to a financial adviser service that is misleading, deceptive or confusing (s34 and s47)
- advertisements must not be misleading, deceptive or confusing (s34 and s48).
- the minimum standards in draft Code Standard 3.

Guidelines for addressing the principle

- An entity must not use its QFE status as a marketing tool or imply its QFE status represents Securities Commission approval of the entity or its advice.
- An appropriate approval process exists for marketing and customer-facing materials to ensure compliance.
- Any marketing materials which constitute a class service to retail clients are identified and appropriately approved.
- Staff preparing marketing materials are aware of the requirements and understand the approval process.
- Records are kept of marketing materials and approval received.

PROCESSES: Information for customers

Compliance principle

The QFE should have governance and compliance arrangements that ensure:

- it supports advisers in giving clear, timely information that helps customers make informed decisions.

Requirements of the Act and the Code

The following requirements are relevant to this principle:

- A QFE must disclose to customers information as required by the Act (s25 to s29) and by the terms and conditions of its status.
- For AFAs, the required disclosures (s22-s24 and s27-s31) and related regulations
- the minimum standards in draft Code Standards 3, 6, 7, 9 and 10.

Expected information

We expect your ABS to address this principle by covering, where relevant:

- an explanation of the process for helping advisers with required disclosures
- an explanation of the approach to understanding and addressing customer information needs.

Guidelines for addressing the principle

- Processes and training help advisers comply with disclosure requirements of the Act (s21-31) and regulations, including requirements for format, content and timing.
- Information is not misleading, deceptive or confusing and is up to date (whether the Act requires it or not).
- The customer is given information when they need it and in a suitable format (written or oral) including during the sale or advice process and, if appropriate, during ongoing servicing, or proactively if it changes.
- Information provided covers matters relevant to the individual customer, in language and at a level of detail the customer can understand.
- Potential adviser conflicts are identified and disclosed, managed or avoided.

- The quality of customer information is periodically assessed and improved as necessary.

Information needs depend on customers' individual circumstances and the products proposed. Regulations will cover some elements of customer information, but customer needs go beyond regulations. Information also helps customers form realistic expectations.

PROCESSES: Suitability

Compliance principle

The QFE should have governance and compliance arrangements that ensure:

- its processes help advisers consistently recommend or guide customers towards suitable products.

Requirements of the Act and the Code

The following requirements are relevant to this principle:

- A QFE application must set out the procedures in place for setting standards for employees and nominated representatives (s65(3))
- Financial advisers must exercise care, diligence and skill (s33)
- Financial advisers and QFEs must not engage in misleading or deceptive conduct (s34 and 47).
- AFAs must, not recommend the acquisition of securities if they are offered for subscription illegally (s38)
- the minimum standards in draft Code Standards 6 and 8.

Expected information

We expect your ABS to address this principle by covering, where relevant:

- an explanation of your approach to ensuring advice is suitable for retail customers, including any differences in the approach of various adviser groups in the QFE. Specifically address how you deal with suitability in the context of an investment planning service, a discretionary investment management service, affordability of credit (responsible lending) and insurance exclusions.

Guidelines for addressing the principle

- Processes take account of the comparison to the relevant Code requirements.
- Enough information is collected to understand customer requirements (within the scope of the service being provided).
- Advice has a reasonable basis and is supported by analysis.
- Advice is suitable, with recommended products being fit for purpose and the most suitable available to the adviser.
- Advice is appropriately explained and recorded.

- Processes allow for situations when advice should not be given or a referral should be made, and the culture supports both options.
- Processes ensure only appropriate classification of customers as wholesale customers, including any ‘eligible customers’.
- Processes ensure only appropriate identification of services as class services to retail clients.
- Controls ensure that the class service is appropriate to the intended class.
- A QFE operating a sales process that only gives customers information or guidance (and is, therefore, unregulated) ensures process design is appropriately approved, staff are trained on its acceptable limits so they do not offer financial advice, and staff are monitored to ensure they adhere to this process and its limits.

PROCESSES: Servicing

Compliance principle

The QFE should have governance and compliance arrangements that ensure:

- it delivers agreed products or services, and meets reasonable expectations for ongoing services.

Requirements of the Act and the Code

The following requirements are relevant to this principle:

- the minimum standards in draft Code Standards 6 and 9.

Guidelines for addressing the principle

- Where the adviser or QFE is responsible for implementing the agreed advice, that is done accurately and promptly.
- Where a discretionary investment management service is provided, this is carried out in accordance with the authority given by the client.
- Appropriate adviser resources and processes exist for responding to customer enquiries and advising on variations or renewals of existing products.
- Processes are in place to deliver on any promises made to customers about future services.
- A customer is given any necessary information and timely assistance if he/she decides to change their adviser.

PROCESSES: Complaints and compensation

Compliance principle

The QFE should have governance and compliance arrangements that ensure:

- it has an internal process for addressing customer complaints and helping advisers learn from them.

Requirements of the Act and the Code

The following requirement is relevant to this principle:

- the minimum standards in draft Code Standard 11.

Expected information

We expect your ABS to address this principle by covering, where relevant:

- your entity's definition of *complaint* and an explanation of its internal complaints process, including whether this is independent
- the number of complaints received and upheld in the last 12 months together with any "hot spots" and actions taken
- the percentage of complaint decisions overturned by any Ombudsman or dispute resolution scheme
- any arrangements in place to ensure the entity can pay customer compensation, if awarded, such as capital, professional indemnity insurance or allocated funds.

Guidelines for addressing the principle

- Internal processes comply with dispute resolution scheme requirements.
- Independent investigation processes for complaints exists, if possible.
- The quality and timeliness of complaints handling are monitored.
- Complaint information, both internal and from dispute resolution schemes, is analysed to identify any information, training and process improvements required and any necessary action is taken.
- Complaints information is used to improve adviser performance, preferably at an individual level.
- The QFE co-operates, as far as possible, with other entities to resolve customer complaints.
- The QFE co-operates with the dispute resolution scheme or the Commission in the investigation of complaints.

PROCESSES: Operations

Compliance principle

The QFE should have governance and compliance arrangements that ensure:

- it has robust compliance arrangements, including those relying on IT systems or outsourcing.

Guidelines for addressing the principle

- Where a QFE relies on IT systems to support advisers, it has appropriate backup arrangements.
- Where a significant part of the financial adviser service is outsourced:
    - due diligence, management and monitoring systems exist to deal with compliance matters, including any changes, and action is taken to address any identified failings
    - the QFE's compliance assurance function has appropriate access to carry out its monitoring role
    - the Commission has appropriate access for carrying out its regulatory function
    - periodic reviews of outsourcing arrangements address compliance performance.

PROCESSES: Record keeping

Compliance principle

The QFE should have governance and compliance arrangements that ensure:

- it retains appropriate, easily accessible records.

Requirements of the Act and the Code

The following requirements are relevant to this principle:

- provide an annual report to the Commission certifying compliance with it obligations under the Act and its terms and conditions and setting out any breaches of which it is aware (s77).
- the minimum standards in draft Code Standards 12 and 13.

Guidelines for addressing the principle

- Records demonstrating compliance with requirements are made and kept.
- Records are promptly accessible by management, compliance assurance functions and the Commission.
- Records kept enable the QFE to fulfil its obligations for annual and any periodic reporting to the Commission.

PROFESSIONALISM: Governance

Compliance principle

The QFE should have governance and compliance arrangements that ensure:

- it has a high-level person or body responsible for overseeing adviser professionalism and compliance.

Requirements of the Act and the Code

The following requirements are relevant to this principle. A QFE must:

- monitor the standards set for employees and nominated representatives (s65(3))
- ensure compliance by the QFE group with the Act and its terms and conditions and by its QFE advisers with their financial adviser obligations (s76)
- maintain procedures to ensure adequate consumer protection for retail customers (s66(1))
- provide an annual report to the Commission certifying compliance with it obligations under the Act and its terms and conditions and setting out any breaches of which it is aware. The report must be signed by a principal officer (s77).

Expected information

We expect your ABS to address this principle by covering, where relevant:

- a description of your reporting and governance framework, including an explanation of the role and composition of the executive body responsible for overseeing professionalism and compliance
- an explanation of the ABS's role in the financial adviser service governance framework, which should include how the ABS was prepared, reviewed and approved, and senior business management's involvement
- the results of the latest framework review.

Guidelines for addressing the principle

- There is a clear reporting and governance framework for adviser professionalism and Act compliance matters.
- The governing body reviews, considers and approves the annual report to the Commission.

- The governing body considers, at least annually, the adequacy and robustness of processes and controls, compliance assurance and governance framework for encouraging adviser professionalism and ensuring Act compliance.
- The governing body reviews, considers and approves the ABS at least once a year.
- Where there is a QFE group, the QFE's expectations for the financial adviser services reporting and governance framework are made clear to the governing bodies of entities in the group.

The Commission expects the executive body chosen by the entity to be responsible for professionalism and compliance will include some senior executives, such as those responsible for business lines associated with financial advice, as well as relevant legal, risk or compliance representatives.

PROFESSIONALISM: Culture

Compliance principle

The QFE should have governance and compliance arrangements that ensure:

- its culture supports adviser professionalism and compliance, and the provision of adequate customer protection.

Requirements of the Act and the Code

The following requirements are relevant to this principle:

- a QFE, member of a QFE group or adviser must refrain from any conduct to do with financial adviser services that is misleading or deceptive or is likely to mislead or deceive (s34 and s47)
- a QFE application must set out the procedures in place for setting standards for employees and nominated representatives (s65(3))
- financial advisers must exercise care, diligence and skill and must not engage in misleading or deceptive conduct (s33 and s34)
- the minimum standards of ethical behaviour in draft Code Standards 1 to 5.

Expected information

We expect your ABS to address this principle by covering, where relevant:

- any steps senior management has taken to sponsor and support an appropriate culture (if the ABS does not address them elsewhere)
- the approach to managing the potential effect of any entity-level conflicts of interest on advisers and their advice (such as group product provider relationships and entity-level commission arrangements).

Guidelines for addressing this principle:

- Management actively supports professionalism in their messages to staff.
- Management monitors the culture in the QFE group and where there are large groups of nominated representatives.
- Management moves quickly to address customer outcome issues.
- Management allows enough time and resources for training and quality checking.
- Management is conscious of potential entity-level conflicts of interest and takes steps to avoid or manage them, including through disclosure and segregation of duties.

- An independent whistle-blowing procedure operates. The QFE does not restrict the ability of an AFA to report breaches of the Act to the Commission (under s45A).
- The QFE deals with the Commission openly and honestly, voluntarily reporting any significant compliance issues.

PROFESSIONALISM: Compliance

Compliance principle

The QFE should have governance and compliance arrangements that ensure:

- it has appropriate arrangements for challenging and testing the adviser compliance framework and its outcomes.

Requirements of the Act and the Code

The following requirements are relevant to this principle:

- a QFE application must set out its procedures for monitoring the standards set for employees and nominated representatives (s65(3))
- a QFE must ensure compliance by the QFE group with its terms and conditions and by its QFE advisers with their financial adviser obligations (s76).

Expected information

We expect your ABS to address this principle by covering, where relevant:

- a description of the entity's approach to testing, including any risk-based approach
- a description of the expected work plan and its governance oversight, along with resources allocated to it, including the number of staff, skills and experience
- an explanation of how the approach allows findings to be independent, along with how and to whom findings are reported and any necessary actions determined and tracked.

Guidelines for addressing the principle

- Challenging and testing address the design and operation of processes, controls and management information, and also consider the outcome for the customer.
- A risk-based approach is taken to compliance assurance.
- A plan is approved by the governing body and its progress monitored.
- Significant findings are reported to the governing body and remedial action is followed up, including any action necessary for customers.
- Compliance assurance has sufficient resources with the necessary skills and experience to carry out assurance work.

- The compliance assurance structure and plan take account of the complexities of any QFE group or nominated representative arrangements.
- Compliance assurance is, as far as possible, independent of line managers responsible for the process and controls being assured.

Assurance is likely to go beyond the day-to-day controls operated by managers directly responsible for key processes to include more in-depth and independent periodic challenges, such as arrangements for separate compliance monitoring teams, internal audits or the commissioning of specific external work.

Entities may wish to refer to the New Zealand Standard on Compliance Programmes (NZS/AS 3806:2006).

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