

## The ABCs of the Financial Advisers Act

The Financial Advisers Act came into effect on 10 October 2002 and all financial institutions are expected to comply with all its requirements from 1 April 2003, so what can consumers expect from financial advisers and their representatives? What are the likely benefits to consumers, and what are the things that they should look out for?

In this, the final installment of a three-part series looking at the Financial Advisers Act from the consumer's point of view, David Choo moves on to the letter 'C' to look at a vital ingredient in the financial advisory industry: the client.

# Does the Client Come First?

When I started out as a life and general insurance broker in 1986, I thought hard about our company's values and its value proposition. Putting pen to paper (computers were still in their infancy, after all) I wrote boldly that the clients' interests should come first. But what does that mean today?

Back when I wrote those words, my statement was warmly received by well-wishers and clients, but when I mentioned recently that I still believe in putting my clients' interests first I received some friendly 'get real' looks. Some people asked me what I meant by it, others told me I needed to wake up. Some agreed that it was a 'win-win' situation and others said it was a definite 'no-no'. People also wanted to know what was in it for them.

So what has happened over the last 20 years or so? There seems to have been a sea change in business values and ethics. Perhaps it is the pervasive influence of Wall Street and its movie characterisation with the credo "greed is good", or maybe

it is because of psychologists' discovery that everyone is basically driven by self-interest.

I know the context is different but Professor Chan Heng Chee's remarks about why Singapore supported the US in the fight against terrorism, not to mention over the issue of Iraq, were not only politically accurate but also disarmingly honest.

"In the war on terrorism and on the issue of Iraq, Singapore arrived at its position out of self-interest," he told the *Straits Times* earlier in May. "We are targets of terrorism. We are concerned about the proliferation of weapons of mass destruction. We are concerned about Korea too. So we could support the United States on this because it is in our self-interest."

## What's in it for me?

When I first heard the WIIFM acronym in the late 1980s it was used in a sales session identifying what would make clients sit up and show an interest, but now I hear it more often from the sales person instead. It seems that the phrase "clients' interests first" no longer features in companies' visions or value statements.

It also seldom features in the standards and codes of ethics devised by associations of financial planners, advisers and agents.

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Standards like objectivity, competence, fairness, diligence, professionalism and confidentiality are all mentioned, so does that mean that putting the interests of clients first is no longer an ethical issue, or is it implied in that list of requirements?

The government and financial advisory businesses have sounded a warning, and that warning is *caveat emptor*, or let the buyer beware. Gone are the days when advisers were guided by an invisible hand of conscience and governed by the idea of *uberrima fides* (utmost good faith). Today those things apply to the filling in of forms and the disclosure of material facts.

But how are clients' interests protected by the Financial Advisers Act and its regulations and notices? The Act does not speak directly about putting clients' interests first (if my reading is right), but to protect those interests it requires advisers and their representatives to observe certain rules when conducting their business.

### Learning curves

One advantage we have over countries like the United Kingdom, which are some years ahead of us in the financial services business, is to learn from their experience. It is interesting that when it comes to advice and product recommendation, the UK has moved from 'best advice' to the 'right advice' to advice that is suitable or reasonable.

Obviously it is a tall order to assess exactly what constitutes the best advice or the right product. That would differ from client to client, and will depend on the situation at hand, so Singapore's FAA opted more realistically to insist on a "reasonable basis" for advice based on the client's objectives, circumstances and risk profile.

Those financial advisers who choose to operate as independent financial advisers (IFAs) are required to observe a few other rules to ensure that they offer advice and recommend products fairly and objectively without being constrained by the product providers or influenced by remuneration packages.

There are several standards and measures that work in the client's favour, from the strict criteria that must be satisfied to gain an FA licence and its subsequent renewal, to the heavy penalties (fines or imprisonment) meted out to repeat offenders. Advisers and agents must take part in training programmes and meet competency requirements, with the sales force also undergoing coaching and counselling.

Strict rules also regulate the conduct of business (disclosure, fact finding, the basis of advice and recommendation of solutions) to prevent non-disclosure,

misrepresentation, and inappropriate or excessive selling. But the FAA also allows for an interesting spectrum of firms and representatives, ranging from the exempt FA firms like life insurance brokers and stockbroking firms to the licensed FA that can also choose to operate independently.

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An exempt financial adviser can, however, own a licensed financial advisory firm, so clients have a range of firms to choose from and need to be aware of the clear differences between the different advisers and their representatives (see **The client-adviser relationship** overleaf).

### Who represents who?

First, the client needs to understand their legal status with regard to their adviser

and representative. Tied agents are employed by an insurance company and, legally speaking, represent their principal not their clients. That means that clients have rights against the insurance company employing a particular agent, as the principal is responsible for the advice and recommendations of their agency force. In more litigious societies legal liabilities can be heavy, which is why some well known insurance companies in the UK have dispensed with their tied agency system, also taking into account the costs involved in maintaining such a sales force.

Similarly the staff of banks and stockbroking firms represent their company and not their clients, so clients have legal rights against these companies, who are legally responsible for the advice and recommendations of their staff members.

On the other hand, if a representative works for a licensed financial advisory firm that is owned by a bank, stockbroker or life insurance company, they can be considered to represent their clients because they operate in a similar way to brokers of old. Having said that, they are not independent and so cannot be viewed as objective, but do clients know that, and will it affect their right to fair and objective advice and product recommendations?



## The client-adviser relationship

Type of Financial Advisory firm	Representatives that clients deal with	How they serve clients' interest				
		Who reps legally represent	Standard of advice and recommendation	Range of products	Diversification provided	Competitive products
Life insurance company	Tied agents (representatives)	Life Insurance Company	Reasonable basis	One company and selected products of other life insurance companies	Little	Depends on firm and current performance
Bank	Counter staff, telemarketers, representatives	Bank	Reasonable basis	Most banks distribute one life insurance company's products and selected unit trusts	Little	Depends on firm and current performance
Stockbroker	Representative, remisiers	Stockbroker	Reasonable basis	If owned by banks, usually one life company's and selected unit trusts	Little	Depends on firm and current performance
Licensed FA owned by exempt FA	Representative	Client	Reasonable basis	A few life company products and selected unit trusts	Some	Choice of a few firms
Licensed FA	Representative	Client	Reasonable basis	A few life companies' products and selected unit trusts	Some	Choice of a few firms
Licensed FA operating as independent FA	Representative	Client	Reasonable basis and 'fair and objective' basis for recommendation of products	Minimum of four life companies' products and selected unit trusts	More	Choice of more firms

Clients have a clearer legal relationship with licensed FAs, who choose to operate as independent financial advisers, or IFAs. IFAs clearly represent their clients and the minimum expectations are spelt out in the regulations and notices of the Financial Advisers Act.

### Who offers what?

Different firms will also offer a different range of products and services, so clients need to find out how many companies' life insurance policies or unit trusts a representative is able to offer. Banks, stockbroking firms and licensed FA firms may offer a "one-stop station" for the convenience of clients, but clients have to ask what choice is available for *each* of these product groups. For example, most banks and stockbrokers only offer life insurance products from one life insurance company, usually because of their shareholding relationship.

This begs the question, wouldn't it be better for clients if all advisers and their representatives were able to recommend the products of all the product providers? Wouldn't this be in the client's interests?

Better still, wouldn't it be good if all the products offered by all the product providers could be compared and analysed objectively to let consumers make an informed and considered choice?

For a time it looked like Singapore was favouring the development of the independent financial adviser. In a speech

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in mid-2002, Deputy Prime Minister Lee Hsien Loong told the local financial community gathered at a dinner that IFAs would soon be licensed and allowed to operate in the financial services industry of Singapore. "IFAs will offer comprehensive financial planning and advice

on the entire range of investment options. Their interest will lie in representing their clients rather than pushing any particular product or service provider".

After a long period of deliberation, however, the MAS (Monetary Authority of Singapore) opted for an impartial stance towards the different distribution channels, leaving the decision and responsibility squarely on consumers' shoulders.

It may be that as consumers become better informed and begin to value objective advice and choices they will seek out the financial advisers that can offer these things. In the meantime, IFAs should not forget that besides offering value for money they need to build strong relationships with clients and revive the old adage of "clients' interests first".

**David Choo is the managing director of PromiseLand Independent Pte Ltd, an independent financial advisory firm.**

