Why no one should care how you're paid

Tony Vidler | Strictly Business | 08 May 2012

Get it right out front - nobody else should care how an adviser gets paid, other than the customer. This is not another piece on which type of remuneration is best. It is about the most significant regulatory debate happening in the developed world today - the fiduciary standard, and how that is applied.

This debate often falls into passionate nonsense about whether fee-based only advisers are better for customers than other sorts of advisers. As this battle rages in a number of countries, there is a great divide emerging between fee-only style advisers and those who are commission-based or working in a hybrid fee plus commission model. The battleground issue is fiduciary care, and how an adviser displays that characteristic - hence the debate resorts to focusing upon remuneration structures and conflicts of interest.

The same arguments have been engaged in here in New Zealand - although the debate is less furious, ranging somewhere between modest and muted (but then Kiwi's ARE a bit more laid back than most). Those favouring adopting higher fiduciary standards want the debate moved up to a higher threat-level, perhaps somewhere around "seriously concerned and frowning". To them it is a critical issue. Most advisers however seem happy for the debate to stay somewhere below muted, perhaps back down at the "she'll be right" level. For them, it is just more noise in an incredibly noisy time.

We must ask ourselves though - should we be concerned about this evolving concept of how a fiduciary is defined?

In my view, all New Zealand financial advisers should be thinking about it. Not because there is something inherently wrong with our standards - we've barely given the new standards time to be taught and implemented, so they remain largely untested. But we DO need to be thinking about where our current practices fit into a fiduciary test due to the probable regulatory creep.

What happens in the USA, UK, or Australia (and so on, and so on) is watched and thought about here. There is a definite trend for the various jurisdictions to align their regulatory philosophies, even if they differ in their implementation - so regulatory philosophy in financial services has a tendency to creep across the different jurisdictions, conquering one unsuspecting adviser population at a time.

The central issue in the debate and proposed regulation overseas is that an adviser can only be called a fiduciary if paid directly by the client, and not via a product provider. If the adviser receives fees via the product provider, or by commission, the adviser is not acting as a fiduciary. And because, as professionals, we aspire to do the best we can for clients, it follows that we must all agree that we should be held to a fiduciary standard, as that is how a professional is

judged.

Does this theory hold true in New Zealand though?

Let's review the position here. The issue of fiduciary responsibility is one that is founded in common law, specifically in the tort of negligence. There is a requirement for an adviser (or anyone providing professional advice) to act in good faith and place the client's interests first.

It is important to note that there is not really an absolute "standard" of acting in good faith, or doing the right thing. The circumstances of each situation dictate whether an appropriate standard has been met, or whether a professional has been negligent or failed to act in good faith. That is, every case must be judged on its merits.

The tricky part here is that in common law, there is an expectation that when a professional receives payment directly from a client for professional services, there is an expectation that they will act at a higher standard than other professionals doing work that was not directly paid for (or engaged) by the client. So, in simple terms, in financial services this means that there is an apparent expectation that the fee-only adviser must carry a higher duty of care obligation than other advisers, due to the fiduciary relationship - if one follows the logic of the common law standards.

Now, it's important to note that I am no lawyer - just another financial adviser trying to fathom what it all means and work out what is the right professional standard that I would be judged by.

For all that, it seems to me that the Code of Professional Conduct and the Financial Advisers Act nullify many of the arguments being bandied about overseas, and make the entire issue of remuneration determining the fiduciary standard a moot one In New Zealand.

In a nutshell, we have new law and regulations that essentially define the fiduciary standard – regardless of an individual financial adviser's business model or remuneration structure. The introduction of "suitability" testing for Authorised Financial Advisers effectively eliminates differing standards, it seems. The requirement for an AFA to determine suitability of advice and then document that clearly and effectively undermines the argument that a different fiduciary standard exists amongst AFAs based upon their remuneration structure.

There is no doubt that advisers use multiple business models, ranging from product or ideas salespeople through to holistic life-planners coaching people to better lifestyles. And this is as it should be, as different consumers want different things from financial advisers. Not everyone wants a Mercedes – some don't even want a car at all, they simply want someone to sell them the best-priced ticket to their destination. The regulators have understood this, and captured the range of possibilities while enshrining a *de facto* fiduciary standard already.

The more you think about it, the more you realise what a clever piece of work the Code of Professional Conduct is (in particular). It captures the heart of the fiduciary obligations – the obligation to act in utmost good faith and the client's interests being paramount. It is reasonably explicit in providing guidance on how that should look at a practical level and, by introducing the requirement for suitability testing (which I admit concerned me when it was just a theory in draft form), they have ensured not only that the adviser understands how their advice will be judged by their peers and the courts, but that the central tenet of fiduciary care is specifically addressed with every client engagement.

In short, the Code provides the best defence mechanism in the world against claims of breach of a fiduciary standard – if followed. Provide advice in the manner and spirit of the Code and the law, and you are acting as a fiduciary is expected to. So, when it is our turn for the inevitable debate over fiduciary standards and how an adviser must be paid to be recognised as a fiduciary, we should be contending that the standards we have are actually very clever. And absolutely adequate.

The real issue for New Zealand is that those standards remain voluntary, and therefore only apply to a minority of

advisers. Best guess is that perhaps 15% of the advisers in New Zealand are AFAs at present. How that minority gets paid does not determine the overall level of fiduciary care at work in the market place, nor the level of care exhibited by those AFAs in their client engagements.

What we should be debating is why isn't AFA the entry point for all financial advisers so that the embedded fiduciary standard applies to all?

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Tony was financialalert Person of the Year 2011.

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