

**SUMMARY OF
SUBMISSIONS IN RESPONSE TO:**

**The Code Committee Consultation Paper on Proposed
Minimum Standards of Ethical Behaviour and Client Care for
Authorised Financial Advisers**

ABOUT THIS DOCUMENT

- This document summarises 146 submissions¹ received from the public in response to the Code Committee's consultation paper on the proposed minimum standards of ethical behaviour and client care released on 17 November 2009.
- All submissions relating to ethical behaviour and client care have been summarised and considered by the Code Committee. This document contains no comment from the Code Committee on the submissions.
- Submissions that were marked confidential were summarised and considered by the Committee but do not appear in this document. All submitters' details have been made anonymous. A full list of the organisations who submitted on the consultation papers is provided in a separate document on the Code Committee website www.financialadvisercode.govt.nz.
- Submissions on topics outside the Code Committee's ambit (such as suggested amendments to the Financial Advisers Act 2008) have not been recorded in this document.
- Each section commences with a question or standard, an overview of the responses to that question/standard and then the summaries of the individual submissions.
- In some instances marked up changes have been used to demonstrate changes suggested to particular standards ie The submitter suggested that the standard should read: "provide services ~~promptly~~ in a timely manner to the client".

¹ Over and above this some submitters endorsed other organisations' or individual's submissions.

ACRONYMS AND KEY TERMS

AFA	Authorised Financial Adviser
Committee	Code Committee
FAA	Financial Advisers Act 2008
FSP	Financial Service Provider
FSPA	Financial Service Providers (Registration and Dispute Resolution) Act 2008
MED	Ministry of Economic Development
National Certificate	National Certificate in Financial Services (Financial Advice) (Level 5)
QFE	Qualifying Financial Entity

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EXECUTIVE SUMMARY

ETHICAL BEHAVIOUR PRINCIPLES (Consultation Question 1)

General comments

- Submitters generally agreed that the principles of client first and integrity and good conduct are appropriate.
- However many submitters expressed concern regarding the principle of independence, objectivity and managing conflicts of interest.

Client first and integrity

- The issue of whether this principle would require an employed AFA to recommend a competitor's product was raised. It was suggested that this was unrealistic for AFAs employed by FSPs or QFEs.

Independence, objectivity and managing conflicts of interest

- The majority of submitters stated that the independence principle was inappropriate and that a focus on disclosure was preferable.
- Concern was raised regarding how AFAs employed by QFEs or FSPs would be dealt with under this principle.
- Other submitters stated that even AFAs who are not employed by FSPs or QFEs often focus on a particular range of products that they know well or use a platform. Several commented that having a selection of approved products that have been compiled on the basis of research and evaluation (via a platform) is of value and does not compromise "independence".
- A change from "managing conflicts of interest" to focus on "avoiding conflicts of interest" was suggested.

CLIENT CARE PRINCIPLES (Consultation Question 2)

- Submitters were generally in favour of the proposed client care principles, subject to some reservations.
- Concerns were expressed about how the suitability standards would be implemented, and whether the standards would prove unnecessarily onerous for advisers and clients.
- Although the capability and capacity requirements were generally endorsed, clarification was sought regarding how the standards would operate.
- Likewise, although the requirement for effective communication was endorsed, a number of submitters expressed concern at its application in particular in relation to the requirement for advice to be in writing.

OVERVIEW OF CLIENT FIRST AND INTEGRITY STANDARD (Consultation Question 3)

- The majority of submitters supported the over-arching ethical behaviour standard.
- However concerns were expressed regarding how receipt of commission would be dealt with.

Who should the standard apply to?

- Most submitters stated that the standard should apply to all AFAs. However some submitters suggested that several groups should not be required to comply with this standard:

- Lawyers;
- AFAs who solely provide financial adviser services to wholesale customers;
- AFAs employed by FSPs and QFEs;
- Research and transaction-only AFAs; and
- NZX Advisors.

OVERVIEW OF INDEPENDENCE, OBJECTIVITY AND MANAGING CONFLICTS OF INTERESTS STANDARDS (Standards 2-4) (Consultation Questions 4-7)

- “Independence” as expressed in proposed standards 2-4 was not seen as appropriate. The most significant objections related to the relationship between commission and “independence”.
- Some suggested that receipt of commission does not affect objectivity and that this should be de-coupled.
- Most submitters stated that the most important limb of determining “independence” in key term (1) was whether or not the AFA had links to any product providers. The submitters identified the following factors as compromising “independence”:
 - existence of quotas or sales goals;
 - obligations to place a certain percentage of sales with one particular provider; and
 - where the AFA’s firm is owned or partly owned by a product provider.
- The issue of whether an AFA could be independent when the AFA only offered a limited range of products was also discussed.

Standard 2

- Many submitters made the point that disclosure should be the focus of proposed standard 2.
- A number of submitters also suggested that objectivity should not be coupled with independence.
- Others also made the submission that the Code should not allow AFAs to provide advice that is not objective as objectivity is a necessary incident of the client first principle.
- The majority of submitters stated that an AFA should not be required to obtain the client’s express consent to the AFA’s lack of independence and that disclosure provides sufficient protection.

Safeguards

- Most submitters stated in relation to the safeguards listed in standard 2(2) that disclosure was sufficient. Several submitters also stated that safeguards should not be prescribed as the ways to protect clients from a lack of independence and conflicts of interests will be fact-specific.
- Most submitters stated that providing the client with the opportunity to take independent advice would:
 - be detrimental to public confidence;
 - be too expensive so that only wealthy clients will avail themselves of this; and
 - be too difficult to obtain given that most AFAs will not be “independent”.
- It was also pointed out that this safeguard may not be suitable for transaction-only services particularly where informed investors are merely requiring the AFA to purchase a product for them.
- Most submitters did not express strong disagreement or agreement with the safeguard in standard 2(2)(b).

Standard 3

- Submitters re-emphasised the point made in relation to standard 2: that the focus should be on disclosure.
- Some submitters stated that there was an overlap between standards 2 and 3.
- Many submitters disagreed with the suggestion that an AFA be required to specify that they are “not independent” or “aligned”. It was thought that preventing those AFAs from using the term “independent” and requiring full disclosure was sufficient.

CONSULTATION QUESTION EIGHT: What effect would banning commission have on consumers and the industry in various sectors: insurance, investment, financial planning, credit contracts and any other relevant sector?

- The majority of submitters expressed the opinion that commission should **not** be banned, however, there were still a significant number of submitters who expressed approval of a ban on commission.
- Many of those who were not in favour of a ban said that this is a matter for Parliament.
- In terms of the mortgage sector, several submitters stated that clients who are wanting advice on a mortgage are in need of cash and generally do not have spare money to spend on financial advisers’ fees (unlike investors). These poorer clients may therefore not receive financial advice.
- It was suggested that banning commission in the insurance sector will result in more frequent under-insurance and sales of unsuitable insurance policies as consumers will not want to pay fees to receive advice.
- Share brokers made the submission that charging clients to access new share issues would affect the uptake of primary market offerings.

CONSULTATION QUESTION NINE: Do you consider that non-financial benefits should be taken into account in determining whether an AFA is independent and objective?

- The majority of submitters agreed that non-financial benefits should be taken into account in determining whether an AFA is independent and objective.
- A materiality threshold for non-financial benefits was suggested.

CONSULTATION QUESTION TEN: Do you consider an AFA is independent and objective if his or her financial adviser services are limited to financial products available through a particular platform where the AFA and all connections of the AFA have no financial interest in the platform?

- Although there were a number of submitters who gave a clear “yes” or “no” answer to this question, many submissions stated that not all platforms create the same risk to independence/objectivity. The greatest risk to independence/objectivity in relation to platforms was thought to arise where the platform:
 - obliges the AFA to solely advise and recommend products that form part of the platform;
 - provides benefits (financial/non-financial) to the AFA in return for sales of those platform products.

- In relation to limited product selection it was observed that it is not possible for AFAs to advise on the whole world of products. But it was suggested that to be independent a “sufficient range” of products should be on offer.

CONSULTATION QUESTION ELEVEN: Are the definitions of “connection of the AFA” and “member of the AFA’s family” appropriate? If not, why not?

- A number of submitters approached the question from the point of view that that the key issue is whether the relationship with the “connection of the AFA” or “member of the AFA” is likely to influence the AFA in some way.
- A number of submitters suggested that siblings and other family members should be included in the definition. However some stated that the definition is too broad.
- Several submitters stated that including “prospective business partners” and “prospective employers” in the definition “connection of the AFA” was a step too far.
- Several submitters suggested that compliance may be difficult as AFAs may not in fact have access to information about the investments of family members or employees. It was submitted that this definition presumes that an AFA would legally and practically be able to disclose the identity of their clients and information about them to family members.

CONSULTATION QUESTION TWELVE: Do you agree that the proposed standards concerning lending and borrowing to/from, and joint investments, with clients (set out in standards 5-6) should be included in the Code? Are there any other standards concerning dealings with clients that should be included in the Code?

- Restrictions on lending and borrowing to/from clients, and restrictions on joint investments with clients, were generally considered to be appropriate, however, several issues were raised in relation to the standards.

Standard 5

- Several submitters were concerned that standard 5 may prohibit AFAs from working for an employer who borrows money from the AFA’s clients. The example provided was of banks who are the business of *borrowing* money from customers (as all bank accounts, term deposits and other debt securities are technically borrowings).
- Several submitters stated that standard 5(2) should be amended to make it clear that nothing prevents an AFA’s employer from lending money where that employer is in the business of lending money.

Standard 6

- A number of submitters stated that joint investments with clients should not be permitted as they create a conflict of interest.
- A number of submitters stated that care needed to be taken to ensure that AFAs would not be prevented from belonging to the same KiwiSaver scheme or registered deposit taker, unit trust, life insurance policy or listed company as their client. It was stated that the key issue is to ensure that the AFA is not in a business or investment relationship with the client.

CONSULTATION QUESTION THIRTEEN: Do you consider that the Code should include standards governing AFAs who take on personal trusteeships and act as directors or corporate trustees of family trusts? If yes, what standards should be included?

- A number of submitters stated that no further standards should be added as trustees' duties are sufficiently covered by existing law.
- Another group of submitters stated that this issue should be dealt with by the AFA via a conflicts management procedure without the Code prescribing any standards.
- Some submitters, however, suggested various standards that the Code could include:
 - a standard on trustees' duties;
 - a standard prohibiting AFAs from providing financial adviser services to a trust if the AFA is also a trustee of that trust; and
 - a standard allowing AFAs to act as trustees provided the AFA fully discloses this and has conflict of interests management procedures in place.

CONSULTATION QUESTION FOURTEEN: Are there any other good conduct standards that should be included in the Code?

- Roughly half of the submitters who answered this question stated that no further standards were required.
- However standards on particular topics were recommended for inclusion in the Code by some submitters:
 - a standard requiring AFAs not to use any complaints or disciplinary process for an improper purpose;
 - a standard setting out confidentiality duties of AFAs; and
 - a standard requiring an AFA to follow the advice process that forms the core practice standard of the National Certificate.

CONSULTATION QUESTION FIFTEEN: Should the Code include a good conduct standard which restricts the ability of AFAs to criticise other AFAs or include other standards which regulate dealings and interactions between AFAs?

- Submitters did not in general object to the sentiment behind this proposal.
- However, although a number of submitters stated that an explicit standard should be included, other submitters made cogent arguments as to why there should not be such a standard. The reasons included:
 - that this issue should be included within a general standard on AFA behaviour;
 - that this issue was covered by standard 7 (which requires AFAs not to bring the financial advisory profession into disrepute); and
 - that existing defamation law provides suitable protection.
- Some concerns were expressed regarding the need to preserve freedom of speech and the utility of professional criticism.
- Many submitters stated that if such a standard was to be included it should not interfere with the whistle-blowing standard (standard 26).

CONSULTATION QUESTION SIXTEEN: Should the proposed standards of good conduct (or any other section of the draft Code) include standards providing guidance on advertising or marketing of financial adviser services over and above the restrictions in the Financial Advisers Act? If so, what should the standards require?

- The overwhelming response was that sufficient guidance on advertising and marketing was already provided in existing law.

CONSULTATION QUESTION SEVENTEEN: Do you consider the proposed over-arching client care standard is appropriate (proposed standard 9)?

- The overwhelming majority of submitters supported this standard.
- Some small alterations were suggested such as the removal of the word “courteous”; and changing “promptly” to “in a timely manner”.
- It was suggested that standard 9(2) should be altered to explicitly state that an AFA may only offer financial adviser services in areas where he or she is competent.

CONSULTATION QUESTION EIGHTEEN: Do you agree that a standard concerning scope of services should be included (proposed standard 10)?

- This requirement was generally endorsed as a useful safeguard.
- Some submitters suggested that the disclosure ought to go further, however, and disclose the scope of options that have been considered when advice is given.
- A number of criticisms were raised:
 - it was suggested that the standard should be subject to reasonable limits;
 - that the requirements should only apply to retail (not wholesale) customers; and
 - that the customer and the adviser should decide what kind of (ongoing) disclosure is required.
- Several submitters suggested that the requirements were not appropriate for certain sectors, including insurance advisers, KiwiSaver and NZX Advisors.
- It was also suggested that where FSPs complied with the obligation, it should not be necessary for individual AFAs to do so also.

CONSULTATION QUESTION NINETEEN: Is it appropriate to require that where trail commission or a monitoring fee is charged, the AFA must provide ongoing proactive advice?

- Submitters were generally in favour of this requirement, subject to a significant qualification: many submitters stressed that there is a difference between a monitoring fee, which is expressly charged in consideration for the supply of an ongoing service, and a trail commission, which may be no more than a continuous payment for the original service.
- Submitters stressed that this question ought to be subject to the agreement reached between the adviser and the client, and as long as the client was properly informed there was nothing inherently wrong with a trail commission that was not associated with ongoing proactive advice.

- The submitters did recognise, however, that where an adviser had agreed to provide ongoing advice they had to comply with that obligation.

CONSULTATION QUESTION TWENTY: Should there be a standard requiring written terms of engagement with clients?

- Submitters were generally in favour of this proposal. A significant minority did, however, suggest that written terms of engagement should not be made mandatory.
- Submitters also proposed several qualifications and exceptions, in particular for employees of FSPs and wholesale advisers.

CONSULTATION QUESTION TWENTY-ONE: Should AFAs be permitted not to undertake a suitability analysis (see proposed standard 11)? Two options were suggested:

- (a) Should AFAs always be required to carry out a suitability analysis and provide advice that is suitable for the client?; or**
- (b) Should AFAs be permitted not to carry out a suitability analysis and to provide services that are not necessarily suitable for the client, provided that the benefits of the suitability analysis are clearly explained to the client and the client consents in writing not to receive such advice?**

- Although the majority of submitters recognised the value and purpose of suitability analyses generally, many felt that standard 11 would require suitability analyses to be carried out in inappropriate circumstances.
- Of the submitters that expressly endorsed one of the alternatives, option (b) received overwhelming support.
- Significant criticism was directed at the perceived assumption that all customers were unsophisticated clients seeking a full financial planning service, and many submitters stressed the importance of allowing experienced investors, or those only seeking a limited (generally transactional) service to opt out.
- Some submitters regarded the extra compliance costs associated with the opt-out process itself as being unjustified.
- Certain groups suggested that special more “light touch” rules ought to be applied for some sectors, such as insurance, KiwiSaver or share broking. It was also suggested that suitability analyses should not be required at all for wholesale clients.

CONSULTATION QUESTION TWENTY-TWO: Is it appropriate that where the suitability analysis shows that the financial adviser services offered by an AFA are unsuitable for the client, the AFA must not provide the financial adviser services or should the AFA be able to provide the services if the AFA informs the client that the services are not suitable but the client still wishes the AFA to provide the services? (see proposed standard 13)

- Submitters were split in response to this question, with a significant majority in favour of permitting AFAs to provide services that they have deemed to be unsuitable as this was a matter for the client and AFA to decide (provided the client was fully informed).
- A significant number of submitters suggested that the AFA should, or should be required to, obtain written consent from the client, while many implied that it would be sufficient if the client proceeded to seek a service after the adviser had explained why he or she deemed it unsuitable.

- A number of submitters did, however, suggest that it would be inappropriate for the adviser to provide a service that is unsuitable.

CONSULTATION QUESTION TWENTY-THREE: Do you agree that the proposed standards concerning suitability (proposed standards 10-16) should be included in the Code? Are there any other standards concerning suitability that should be included in the Code?

- A number of submitters replied that the proposed suitability standards were appropriate and that no more standards were required.
- Many stressed that it was necessary to recognise the fact that many clients did not want a full financial planning service, and suggested that the suitability standards should be flexible to reflect this. The importance of distinguishing between retail and wholesale customers was also highlighted.
- In relation to standards 11, 12 and 13, it was suggested that the exemption would be so universally utilised that the standards could prove meaningless.
- It was suggested that standard 15 ought to be narrowed to take account of clients who did not require a full service, such as in share broking.

CONSULTATION QUESTION TWENTY-FOUR: How long should AFAs be required to keep records in relation to proposed standard 16? Should there be specific standards relating to electronic records?

- Most submitters endorsed a requirement to maintain records, although a significant minority suggested that existing legislative requirements were sufficient.
- Others suggested that if the Code did include a standard on this matter it should impose obligations that were consistent with those existing legislative requirements ie seven years for tax records.
- Some suggested that the standard allow records to be kept by an AFA's employer and that this standard should only apply in respect of retail clients.

CONSULTATION QUESTION TWENTY-FIVE: Are the proposed capability and capacity standards appropriate (standards 17-19)? Should the standards be modified or expanded in any way? Are there other capability and capacity standards that should be included in the Code?

- Submitters were generally supportive of these standards.
- Standards 17 and 18 were particularly endorsed, while Standard 19 attracted some criticism. The criticism directed towards Standard 19 was generally concerned with the position of FSPs and QFEs.

CONSULTATION QUESTION TWENTY-SIX: Do you agree that information and/or advice should be provided in writing unless that is not practicable?

- A large number of submitters endorsed the requirement for advice to be in writing, but a number of submitters also rejected it.
- Many of these submitters suggested that it should be a matter for the client and the adviser to agree on.

- Submitters in the share broking context were particularly concerned about the proposal to require advice to be in writing.
- Particular refinements to the standards were suggested, particularly regarding the retail/wholesale distinction.

CONSULTATION QUESTION TWENTY-SEVEN: Should the client be able to waive this requirement by agreeing in writing that subsequent disclosure of specified information or advice is not required to be in writing?

- Submissions were generally in favour of permitting clients and advisers to agree that future advice be able to be provided verbally.
- A significant majority suggested that this was too risky, because it would put naïve customers at risk and create problems of proof in the event of a dispute.
- Other submitters suggested that the requirement will be useless, because firms will obtain waivers as a matter of course, while others suggested that the proposal be reversed so that clients can *request* that advice be provided in writing.
- A number of submitters suggested that advice should not be required to be in writing in the first place, and therefore the client and adviser should not be required to sign a waiver.

CONSULTATION QUESTION TWENTY-EIGHT: Proposed standard 21 requires AFAs to have an internal dispute resolution process. Is this practical? How should an individual AFA who does not practise with other AFAs be required to deal with complaints?

- In general submitters endorsed the requirement for an internal dispute resolution system, and many suggested that sole practitioners be required to at least consider complaints or maintain a complaints register.
- The difficulties for sole practitioners were also recognised and it was suggested that the extent to which they can maintain an internal dispute resolution system is limited. A number of submitters suggested using an external person or a professional organisation to provide a reciprocal or peer “internal” process for sole practitioners.

CONSULTATION QUESTION TWENTY-NINE: Are the proposed internal dispute resolution standards (standards 21-23) appropriate?

- Most submitters endorsed these requirements, although it was suggested that NZX firms and employed advisers should be exempted.
- The most frequently suggested modification was that *only* written complaints should be required to be recorded in the complaints register.

CONSULTATION QUESTION THIRTY: How long should records of complaints be kept under proposed standard 23?

- A large number of submitters suggested that records be kept for seven years, to be consistent with other reporting requirements.
- Other submitters just noted that this standard should be consistent with other legislation and the other record-keeping standards in the Code.

CONSULTATION QUESTION THIRTY-ONE: Are the proposed compliance standards (standards 24-26) appropriate? Should the standards be modified or expanded in any way? Are there any other compliance standards that should be included in the Code?

- Although these standards received widespread support, a number of particular points were made about them.
- Some submitters questioned whether standard 25 was necessary, while other submitters sought clarification as to its scope and application, particularly in relation to employees.
- Some submitters rejected standard 26. Various changes were suggested including: the creation of a peer review system; altering the standard to minimise reporting of unfounded complaints and minor breaches; and increased protection for “whistle-blowers”.

CONSULTATION QUESTION THIRTY-TWO: The general rule in proposed standard 28 is that an AFA must not disclose information without the client’s prior express written consent. Are the exceptions to this general rule (set out at standards 28(1)(a)-(e)) appropriate? Should they be modified or expanded in any way? Are there any other exceptions that should be added?

- While a number of submitters endorsed this standard, many stressed that its relationship with other legislation (particularly the Privacy Act) needed to be taken into account.
- Some suggested that the Privacy Act alone was sufficient, while others suggested that it should be ensured that the content of standard 28 be consistent with the Act.
- A number of exceptions were suggested, including for NZX firms, for peer review and to other professionals such as lawyers and accountants.

CONSULTATION QUESTION THIRTY-THREE: How long should records for trust accounts, client money and client assets be held under proposed standards 30, 33 and 34?

- A number of submitters suggested that records ought to be required to be kept for seven years (although some submitters suggested up to ten years).
- A number of submitters stressed that the requirements should be consistent with existing legislation, while some suggested that the existence at general law of obligations to retain documents meant that it was unnecessary for the Code to regulate this matter.
- Particular submissions were made on how the requirements would apply to FSPs and QFEs.

CONSULTATION QUESTION THIRTY-FOUR: Is it appropriate to require trust accounts to be audited annually by a chartered accountant (see proposed standard 35)?

- This standard was generally endorsed as a useful safeguard.
- However some submitted that this imposed disproportionate costs on AFAs and that an internal audit would be sufficient.
- It was also submitted that this standard should not apply to lawyers, registered legal executives, NZX Advisors and statutory trustee corporations.

CONSULTATION QUESTION THIRTY-FIVE: Are the proposed custody standards (standards 27-35) appropriate? Should the standards be modified or expanded in any way? Are there other custody standards which should be included in the Code?

- One major issue raised was whether these standards should apply to AFAs who are employed by QFEs or FSPs. It was submitted that QFEs and FSPs will have systems to cover these matters and that the AFAs would not have personal control of the custody systems and procedures.
- Several submitters referred, in relation to standard 31, to difficulties they had experienced with banks in trying to get client fund accounts designated as trust accounts.
- Some submitters stated that in the share broking market standard 32 would be unworkable as NZX Firms did not usually pay credit interest on trust settlements to clients. They submitted that disclosure should be sufficient.
- It was suggested that lawyers and NZX Advisors should not be required to comply with these rules.

CONSULTATION QUESTION THIRTY-SIX: Noting the Ministry of Economic Development’s targeted consultation on regulation of investment transactions, are there any standards that you think should not apply to those who only make investment transactions (as defined in section 5 of the Act) and who do not provide other financial adviser services?

- Most submitters felt that AFAs who only make investment transactions should be treated differently under the Code.
- Several stated that the suitability standards should not apply to these AFAs. Others stated that only the custody standards should apply.

CONSULTATION QUESTION THIRTY-SEVEN: Is there anything else you would like to comment on in relation to the proposed minimum standards of ethical behaviour and client care?

- A large number of submitters stated that there should be different standards for different classes of AFAs and that a “one size fits all” approach is inappropriate given the width of the application of the FAA.
- Some of the different classes of AFA suggested were:
 - *those who provide services only to wholesale FSPs or habitual clients.* It was suggested that these AFAs should not be required to comply with the: suitability analysis standards; advice in writing standard; and the scope of services standard.
 - *AFAs employed by FSPs (and QFEs).* It was suggested that these AFAs should not be required to comply with: any standard requiring written terms of engagement; dispute resolution standards; standards requiring the AFA to keep individual client files; and the advice in writing standard.

The rationale for these exceptions is that employed AFAs should be able to rely on the employer to be responsible for client communications, dispute resolution processes and custody systems.

- *AFAs giving non-personalised advice:* It was also suggested that a distinction between the provision of general advice and the provision of personal advice should be recognised.

- *Mortgage brokers and insurance brokers*: expressed concern that the standards focused on investment advisers and were not tailored to insurance and mortgage sectors.
- It was submitted that lawyers and lawyers' employees should not be required to comply with the ethical behaviour and client care standards as they are required to comply with the Lawyers and Conveyancers Act (Lawyers: Conduct and Client Care) Rules 2008 and Lawyers and Conveyancers Act (Trust Account) Regulations 2008.
- NZX Advisors also submitted that the NZX Rules cover the matters in the Code and therefore the Code should not apply to them.

CONSULTATION QUESTION THIRTY-EIGHT: Do you consider there are areas other than competence; knowledge and skills; ethical behaviour; client care; and continuing professional training that should be covered in the Code?

- Only a small number of submitters answered this question but most felt that there were no other areas that ought to be covered.
- However some did comment that as the regime matures other areas that should be covered may emerge.

MISCELLANEOUS MATTERS

- Other topics covered in the submissions included (amongst others): QFEs; suggested changes to the FAA; prohibition on contracting out of the Code; cost of the regime to AFAs; consumer education; regulatory requirements for "Category 2 Advisers"; advisers trading as principals; Secret Commissions Act 1910; consultation; competence; and Corporate Trustees.

PRINCIPLES OF ETHICAL BEHAVIOUR

QUESTION ONE: Are the ethical behaviour principles (client first and integrity; independence, objectivity and managing conflicts of interest; and good conduct) appropriate to base ethical standards upon? If not, what are the appropriate principles?

SUMMARY

Submitters generally agreed that the principles of client first and integrity and good conduct are appropriate. However many submitters expressed concern regarding the principle of independence, objectivity and managing conflicts of interest.

Client first and integrity

The issue of whether employed AFAs would be able to comply with this principle was raised. It was submitted that if an AFA was putting the client first, they would need to advise on all products in the marketplace and may even be required to recommend competitors' products. It was suggested that this was unrealistic for AFAs employed by FSPs or QFEs.

Independence, objectivity and managing conflicts of interest

The majority of submitters stated that the independence principle was inappropriate and that a focus on disclosure was more appropriate. Many submitters stated that there would be few AFAs who could achieve "independence".

Concern was raised regarding how AFAs employed by QFEs or FSPs would be dealt with under this principle as most will be required to sell their employer's products. Some submitters stated that in the case of employed AFAs the lack of independence will be obvious to consumers and therefore not an issue.

Other submitters stated that even AFAs who are not employed by FSPs or QFEs often focus on a particular range of products that they know well or use a platform. It was submitted that requiring AFAs not use platforms in order to be "independent" was unrealistic. Several commented that having a selection of approved products that have been compiled on the basis of research and evaluation (via a platform) is of value and does not compromise "independence".

Concern was also expressed regarding the focus on managing conflicts of interest and it was submitted that the principle should be *avoiding* conflicts of interest. It was commented that a focus on disclosure can lead to a situation where disclosure statements are incomprehensible for the average consumer.

Some submissions were made in support of including a "fiduciary duty" as one of the ethical behaviour principles.

INDIVIDUAL SUBMISSIONS

Principles are appropriate

Thirteen submitters agreed that the ethical behaviour principles are appropriate.

Three submitters endorsed the principles, subject to reservations regarding commission.

Three submitters stated that apart from concerns with “independence” the principles are sound.

One submitter agreed with the principles but felt that there was too much focus on investment advice.

Another submitter stated that the principles should also apply to those giving advice on category 2 products.

Another submitter agreed that the ethical behaviour principles are appropriate except that they should not be applied to lawyers.

Principles are inappropriate

One submitter expressed concern that there is an investment focus and that inadequate provision has been made for wider areas of advice. Another submitter expressed similar concerns suggesting that the principles could be difficult to apply outside the context of an individual adviser providing a comprehensive financial adviser service.

One submitter stated that some of the proposed standards water down or contradict the overarching ethical behaviour principles for instance the receipt of commission and incentives is incompatible with the principle of putting the client’s interests first and acting independently.

One submitter stated that these are idealistic standards.

Need for guidance

Twenty submitters expressed concern regarding how advisers would be judged against the proposed principles. Another submitter stressed that principles should be both clear (and not subjective) and capable of being measured.

General comments

One submitter stated that the client must be placed first in all instances and that integrity, objectivity, and managing conflicts of interest and good conduct are all of equal importance.

Another submitter suggested that the “ethics” of advisers should be screened by employers on appointment.

One submitter stated that all AFAs should comply with the ethical behaviour standards and knowledge of the Code (however that submitter suggested some changes to the principles).

Client first and integrity

One submitter stated that this should be more strongly worded ie: “acting solely in the interests of the client and with integrity at all times”.

One submitter suggested that the principle of placing clients first was elementary, but that integrity is something innate that cannot be manufactured.

One submitter strongly supported the principles of client first and integrity. However it was submitted that these are separate principles. It was stated that integrity is a quality of overriding importance and implies honesty, fair dealing and truthfulness. It was pointed out that this is one of the fundamental principles of NZICA's Code of Ethics. It was submitted that placing the client's interests first is different to integrity but the submitter agreed that it is also a fundamental principle for AFAs.

That submitter stated that client first and integrity could lead to conflicting outcomes ie the investment may be in the best interests of the client but may not be acceptable to the adviser ie a company that makes profits by exploiting workers. Therefore it was recommended that these principles be separated.

Another submitter stated that "integrity" and "good conduct" should be paired together.

Another submitter stated that the client first principle is the most important principle "without a doubt".

Integrity is difficult to measure

One submitter stated that the word "integrity" is a vague assertion conveying no meaning between people with differing definitions of absolute morality. It was submitted that the word "integrity" be defined or replaced with the words "fair and reasonable".

Two submitters stated that although the principles are appropriate, integrity is difficult to measure.

Employed AFAs

One submitter stated that the obligation to place the client's interests first may require an AFA to give advice on every product in the market which would require AFAs to adviser on competitor's products. It was submitted that no AFA has the capability to have in-depth knowledge of every product in the market place. Therefore the submitter pointed out that placing the interests of the client first could be against the employer's interests or the AFA's interest. For example the bank sets credit criteria to inform credit advice, and the outcome of the adviser's analysis of the customer's ability to repay a loan may not correlate with the customer's interpretation of the AFA putting them first. It was suggested that an objective test is needed in the Code.

NZX Advisors

It was submitted that under the NZX rules NZX Advisors are already required to act at all times with honesty, integrity and fairness (rule 8.1) and are required at all times to place the interests of their clients above their own interests (rule 9.1(d)). Therefore it was submitted that standard 1 should not apply to NZX Advisors.

Independence, objectivity and managing conflicts of interest

One submitter stated that they agreed with the principle: independence, objectivity and managing conflicts of interest.

Another submitter strongly supported the principle of independence, objectivity and managing conflicts of interest and noted that this is a fundamental part of the NZICA Code. It was pointed out

that NZICA members are required to be fair, impartial, and intellectually honest and must not allow prejudice or bias, conflict of interest or influence of others to override objectivity in all circumstances. However it was noted that under the NZICA code, independence is a stronger concept and is essential for the types of work NZICA members perform. That submitter agreed that there should be stringent requirements for AFAs claiming to be independent.

One submitter stated that the ethical behaviour principles have been captured well except for the “independence” concept. It was submitted that independence is not about a business model or remuneration structure but is about individual character and managing consumer interactions. It was submitted that receipt of commission does not affect ethical behaviour or ability to manage client advice and relationships. It was submitted that the appropriate ethical behaviour principles should be:

- placing the client’s interests first and acting with integrity;
- objectivity of advice, and managing conflicts of interest; and
- good conduct.

One submitter stated that those who can rightly use the word “independent” to describe their ability to provide advice is an entirely separate matter to ethical behaviour.

One submitter stated that the principles are appropriate but it will be difficult to provide independent advice when advisers operate on a commission basis. That submitter stated that there is too much emphasis on independence and objectivity in the ethical behaviour principles rather than appropriateness and reasonableness of advice.

One submitter suggested that the principles of objectivity and independence did not add anything to the other principles, and should therefore be omitted.

One submitter argued that the standards needed to be modified to move the emphasis away from independence and objectivity towards demonstrating integrity and managing conflicts of interest, because independence – as defined – is an unrealistic aspiration. It was noted that a large proportion of current advice delivery arrangements would not comply with the proposed definition of “independent.”

One submitter endorsed the concepts of putting the client first, integrity and management of conflicts of interest, but questioned how the concepts of independence and objectivity added anything and suggested that they should be abandoned (or at least an exception made for NZX-regulated advisers). It was suggested that no adviser, at least in the share broking industry, could qualify as fully independent, and that the term should therefore be abandoned and prohibited from being used.

One submitter stated that the principles of “independence” and “objectivity” are good but not useful/appropriate to use as standards. It was queried: When an adviser asserts their advice is independent and objective, what do they mean? Independent of what? Objective in relation to what? The submitter stated that a better principle may be “impartial” meaning unprejudiced, unbiased, just, equitable and complete.

One submitter stated that the skill in providing financial advice is to match the clients facts (personal situation, objectives, risk profile, time horizon etc) to subjective practical solutions. They submitted that investment markets are naturally emotive and good advice is coloured by the benefit of knowledge, skill and especially experience and that this is what clients are paying for.

One submitter suggested that the concept of “independence” is virtually meaningless because virtually no advisers would comply with it.

One submitter accepted that independence may not always be possible and that managing any conflict of interests and placing appropriate safeguards would be an appropriate way to protect clients. However they stated that the duty to place the client first, be objective and act with integrity should not be waived.

One submitter stated that independence is not necessarily required for an AFA to be ethical.

One submitter suggested that “independence” was very difficult to define, and should be removed in favour of terms like “non-aligned” and requiring clear disclosure of conflicts of interest.

Another submitter suggested that, given the difficulty in achieving “independence” as it is proposed to be defined, it is better to define the concept as being free from conflicts of interest.

One submitter suggested that more guidance is required on the meaning of independence and objectivity, taking account of the difference between investment advisers and insurance advisers. That submitter stated that the obsession with the concept of “independence” was misplaced, and that care, integrity, trust, enthusiasm and knowledge were more important to the adviser/client relationship.

One submitter argued that some business models that are sub-optimal would be hidden by the “independence” tag. It was submitted that some business models may satisfy the “independence” test” but may have insufficient qualifications and processes to undertake their role.

One submitter stated that they did not think that independence was an appropriate principle on which to base the Code, because links with other service providers (including other advisers and other professions like accountants and lawyers) are an important part of delivering effective advice.

One submitter suggested that independence was an inappropriate principle, because most advisers were not independent but this does not mean that they are not ethical.

Another submitter sought clarification as to what “independence” was, because it was an unclear concept.

One submitter endorsed the principles generally, but suggested that the concept of “independence” was fraught with interpretative difficulties. It suggested that advisers state whether or not they were “aligned” instead.

Another submitter suggested deleting the term “independence”.

Focus on independence is inappropriate and transparency/disclosure is more appropriate

One submitter stated that “independence” is difficult to understand and that provided that disclosure is clearly given that should be sufficient.

Three submitters stated that regardless of how advisers are recompensed it would appear to be very difficult to demonstrate complete “independence”, however this could be mitigated by comprehensive full disclosure of all conflicts of interest.

One submitter felt that “independence” is not realistic as all business models have some sort of conflict of interest. It was submitted that the best way to manage this is open disclosure of conflicts and payments.

One submitter suggested that while “objectivity” was a desirable aim, the concept of “independence” was unhelpful because advisers will always be subject to a number of potential conflicts. The submitter pointed out that all advisers will be somehow constrained in the products they can offer, and that disclosure represents a more appropriate safeguard.

One submitter suggested that the concept of “independence” was so slippery and hard to define that it should be removed from the Code, and furthermore should be banned from use by advisers because it is usually used misleadingly. That submitter suggested that full, proper and clear disclosure should be explicitly stated in the Code as the foundation of trust.

Another submitter agreed that communicating a lack of independence is important. However it was submitted that including “independence” as an ethical standard perhaps implies that an AFA who is not independent is not ethical. That submitter stated that they presumed this was unintended and that the focus of the Code should instead be on the disclosure of lack of independence.

One submitter stated that full disclosure of potential conflicts was the best way of protecting the consumer.

Three submitters stated that “independence” will be difficult for AFAs to achieve but that this can be mitigated by full disclosure of all conflicts. It was submitted that this is the standard required under the Securities Markets Act 1988 but that this could be strengthened with further appropriate conflict of interests management.

Four submitters suggested that the term “independent” was misleading, because most advisers would have some associations – and that full disclosure was a more appropriate benchmark. Another submitter suggested that “independence” will be difficult to achieve, and that full disclosure is more important.

One submitter noted that disclosure of the adviser’s position was important, but that the fluid concept of “independence” might not be the best way to express it.

One submitter stated that the Code should place less emphasis on achieving independence and focus more on achieving transparency.

One submitter stated that the ethical principles are generally appropriate but the independence standards are unsuitable and clients will be better served by an emphasis on full and frank disclosure.

Two submitters stated that the ethical principle for all AFAs of “independence, objectivity of advice and managing conflicts of interest” should be changed to “transparency and communication as to independence of advice and the management of conflicts of interest”.

One submitter stated that the Code should focus on communicating the extent of alignment or conflicts of interest rather than on achieving independence, which the submitter considered would be rarely achieved.

One submitter suggested that “independence” be replaced with “transparency”, including a requirement that the adviser explain the approach s/he takes to designing a client portfolio.

One submitter stated that the principles are appropriate but that the standards should accommodate the fact that most AFAs will not be independent and it should promote a robust and comprehensive disclosure regime.

One submitter stated that the Code should define “independence” and “objectivity” and place the onus on individuals claiming to be either or both to state this in their disclosure statement. That submitter also suggested that AFAs should be required to disclose, the ways in which they fall outside the definitions of “independence” and “objectivity”.

Another submitter stated that the proposed principle of “independence” should be refocused. They submitted that it should not focus on achieving independence as this may never be possible for AFAs who are employed by FSPs and that therefore the focus should be on transparency. That submitter stated that transparency would underpin the disclosure obligations proposed in the minimum standards. They submitted that achieving “independence” is unnecessary as that concept is sufficiently addressed by the principle of client first and integrity.

One submitter stated that the areas of concern surrounding independence are:

- where the financial adviser is either tied or has a quota arrangement to only use a limited set of financial products;
- where the adviser’s product choice is potentially influenced by the payment of higher commissions, or hidden bonuses, for criteria of volume or loyalty;
- where there is no clear, documented connection (financial plan) between the client’s needs and the investment solutions recommended;
- where advisers fail to provide an ongoing advice service to their clients to ensure that their clients’ changing circumstances are taken into consideration and the client is kept informed of changes in their investment and the investing environment.

One submitter stated that these concerns will not be solved by imposing the “independence” standards as the approach is too technical and is unlikely to raise the quality of advice. The submitter was doubtful as to whether any advisers would meet this standard. That submitter suggested that “independence” be replaced with one of transparency and a requirement for AFAs to explain the approach they take to designing, selecting and managing client portfolios. The adviser would need to disclose:

- any arrangement that might constrain their freedom of choice with regard to investment products (quotas, tied arrangements etc);
- any remuneration received from financial product providers (commissions, bonuses etc);
- their approach to designing, selecting and managing client portfolios including:
 - use of an investment panel for making investment and portfolio decisions;
 - the basis on which they have chosen or partnered with other specialists to perform the investment and portfolio functions; or
 - any other arrangement they have chosen to implement client portfolios.

One submitter suggested that using a restrictively-defined concept of “independence” was not useful, and full disclosure of potential conflicts should be preferred.

Another submitter suggested that the Committee was expending too much energy trying to define the concept of “independence” instead of relying on disclosure.

Objectivity

Two submitters suggested that although the principles are appropriate, objectivity is difficult to measure.

One submitter stated that objectivity “can always be argued against”. He stated that objectivity is open to “significant interpretation” ie some advisers prefer property, some prefer government bonds.

Another submitter stated that he is happy for the term “objective” to be part of the ethical behaviour principles.

One submitter stated that the imposition of “independence” as defined in the proposed standards will not correlate with a higher level of objectivity. They state that the best measure of objectivity is that the adviser has a clear understanding of the client’s needs and is able to document a clear connection between these needs and the investments recommended.

One submitter questioned whether an adviser’s business relationships necessarily compromised his or her objectivity, and suggested that the need for objectivity be dealt with as part of the suitability analysis.

Another submitter suggested that “objectivity” should not be defined solely by reference to remuneration, and submitted that the worst examples of poor advice recently have come from the financial planning community and that these advisers generally uses a fee-based model.

Conflicts of interest

One submitter strongly urged the Committee to place the avoidance of conflicts of interest at the heart of the Code. They stated that the Code cannot succeed in restoring public confidence unless it deals with this fundamental issue: that financial advisers must avoid real or perceived conflicts of interest, and that this should include conflicts which arise due to the type of remuneration.

That submitter stated that “managing conflicts of interest” contradicts the client first principle and that the principle should be to avoid conflicts of interests wherever possible. It was submitted that the idea that “disclosure” can offset the negative impact of conflicts of interest had been rejected by the Australian Securities and Investments Commission and Ripoll report as failing to provide adequate protection for consumers. The submitter referred to a comment made by ASIC where they noted that achieving adequate disclosure where there are complex remuneration structures can be very difficult. It was also noted that the emphasis on disclosure in Australia has led to a risk adverse approach where disclosure had been so lengthy that it was not comprehensible to the average consumer. It was submitted that some Australian consumer organisations have suggested that disclosing conflicts can perversely increase consumer confidence in the advice rather than act as a warning on the quality of the advice.

One submitter stated that AFAs have a fiduciary duty to their client and this requires AFAs to avoid conflicts of interest and as a result third party payments are unacceptable. It was submitted that the main obligation should be to avoid a conflict and disclosure should not be considered sufficient if the conflict can in fact be avoided.

Another submitter stated that once an adviser is not independent, conflicts of interest issues are not as relevant. The submitter queried: if an adviser is receiving payment from a third party, and is acknowledged by the client as not independent, is a conflict still present?

One submitter stated that full adviser disclosure is important particularly for conflicts of interest.

One submitter stated that the issue of conflicts of interest, particularly pertaining to the use of confidential client information, should be dealt with in its own standard.

AFAs who sell a limited range of products ie employed AFAs

One submitter stated that most advisers would not be able to demonstrate complete independence and it would be impossible for QFE employees to be independent. They suggested that “independence” be reviewed to recognise the limitations of its meaning in the advisory context. That submitter stated that the solution should be that advisers fully disclose and manage conflicts of interest and an overriding standard could be written to reflect this. The submitter re-iterated the importance of uncomplicated disclosure provisions for customers.

One submitter stated that the principles of “independence” and “objectivity” are easy to define but not easy to meet or measure. It was submitted that in practice, financial advisers in employment are subject to the broad guidelines of their employer (the universe of financial products and instruments needs to be reduced to a reasonable level acceptable to the company and within their expertise). Individual advisers remain influenced by core or guiding principles so there is continuity across the advice of a team of advisers within a company. They stated that advisers are also limited by the support of technology systems and platforms of their employers and they are also dependent on some form of remuneration.

One submitter suggested that requiring an adviser to consider the full “universe” of products for every client (instead of an approved product list), and preventing them from using a platform, in order to qualify as “independent” was unrealistic. It was submitted that there is value in having approved product lists compiled on the basis of research, and that this does not necessarily compromise an adviser’s independence. That submitter suggested that a better approach was to require an adviser to be *objective*, and to disclose any factors that might impair their objectivity. They stated that this would avoid constraining advisers from adopting appropriate business models.

One submitter suggested that establishing independence is difficult as an adviser for KiwiSaver will promote their own product rather than another provider’s product. That submitter stated that the transparency between independence and managing conflicts of interest is of the utmost importance where KiwiSaver is involved. It was stated that consumers would be well aware that a KiwiSaver provider is unlikely to promote another provider’s product. It was also observed that it would be ambitious to expect an adviser to understand the whole KiwiSaver market and then market another provider’s product under their own business name or to understand the client 100% particularly where the client does not reveal all information.

One submitter stated that financial advisers should adopt the opposite business model from the one of “independence” advocated in the consultation paper. They submit that all AFAs should establish themselves a network of professionals with whom they work ie accountants, tax experts, lawyers and investment managers. They submitted that this enables the adviser to establish a deep understanding of the solution most appropriate for their client’s needs. They stated that generally advisers will have a preferred solution set they use often and it was submitted that imposing independence requirements on advisers will undermine these valuable networks effectively leaving advisers solely to their own resources. It was submitted that this preferred solution set allows advisers to focus more on the client’s needs.

That submitter went on to say that the independence standards will create significant research burdens for advisers which will reduce the time they have to understand the client's needs. It was submitted that advisers that give recommendations on a limitless range of products will not have the capacity to service their client's needs in a high quality way.

That submitter also suggested that it was unrealistic to expect an adviser to be able to advise on a limitless range of products, and that specialisation and in-depth knowledge was necessary and beneficial. It was stated that advisers should disclose: any arrangements with providers that might constrain their freedom to advise; all their sources of remuneration; and what approach they take in designing portfolios.

One submitter stated that the principles proposed are sound ethical behaviour principles but they doubt that AFAs will ever be truly "independent" and "objective" and doubt that the interests of the client will always be placed first. They stated that this is because some bank-employed advisers have an approved list of products to work from, depending on the risk rating of the product and the profile of the customer. It was stated that no bank-employed adviser has a full suite of products. That submitter stated that this would be the case with most if not all financial institutions and most individual advisers. They pointed out that this compromises "independence" and "objectivity".

That submitter stated that financial advisers or their employer commonly receive a commission or other benefit from the sale of a product or they are exclusively tied to a particular issuer or group of issuers that promote a product on a platform (ie joint venture products).

Good Conduct

One submitter supported the sentiment behind the principle of good conduct but expressed concerns that the term may be open to interpretation as "good" is nebulous and potentially a weak term. Something may be "good" but not necessarily right or appropriate. Therefore it was submitted that a different term be used for this principle ie "professional conduct".

One submitter questioned whether good conduct is an ethical principle – they submitted that good conduct is rather the result of following ethical principles. That submitter stated that "doing no harm" be introduced instead.

Additional principles

One submitter stated that professionalism should be added to the list of ethical principles.

One submitter stated that the ethical behaviour principles are clearly important to ensuring that retail clients receive good advice. However, having well-informed and educated advisers who can advise on a wide group of diversified asset classes is also critical. It was submitted that an adviser could meet all the ethical principles but not provide good advice due to a lack of knowledge or research.

One submitter stated that these principles were only a subset of six internationally-recognised principles: client first, integrity, objectivity, fairness, professionalism, competence, confidentiality and diligence. The submitter suggested that recognising the full range of principles would allow for a less prescriptive approach in other parts of the Code.

Fiduciary obligations

One submitter stated that the principles are derived from equitable fiduciary obligations without actually being fiduciary obligations. It was suggested that it would be clearer if actual fiduciary obligations were adopted and the principles should mirror those obligations. They submitted that to create a separate, albeit similar, set of principles or codifying fiduciary duties is fraught with problems (the submitter referred to loss of precedent value).

That submitter, however, stated that if the Code Committee intends to “codify” fiduciary obligations for financial advisers, more comprehensive rules should be adopted and the legislation should be amended to clarify that advisers are not subject to fiduciary obligations.

That submitter stated that advisers will be subject to three different sets of obligations:

- equitable fiduciary obligations;
- statutory duties to exercise reasonable care under the FAA; and
- codified hybrid duties to place client interests first and act with integrity under the Code.

That submitter also stated that there are too many standards and the standards should be simplified to avoid confusion. They stated that AFAs should be required to comply with:

- statutory duties under the FAA to take reasonable care – applicable to all advisers; and
- fiduciary obligations (either codified or equitable) which are applicable only to those advisers that are considered fiduciaries (ie financial planners and “independent advisers” but should exclude sales agents and non-independent advisers).

That submitter suggested that there must be some ultra-vires regarding the Code’s proposed standards and the submitter suggested that they exceed the statutory obligations.

Another submitter suggested that in addition to these principles, advisers should be regarded as being in a fiduciary relationship with their client.

PRINCIPLES OF CLIENT CARE

QUESTION TWO: Are the client care principles (professionalism; capability and capacity; effective communication; effective dispute resolution; compliance and custody) appropriate ones to base client care standards on? If not, what would be the appropriate principles?

SUMMARY

Submitters were generally in favour of the proposed client care principles, subject to a number of reservations. Several stressed the importance of ensuring that the principles are clear and easy to understand, while others noted that the last two principles were more accurately described as headings for prescriptive requirements.

Several submitters were concerned about how the principles would be implemented, and in particular sought clarity on how advisers would be measured against the principles. Some submitters stressed that the application of the principles should take into account the particular type of client. It was also submitted that both NZX Advisors and lawyers should be exempt.

The principle of professionalism was endorsed, and it was suggested that this would require good product knowledge. It was suggested that the requirements of professionalism should be graded according to the needs of the client.

Concerns were expressed about how the suitability standards would be implemented, and whether it would prove unnecessarily onerous for advisers and clients. This is more fully discussed in Question 21.

Although the capability and capacity requirements were generally endorsed, clarification and specificity was sought. Likewise, although the requirement for effective communication was endorsed, a number of submitters expressed concern at its application. The requirement for advice to be in writing was particularly mentioned (and is discussed further in relation to Question 26). Several submitters had suggestions as to what “effective” communication constituted.

Several additional principles were suggested, including: consistency of dealing; training obligations; sufficient resourcing and client satisfaction.

INDIVIDUAL SUBMISSIONS

General responses

Twenty-two submitters expressed support for the seven client care principles and stated that these principles would establish a solid basis from which to improve the level of client care.

One submitter suggested the following client care (and ethical) principles instead, suggesting that the Code should be framed as a set of principles supplemented with guidance notes: tailoring to the consumer; consumer interest; compliance; remuneration; professionalism; objectivity; competence; continuing professional development; responsibility for actions; conflicts of interest; scope of service; and suitability of service.

One submitter invited the Code Committee to view the standards on www.cluinstitute.ca which provide a perspective on risk and insurance advisers.

Another submitter suggested that suitability and effective dispute resolution were the key principles, and that the rest were too vague.

One submitter largely agreed, although it was noted that the last two were not so much principles as “headings for sets of prescriptive requirements.”

One submitter stated that it could be argued that some of the terms are not really principles but nevertheless strongly supported the sentiment behind them. It was submitted that quality performance (ie performing work with due care and diligence to the best of their ability and in a timely manner), professional behaviour (ie respecting the confidentiality of information acquired and conducting oneself in a courteous and considerate manner) should be the minimum standards expected of an AFA.

Another submitter agreed that the principles are appropriate but suggested that these should not be complicated so that the client can easily understand them.

Another submitter agreed that the client care principles are appropriate. It was submitted that there needs to be clear definitions but that the client care principles must not be too onerous for the client or adviser.

Implementation

One submitter stated that the principles are fair and seem obvious. However that submitter was concerned with how the principles will be measured. She queried whether there will be exact definitions for these principles and she expressed concern about how this will be measured to achieve the desired outcome.

Three submitters stated that they have no issue with the principles but have concerns regarding how AFAs will be measured against these. For example “communication” which requires that all financial advice and recommendations must be communicated in writing would be inappropriate in some circumstances and would also add unnecessarily to the cost of compliance.

One submitter stated that in principle the client care principles are ones which they expect their advisers to adhere to. However the extent to which the AFAs are required to abide by these principles depends on the needs of the particular client.

That submitter suggested that client care principles need to be client focussed and not focussed on the organisation of the adviser or the adviser themselves. They stated that all AFAs should be guided by the principles but the extent to which they have mandatory minimum standards to follow should depend on the needs of the particular client: eg the reliance of “retail” clients receiving a financial planning service is higher than “wholesale” clients receiving financial advice.

One submitter agreed that the principles are appropriate but argue that they should not be applied to lawyers.

One submitter agreed that the principles are appropriate but that NZX Advisors are already subject to similar standards under the NZX Rules. It was submitted that NZX Advisors are required at all times to act with due care, diligence and efficiency and operate under a dispute resolution scheme

operated by the NZX (NZX Rules 8.1.1(a) and 17.2). It was submitted that when providing advice to clients, NZX members are required to maintain the standards of objectivity and professionalism at all times (rule 9.1(c)). Therefore it was stated that the standards are unnecessary.

Professionalism

One submitter stated that professionalism should be a priority at all times.

Another submitter suggested that in setting the standards of professionalism regard should be had to the circumstances and the service/s being offered to avoid imposing unrealistic obligations.

One submitter stated that professionalism can be defined as adherence to ethical behaviour principles. It was submitted that this should include the obligation to be well-informed about a wide range of products and services.

Suitability

One submitter stated that the intent of the suitability provision is accepted and appropriate. However it was stated that it is not totally clear what is expected by a suitability analysis or at what stage the suitability analysis should be used. It was submitted that “suitability” means testing whether a recommendation given is a good recommendation. It was submitted that proposed standard 11 suggests that this analysis must be done “before providing any financial adviser services” which is illogical and unworkable. It was also stated that prior to engaging with the client and conducting data gathering and then analysis it is not possible to determine what advice or product may be chosen. Therefore the suitability analysis cannot be undertaken until the adviser is nearly two thirds through a comprehensive advice process.

One submitter suggested that the suitability requirement be limited to the information available to the AFA and the scope of the activity for which they have been retained.

Another submitter stressed that the suitability issue needed to be adequately addressed at the outset, and argued that doing so can pre-empt misunderstandings later on.

One submitter stated that while the suitability standards may be appropriate for investment advisers, the suitability standards will be of great concern to both the life and general insurance sectors and to other non-investment areas too.

One submitter preferred the concept of “competence” to “suitability.”

One submitter stated that a needs analysis approach is recommended and that a client could waive this approach if it is explained to the client.

One submitter argued that in assessing suitability the position (and sometimes vulnerability) of older people needs to be considered.

Another submitter referred to PAA’s Code of Ethics (canons 1 and 2) on client “advocacy” and “diligence”:

Advocacy – Endeavour to provide advice and service which are in the client’s best interest
Rules:

- 1.1 A member possessing a specific body of knowledge which is not possessed by the general public has an obligation to use that knowledge for the benefit of the client and to avoid taking advantage of that knowledge to the detriment of the client.
- 1.2 In a conflict of interest situation, the interest of the client must be paramount.

Diligence – Provide ongoing professional advice and service to clients

Rules

- 2.1 The member must make a conscious effort to ascertain and understand all relevant circumstances surrounding the client.
- 2.2 Advice and service is to be competent and ongoing to best match the client's changing circumstances.
- 2.3 Remain informed of economic and legislative changes which relate to the client-member relationship.
- 2.4 In the making of oral or written recommendations to clients, a member shall:
 - distinguish clearly between fact and opinion.
 - Base recommendations on sound professional evaluation of the client's needs; and
 - Support recommendations with appropriate research and adequate documentation of the facts.

One submitter suggested that the requirement for a suitability analysis is inappropriate for the share broking business, and would be likely to annoy customers who demanded particular financial products and were told by their share broker that a costly suitability analysis would have to be undertaken first. This would be particularly true of sophisticated investors who simply used AFAs to undertake the transactions themselves.

Capability and capacity

One submitter stated that this would be ideally linked to the principle of professionalism.

Another submitter rejected the inclusion of "capability," because it was the same as competence.

One submitter suggested that the concept of "capability and capacity" needed to expressly include good practice management, including record-keeping and appropriate professional indemnity insurance.

One submitter agreed that the principles are generally appropriate. However it was submitted that the capability and capacity principle requiring AFAs to "identify, implement and review appropriate client care processes and controls" is vague.

Effective dispute resolution

One submitter stated that internal dispute resolution processes must be communicated to all clients as well as options for external dispute resolution. It was stated that the complaints investigation facilities of the Securities Commission should also be stated in the advisers' disclosure statement.

Effective communication

One submitter agreed that all information and advice should be confirmed in writing to the client. It was also submitted that there may be some instances of telephone contact which should be noted on the client's file. They submitted that all primary advice should be communicated in writing,

ongoing advice would need to be communicated in writing unless not practical in certain circumstances – however notes should be kept of ongoing advice.

One submitter suggested that the principle of effective communication could be expanded to require communication in a timely fashion.

Another submitter suggested that AFAs should not be held liable because certain clients have difficulty understanding complex financial information, no matter how clearly it is set out. That submitter also suggested that when information is required to be communicated it should be sufficient to refer the client to a website, and suggested that terms such as “prominent” should be defined.

One submitter stated that in some instances transactions need to be auctioned quickly ie currency conversions or sales of securities and verbal instructions must be adequate in these circumstances.

One submitter argued that if full disclosure is made, the client will already be aware of any restrictive relationships or remuneration and is thus in a position to decide for themselves how to proceed.

One submitter agreed that financial advice should be confirmed in writing and communicated clearly wherever possible and that this would avoid any ambiguity of instructions and service provided.

One submitter suggested that the requirement to provide advice in writing could be impractical as securing on-market transactions often required speed. The submitter stated that the requirement would ultimately become a meaningless compliance cost, because firms would simply obtain written waivers from every client.

One submitter stated that with regard to effective communication, the enforcement of this particular principle may need to be tempered by prescribed text from MED regarding disclosure. It was stated that effective communication must mean plain language and that communication should, without exception, be in writing. It was stated that part of effective communication is allowing time for consideration and consultation before financial decisions are made. It was also noted that informing clients of procedures for dealing with disputes and redress must also be part of effective communication.

One submitter stated that she is in general agreement with these principles. However she queried how far the Code will require advisers to go: for instance, communication could require compulsory written advice/information in all instances which could be costly for the client. It was acknowledged that written communication reduces risk in all areas, however some clients do not require it and the full range of clients and situations cannot be put into one basket.

One submitter stated that the level of disclosure (full and thorough documentation of the process, including information, advice, suitability analysis and any waivers or disclaimers subsequently required) should be set at a high level. It was submitted that such a structured process, particularly for more complex category 1 products, is essential to meeting the objectives of the Act.

Custody

One submitter noted that the custody concept arguably overlays with the legislative requirements of the Privacy Act 1993.

Additional principles

One submitter stated that additional principles could include consistency in how AFAs deal with all clients, their approach, the integrity of the analysis, review periods and disclosure.

Another submitter suggested that notwithstanding standard 17 and the separate rules on competence and training, it would be useful to record training obligations as a specific duty or principle. For instance it was submitted that an adviser should only provide advice in areas where they are qualified and competent; all advice should be properly researched; training must be current and up-to-date at the time of giving advice and the adviser must have proper resources available to provide that advice ie market data.

One submitter stated that one element that is missing from the Code is the ability to deliver sound advice in the interests of consumers. They also submitted that another standard that should be included is simplicity in the advice process which should be part of effective communication.

One submitter stressed that qualifications and skill were not all that was required, and the Code should also require advisers to be appropriately resourced with good research backup.

Another submitter suggested the addition of “client satisfaction” as a principle.

ETHICAL BEHAVIOUR STANDARDS

QUESTION THREE: Do you think the proposed over-arching ethical standard (proposed standard 1) is appropriate? Should it apply to all AFAs?

Proposed standard 1: AFAs must place the interests of the client first and act with integrity

In providing financial adviser services, an AFA must:

- (a) place the interests of his or her client first; and
- (b) therefore, not place the AFA's own interests, or the interests of any third parties (including those of any employer), ahead of the interests of his or her client; and
- (c) act with integrity.

SUMMARY OF COMMENTS ON STANDARD ONE

The majority of submitters supported the over-arching ethical behaviour standard (standard 1).

However concerns were expressed regarding how receipt of commission would be dealt with and also possible legal liability where third parties' interests have been harmed by the AFA placing the client's interests first.

Several submitters raised the issue of whether fiduciary duties should be imposed on AFAs instead of the concepts of client first and integrity.

Who should the standard apply to?

Most submitters stated that the standard should apply to all AFAs.

Some submitters suggested that several groups should not be required to comply with this standard:

- Lawyers – as these concepts are covered in the Lawyers and Conveyancers Act (Lawyers Conduct and Client Care) Rules 2008;
- AFAs who solely provide financial adviser services to wholesale customers;
- AFAs employed by FSPs and QFEs;
- Research and transaction-only AFAs; and
- NZX Advisors.

In relation to AFAs employed by FSPs and QFEs, it was submitted that this standard would require AFAs to advise on all products on the market and may require an employed AFA to recommend a competitor's product. It was suggested that a proviso be added to standard 1 stating that an AFA can still put the client first and act with integrity even though they are advising on a limited product range providing the disclosure requirements set out in the Code are satisfied.

Several submissions also suggested that standard 1 should apply differently according to the financial adviser services being provided.

INDIVIDUAL SUBMISSIONS

Twenty-eight submitters supported the over-arching ethical behaviour standard and eighteen submitters stated that the standard should apply to all AFAs.

One submitter stated that standard 1 should apply not only to AFAs who deal with category 1 products but also to AFAs who only deal with category 2 products.

Another submitter stated that this standard underpins the proposed client care principles of professionalism, suitability and capacity and capability. It was submitted that the only third party that may take issue with this standard is an AFA's insurer. They stated that this will depend on the nature and manner of the insurance and the process for dealing with complaints and/or claims in place as a result.

One submitter stated that placing the client's interests first is paramount together with integrity and objectivity. It was submitted that objectivity is an over-arching principle of equal importance to integrity and client first. It was also submitted that this principle should apply to all AFAs including those providing financial adviser services to wholesale FSPs.

One submitter stated that it is appropriate but there could be conflicts when staff receive commissions. That submitter also raised concerns regarding the legal liability when AFAs endeavour to meet standard 1. It was stated that an unintended consequence of meeting this standard could be the threat of legal action over conflicts that could arise. They submitted that there needs to be statutory protection from action from parties other than the consumer and that this standard should be reviewed.

One submitter suggested that this is the precise standard that financial advisers should strive to meet, but that the Code should not try to define what constitutes "ethical" behaviour.

Another submitter suggested that employers should have a binding obligation to support their employees' fulfilment of standards.

Suggested alterations to the standard

One submitter stated that the standard should be amended to read "AFAs must act solely in the interests of the client and with integrity at all times". It was submitted that this should apply to all AFAs without exception.

One submitter stated that sub-paragraph (b) (*"not placing the AFA's own interests, or the interests of any third parties (including those of any employer), ahead of the interests of his or her client"*) should be omitted as it is tautologous to sub-paragraph (a).

One submitter suggested that sub-paragraphs (a) ("place the interests of his or her client first") and (c) ("act with integrity") need to be "fleshed out".

Another submitter stated that the standard is not necessarily appropriate as it does not mention the statutory obligations in s 33 (AFAs must use care, diligence and skill) and s 34 (AFAs must not engage in misleading, or deceptive conduct) of the FAA. It was submitted that these should be included in the Code. That submitter queried how the ss 33 and 34 duties compare to the duties in the proposed standards.

One submitter stated that the standard should be separated into:

- placing the client’s interests first; and
- integrity.

That submitter also stated that this standard should apply to all AFAs.

One submitter stated that the “client first” and “integrity” concepts are really two principles, and that they should be separated.

Another submitter stated that they did not support the standard as it failed to take account of the constraints on the client first requirement, and failed to recognise that sometimes clients would have to be placed on an equal footing, not be given precedence. It was also noted that the promotion of the client’s interests would be subject to the restrictions imposed by the client, the time able to be expended on the client and the fee the client is willing to pay.

That submitter also suggested that an adviser be accorded statutory protection or indemnity against claims by third parties who have been prejudiced by the adviser placing the interests of clients first.

One submitter expressed concerns regarding standard 1 and the reference to “any” employer, when considering section 10 of the Life Insurance Amendment Act 1977 and the impact of QFEs especially bank employees giving financial advice. It was submitted that if this remains, major changes will be required for all insurers to alter their contractual arrangements with financial advisers.

One submitter suggested that standard 1 is missing an “external objectivity test” and proposed the following amended standard:

In providing financial adviser services, an AFA must:

- a) Act with integrity and be able to demonstrate consistency in their actions, values, principles and motivations for their services provided;
- b) Place the interests of their clients first and therefore not place the AFA’s own interests, or the interests of any third parties (including those of any employer), ahead of the interests of their client; and
- c) Exercise prudent judgement, ensuring that the circumstances must be weighed to determine the correct action and would withstand a reasonable person test.

Fiduciary relationship

One submitter suggested that there was merit in aligning New Zealand’s approach with Australia’s approach. The submitter referred to the Ripoll Report which recommended that AFAs be subject to a fiduciary duty to their clients.

Another submitter suggested that the meaning of “priority of client interests” had an unclear scope, unlike the well-established concept of a fiduciary relationship. They suggested that part of the “priority of client interests” analysis required taking account of the fact that the parties have a business relationship, and the client’s ability to pay the fees.

One submitter suggested that proposed standard 1 was suitable, and should apply to all AFAs with the qualification that the adviser’s obligation to place the client’s interests first must be judged in the business context – so, for example, the principle would not extend so far as to require an adviser to give advice for free.

One submitter generally endorsed the standard, but suggested that a degree of commercial pragmatism – in light of the fact that the adviser is under no obligation to provide the advice – was

necessary. For example, a client would be better off with a lower fee, but the adviser should not be obliged to charge lower fees.

Groups of AFAs that the standard should not apply to

One submitter agreed that the standard is appropriate but stated that the Committee should take care that the standard is suitable for the wide range of AFAs.

One submitter suggested that standard 1 should apply to all AFAs involved in providing investment advice, including employees.

Lawyers and employees of lawyers

One submitter stated that the over-arching standard should apply to all AFAs except lawyers and employees of lawyers.

AFAs serving wholesale customers only

Two submitters stated that standard 1 is appropriate but it suggested that it should not apply to AFAs who provide advice solely to wholesale clients.

Another submitter stated that the application of this standard should differ depending on what type of client is being served:

- where a “retail” customer is being provided a financial planning service then their interests should be placed first;
- but where the client is a wholesale client, there should not be a mandatory requirement for the customer’s needs to be placed first. They stated that this is justified as wholesale customers are financially literate and can avail themselves of financial and legal advice and can determine whether the advice is in their interests.

Employed AFAs

One submitter agreed that the over-arching ethical standard is appropriate except for (b) (“*not placing the AFA’s own interests, or the interests of any third parties (including those of any employer), ahead of the interests of his or her client*”) as those who are employed by a financial product provider (i.e. a KiwiSaver provider) cannot be expected to recommend a competitor’s product. Instead in this circumstance it was recommended that the adviser should be required to declare to the client that they only deal with certain products.

Another submitter expressed similar concerns and stated that standard 1 needs to include a proviso stating that AFAs are not required to advise on all products in the market. They submitted that without this proviso it is possible that the standard will be interpreted to require AFAs who are employed by a FSP to investigate and advise on products sold by competitors.

That submitter proposed that standard 1 should read as follows: “In providing financial adviser services, an AFA must:

- (a) place the interests of his or her client first; and
- (b) therefore, not place the AFA’s own interests, or the interests of any third parties (including those of any employer), ahead of the interests of his or her client; and
- (c) act with integrity.
- (d) For the avoidance of doubt, this requirement does not prevent an AFA from only advising on a limited range of products and/or acting as an AFA who is not independent, providing the AFA has complied with the disclosure requirements set out in this Code.

That submitter stated that it understood that the obligation to act in the client's best interests would not prevent AFAs from providing financial adviser services:

- if the AFAs, or connections of the AFAs, receive a financial benefit from selling the product advised on; or
- if the AFAs are limited in their ability to provide advice (for example through an employment contract that requires the AFA to only advise on products approved by his or her employer).

That submitter also referred to the Australian Securities and Investments Commission's comment that advisers "would not [be] require[d]...to provide the best advice to clients, or that every product available in the market would need to be considered".

Another submitter was concerned that AFAs who are employed or engaged by FSPs will not be able to comply as to put their client's interests first would need to:

- advise on all products in the market, including products sold by competing FSPs; and
- refer clients to competitors of FSPs if the competitors are offering better products ie higher returns or lower premiums.

That submitter suggested that the standard should say that AFAs can still put their clients' interests first even if they only advise on a limited suite of products. That submitter also noted that the Ripoll report makes a similar proposal in respect of the client first standard in Australia.

One submitter stated that generally this standard is fine but raised concerns regarding paragraph (b). That submitter queried how the responsibilities of employed AFAs will be managed. It was suggested that unless this standard is changed, there is a possibility that AFAs employed by institutions will be perceived as a higher employment risk, resulting in fewer of them being employed by institutions. However they stated that in all other respects the proposed standard is appropriate, and should apply equally to all AFAs.

One submitter questioned how the principle of placing the clients interests first will be applied and understood in relation to an AFA who is selling a particular "brand" of product. They queried whether people providing information purely about their own products can really be considered as providing "advice". It was acknowledged that some of the proposed standards (particularly aspects of the suitability standard) would appear to place obligations on AFAs who are only providing information about their own "brand" of products, but it was stated that the obligations of such AFAs need to be made much clearer.

One submitter considered that in general terms, the proposed standard is appropriate, and should apply all AFAs. However it was stated that the standard needs to reflect the nature of the adviser-client relationship and the scope of services. They referred to AFAs who are aligned or tied to a product provider and stated that at any given time, it is possible that there will be a more suitable product offered by another provider. It was submitted that if the AFA has disclosed the limitations on the range of products on which he or she is able to sell, and recommends only suitable products within that range, the AFA should not be in breach of the standard if they do not recommend that the client purchases a different product offered by another product provider.

One submitter suggested that if the "priority of client interests" principle were taken too far, then an adviser who advised on a set range of products would have to continually refer their client to another adviser. The submitter suggested that a better solution was for the adviser to disclose to the client what products s/he did and did not advise on. It was suggested that the crux of the matter was whether there was a conflict of interest, and the reference to priority of client interests should be qualified by reference to this.

However one submitter was firmly of the view that the principles should be applicable to QFE advisers providing category 1 products to counter the inherent concerns with QFE advisers only being able to promote approved products (which may not be the best available in the market.)

Research staff and transaction-only AFAs

One submitter suggested that the primacy of clients' interests was not necessarily an appropriate yardstick for some AFAs, such as backroom research staff or transaction-only advisers.

Different standard according to the service provided

One submitter suggested that there should be three different classes with varying obligations to reflect the different services, in a manner that is readily understood by the consumer:

- financial planners: who are independent and give personal advice should be subject to fiduciary obligations (codified or equitable) and the statutory obligations in the Act;
- brokers: non-fiduciary, who give general advice related to particular transactions, should only be subject to the statutory obligations in the Act;
- agents: who are non-independent and give sales advice on particular products should only be subject to the statutory obligations in the Act.

One submitter suggested that the current proposals display a bias towards financial planning advisers, and that conduct and client care standards should be tailored to different classes of AFAs, based on the clients they serve. The submitter suggested three classes:

1. Advisers dealing with wholesale/sophisticated customers (in respect of whom client care standards would not be applicable);
2. Financial planning advisers; and
3. Advisers selling specific products.

Non-independent AFAs

One submitter stated that the obligation of placing the client's interests first and presumably avoiding conflicts of interest is only functional in a proper fiduciary relationship. It was suggested that if a distinction is drawn between independent advisers and non-independent advisers, the overarching standard is probably inapplicable to non-independent advisers.

STANDARDS OF INDEPENDENCE, OBJECTIVITY AND MANAGING CONFLICTS OF INTERESTS

SUMMARY OF GENERAL COMMENTS ON THE STANDARDS AND KEY TERMS

“Independence” as expressed in proposed standards 2-4 was not seen as appropriate. The most significant objections related to the relationship between commission and “independence”. A number of submitters stated that “independence” should not be linked to commission. Some submitters stated that receipt of commission does not affect objectivity and that independence and objectivity should be de-coupled.

Most submitters stated that the most important limb of determining “independence” in key term (1) was whether or not the AFA had links to any product providers. The submitters identified the following factors as compromising “independence”:

- existence of quotas or sales goals;
- obligations to place a certain percentage of sales with one particular provider; and
- where the AFA’s firm is owned or partly owned by a product provider.

The issue of whether an AFA could be independent when the AFA only offers a limited range of products was also addressed. Some suggested that this may impinge on independence. However other submitters referred to the benefits of research that an AFA has access to when they belong to a platform.

INDIVIDUAL SUBMISSIONS

Appropriate

Three submitters stated that they supported proposed standards 2-4.

Two submitters stated that provided there are clear guidelines on the principles and how advisers are measured against them then proposed standards 2-4 are appropriate.

One submitter stated that the standards are acceptable provided they are treated separately. It was submitted that the most important concepts are disclosure and acting in the best interests of the client.

One submitter stated that high standards should be required of those who call themselves independent.

Not appropriate

One submitter rejected the proposed standards in favour of a principle-based standard focused on objectivity and appropriate management of conflicts of interest, supplemented by a guidance note. That submitter stated that they are opposed to the introduction of standards that restrict consumers’ access to advice in the guise of protecting them, or make advice more expensive. They stated that this would inevitably lead consumers to forego advice which has been shown to be a major cause of the losses suffered by investors in recent years.

One submitter disagreed, suggesting that the Committee was operating on the basis of insufficient experience with investment clients.

One submitter suggested that the proposed standards assume that the client’s interests are not being met. The submitter gave the example of an NZX Advisor who is asked to advise on the purchase of equities, who after showing the client research on a given issuer immediately has to tell the client that the research has been produced in-house, that the adviser will receive a commission,

that s/he is therefore not independent and objective, possibly that s/he is aligned, and will have to tell the client to obtain independent advice. They also suggested that it might be inappropriate to taint expensive research as biased just because the firm may earn money from the research (and because broker research is tied to a set of advisers.)

One submitter stated that the standards are not appropriate except for the standards requiring full disclosure. They argued that independence is not essential and many members successfully represent differing providers and give consumers a comprehensive and objective review of suitable products, policies and advice.

Changes to the standards generally

One submitter stated that if the “independence” principle is maintained, the Code should set out the circumstances in which it would be appropriate for an AFA to claim to be independent, and require disclosure of any limits on the range of products/services and any direct or indirect fees or other payments received. In reality, they stated that it is obvious that bank employees are not independent and banks uses branding and disclosure to ensure that they are not promoted as such.

That submitter stated that the proposal would be very difficult to comply with unless the Code contains provisos such as that the conflict of interest needs to be proven to be known to the AFA at the time the financial advisory services were performed.

Another submitter suggested that the scope of the independence principle could be strengthened by referring to the importance of clear, user-friendly and complete disclosure of remuneration and other non-remunerative incentive arrangements that may influence the extent and nature of the adviser’s independence. It was submitted that disclosure should cover not just bonuses, commissions and other direct forms of remuneration linked to products but also less direct forms of remuneration ie non-cash perks, trail commissions, step-up in commission rates tied to volume of sales of particular products. They noted that disclosure regulations may deal with this but suggested that it should be prominently referred to in the Code as well.

One submitter stated that the standards regarding independence and objectivity should be re-drafted so that:

- only AFAs who are independent can describe themselves as such; and
- AFAs who are not independent must disclose the information in proposed standard 3(a) (but are not required to state that they are “not independent or objective”).

One submitter suggested that standards 2 and 3 are redundant if full disclosure is made to clients.

One submitter suggested that standards 2 and 3 are redundant if full disclosure of potential conflicts is made and the principles in standard 1 are complied with.

Another submitter suggested that the Adviser Disclosure Statement should disclose all material relationships the adviser has and the forms of remuneration that the adviser might receive if the client accepts the advice. The adviser should be required to guide the client through the disclosure statement and give them an opportunity to withdraw from the relationship if they wish.

One submitter stressed that these standards needed to be meaningfully policed.

Objectivity

One submitter suggested that a separate and distinct standard that AFAs should always provide financial adviser services with an objective mind should be introduced.

Conflicts of interest

One submitter stated that more guidance needs to be provided on managing conflicts. They submitted the reference should be made to the Lawyers Client Care and Conduct rules.

Another submitter stated that it should be made clear that interests can be disclosed as a means of discharging any conflict without otherwise avoiding other obligations associated with providing advice, such as acting with integrity.

One submitter suggested that conflicts of interest must be disclosed so that the client is able to decide whether to accept the advice.

One submitter suggested that the presence of potential conflicts of interest did not prevent other professions from being objective, and that disclosure was only required when a real potential conflict arose. That submitter suggested that the Code and the education standards should include guidance and examples as to what conflicts exist in the industry.

Another submitter noted that compliance with standard 1 would require the adviser to demonstrate that any potential conflicts had been managed appropriately.

NZX Advisors

One submitter stated that standards 2-4 are inappropriate for the realities of an NZX Advisor who is also an AFA. It was stated that NZX Advisors will not qualify as independent as they have an association with a business, a platform or a type of product ie traded equities and debt. It was submitted that very few, if any, financial advisers will be independent meaning that retaining “independence” as a core value would create a large compliance burden. It was stated that the emphasis should be on full and frank disclosure so the client can make his or her own judgement.

The submitter stated that NZX firms are already required to have written internal conflict management procedures in place (NZX Rules 11.10.1) with regard to any conflict between the NZX firm, its employees and any client of the NZX firm and therefore no new standards are necessary. Therefore although the submitter saw the merit of the standards, they stated that the standards should not apply to NZX Advisors.

KEY TERMS

- (1) It is proposed that financial adviser services provided by an AFA will not be regarded as **independent and objective** if-
- (a) in addition to or instead of payment by the client, the AFA, or a connection of the AFA, may directly or indirectly receive a benefit from the services such as receiving commission on any financial product recommended; or
 - (b) the AFA, or a connection of the AFA, is under an obligation, or is a party to an arrangement, that in any way limits the AFA's freedom to provide the services, such as being under an obligation, or party to an arrangement, to recommend:
 - (i) a particular financial product or service; or
 - (ii) a particular type of financial product or service; or
 - (iii) a particular provider of a financial product or service; or
 - (c) for any other reason the AFA is unable to provide the financial adviser services on a fully independent basis or the services are provided on a basis that could reasonably be perceived as lacking full independence or objectivity.

General comments

One submitter supported the proposal that an AFA is not acting independently if an AFA or connection of the AFA:

- receives a direct or indirect benefit from the services, eg commission; or
- is under an obligation, or is party to an arrangement, that in any way limits the AFA's freedom to provide the services, eg an employment agreement.

One submitter pointed to the difficulties of a restrictive definition of "independent", preferring definable terms like "non-aligned" and clear definitions of what constitute potential conflicts of interest.

One submitter suggested that the client's best interests should be the focus of any definition.

Another submitter stated that the proposed definition of "independence" was "outrageous."

Another submitter suggested that "independence" was too hard to define.

One submitter stated that even if advisers "rebate" (ie credit) any commission to the client they are still subject to influence. They stated that the provisions in 2(b) and (c) allow loopholes to a prohibition on commission and should not be allowed.

One submitter stated that the word "independence" poses definitional problems and is extremely difficult to achieve. They suggested that if the "independence" concept is retained in the Code it should not be defined in a way that circumscribes an AFA's operations or implies that their advice is

unprofessional. They submitted that the real issue is disclosure of interests and sensible management of conflicts.

Three submitters stated that “independence” needs to be defined or the meaning clarified. One submitter suggested that “objective” needs to be defined.

Another submitter stated that “independent” is already used in the securities industry to mean no association with other financial services firms. It was submitted that this is standard industry practice and commonly understood term. It was suggested that requiring NZX Advisors to disclose non-independence or to state that they are aligned would cause confusion.

One submitter stated that AFAs must give priority to objective advice for the client regardless of their employment contract terms and conditions. It was argued that if objectivity and fiduciary care are the central tenets of “independence” then all AFAs must by definition be “independent”. It was also submitted that the term “independent” (although often misused) has an existing meaning in the minds of consumers and advisers alike. The submitter suggested that the Code should prohibit incorrect use of the term “independent” but that it should carry the same meaning as it currently holds in the industry. It was submitted that in the industry “independent” means “able to offer objective advice without being compelled to provide any particular solution”. It was submitted that inevitably advisers are all biased in some way even if only because of their own experience with particular suppliers. One submitter suggested that AFAs who are able to offer objective advice and begin from a position of neutrality on product solutions and disclose what bias they carry, would meet the definition of “independent” in the consumer and industry’s view.

That submitter suggested that the consultation paper implies that professionalism equals independence and that an adviser cannot be ethical unless one is independent. It was submitted that as defined there is virtually no such thing as utterly independent and objective advice. It was submitted that all financial advisers are influenced in some way ie their view on the strength of the product.

That submitter also discussed the following terms:

- aligned adviser – signifies an adviser that has a degree of independence only – but is still constrained by the products they offer.
- tied adviser – is a contractor commissioned (but not necessarily so) who is compelled to offer the products approved by their institutional supporter/relationship only.

Objectivity definition

One submitter stated that they were concerned that neither independence nor objectivity are defined. It was recommended the definition of objectivity in the Institute of Financial Advisers Code of Ethics: “Objectivity requires intellectual honesty and impartiality. It was stated that regardless of the services delivered or the capacity in which a financial adviser functions, objectivity requires financial advisers to ensure the integrity of their work, manage conflicts and exercise sound professional judgement.”

One submitter argued that objectivity could not be judged entirely by the form of the adviser’s remuneration.

Three submitters stated that independence and objectivity have separate meanings.

One submitter stated that some expansion in terms of objectivity may be required as the definition of this concept is more to do with not being influenced by personal feelings or opinions.

Quality of advice

One submitter stated that this section needs to be reconsidered and stated that it is important to distinguish between the adviser's method of remuneration and the quality of advice given to clients.

Most important aspect is disclosure of links to product providers

One submitter stressed the importance of principles that require financial advisers to identify to their clients the extent to which, if at all, they are independent of product providers. It was stated that this goes to the heart of the reputation and credibility of the financial adviser industry.

One submitter rejected the utility of references to "independence", suggesting instead that advisers disclose with whom they have contractual arrangements, whether they are obliged to place a certain amount of business with a provider, whether they have a preferred provider and so on.

One submitter suggested that the concept of "independence" in the Code was rather technical and was unlikely to address the perceived causes of poor advice (advisers restricted by quotas, advisers having a limited product selection, where there is no connection between a client's needs and the recommendation and the failure to provide ongoing advice).

One submitter suggested that the concept of "independence," as understood in the industry, was defined by whether an adviser was aligned.

One submitter suggested that independence should be judged according to whether an adviser has a contractual alignment and an obligation to place a certain amount of business with a provider.

One submitter stated that if an AFA does not have an obligation to place business with a particular company then this is sufficient to be independent.

One submitter stated that "independence" means that (1) there is no restriction in terms of product selection and (2) there is no alignment to any product provider.

One submitter questioned whether receiving a commission necessarily compromised the quality of an adviser's advice (in the same way that, for example, being tied to a single provider might).

One submitter suggested that the absence of tied arrangements, combined with full disclosure, would ensure that independent advice could be provided to clients.

Very few advisers will be "independent"

One submitter stated that it is unlikely that many advisers will be both objective and independent.

Another submitter agreed that due to this definition, very few advisers in the mortgage or insurance industry will be able to use the term independent or objective.

Four submitters stated that under this definition whilst AFAs are remunerated in any shape or form it is impossible for AFAs to achieve the status of being independent.

Two submitters suggested that there would be no truly independent advisers in New Zealand.

One submitter stated that "independence" was the subject of debate some years ago and the result was that it was impossible for anyone to call themselves independent if they received any remuneration other than a fee from the client.

Another submitter pointed out that it would preclude anyone who receives any commission from a product provider, including commission for sales of insurance products from calling themselves "independent". It would also prevent anyone who receives trail brokerage from financial products

such as personal superannuation plans, KiwiSaver plans, managed funds from calling themselves “independent”.

Discussion of Key Term (1)(a) – Direct or indirect receipt of a benefit such as receiving commission

Appropriate

One submitter stated that the behaviour and recommendations of AFAs who receive commission is affected by commission and the value of that commission.

One submitter stated that advisers should only be permitted to call themselves independent if they charge fees only and do not receive any reward or remuneration from the product provider.

Another submitter stated that they believed that commissions create an inherent risk that advice will not be based on what is best for the client, but did not believe that the concept of “independence” was useful or easy to understand.

One submitter stated that they were concerned that mandatory disclosure of commissions could be misleading, because advisers may have to disclose commissions when banks did not. This would suggest to a lay client that the adviser’s advice was less impartial, when in fact the bank’s advice would be far less impartial because the bank would be pushing the products of the provider with whom it had arrangements (even if it was technically not receiving a commission). The definition of commission should include payments the banks receive even if it was technically not commission ie profit sharing arrangements or fixed agreements that they receive instead of ordinary commissions.

One submitter suggested that advisers should be required to detail their sources of remuneration.

One submitter suggested that only advisers who rebated all commissions and only earned a fee from their clients should be able to describe themselves as independent.

Inappropriate

One submitter suggested that the receipt of a commission did not mean that an adviser was not independent, and what was more relevant was whether the adviser was aligned or had certain targets to meet.

One submitter questioned why an adviser should be considered not to be independent when they take a commission, when they are permitting a consumer an informed choice consistent with s 3(a) of the FAA.

One submitter did not support the connection made between the receipt of a commission and non-independence, and suggested that a term such as “unbiased” or “unaligned” would be more appropriate.

Two submitters rejected the suggestion that he ceased to be independent just because he accepted commissions, and suggested that abolishing fees would have a deleterious effect.

One submitter stated that disclosure is the key matter and they submitted that whether or not an AFA receives a fee or commission is not pivotal.

One submitter stressed that independence was not necessarily compromised by the receipt of commissions, and that disclosure was sufficient.

One submitter questioned how you define independence, and suggested that if a commission made an adviser non-independent then all payment, even from the client, would make them non-independent – the client ultimately pays either way. The submitter referred to the media discussion of corrupt lawyers, showing that the fact they received “fees” did not stop them being corrupt.

One submitter suggested that provided full disclosure was made, the receipt of a commission did not necessarily mean that an adviser was not independent or objective. He suggested that advisers who only supply a restricted range of products, or otherwise receive “soft dollars”, should not be able to describe themselves as independent or objective.

One submitter stated that they did not agree with tying “independence” to commission and suggested that independence and objectivity is a state of mind. It was submitted that the client should be placed first but that it is not a problem if the AFA and client mutually benefit.

One submitter suggested that commissions, independence and client care were not mutually exclusive as long as an adviser was not corrupt.

One submitter suggested that (1)(a) is inappropriate. It was submitted that if an AFA has access to all products available in the market, understands the differences between them, their strengths and weaknesses and makes a recommendation based on his or her analysis of the client’s needs and wants and the understanding of the products, the fact that he or she is remunerated by commission is irrelevant.

One submitter stated that if the standards were implemented as they are currently drafted their disclosure statement would read as follows:

We are remunerated by commission or brokerage payments paid to us by life and health insurers for new policies placed in force. The Securities Commission, as the regulator of financial advisers, has taken the view that advisers who receive commission cannot be independent or objective. We have access to all products offered by all life insurers currently in the market. We subscribe to an independent service that analyses these products to ensure we understand the differences between them and their strengths and weaknesses. We make our recommendations to you based upon our analysis of your needs and wants, and our understanding of the various products. We have no obligation to any insurer to place any or all new insurance business with them. We do not owe any insurer money. We act independently of the insurers and always recommend what we consider to be the best product for each client on a case-by-case basis. We consider our advice to be objective. We are not aligned to any insurer. Notwithstanding all of this, we are not permitted to call ourselves “independent”!

One submitter stated that it is not sufficient to deny use of the term “independent” to any AFA who receives commission or payments from product providers. They stated that this is impractical and virtually unenforceable as they said that the market invariably finds a way to meet the specific wording of impractical rules without honouring their intent. It was also submitted that the Committee should not attempt to determine the rights and wrongs of commission.

One submitter suggested that commission arrangements did not prevent brokers being independent, and that disclosure requirements are sufficient to protect consumers.

One submitter stated that merely because commission is received does not mean that the AFA is not independent. That submitter also stated that the standards should be modified to allow an adviser with no ties or sales goals, who has an over-arching duty of care to put the client first, to call themselves independent (even if commission is received).

One submitter stated that conflicts of interests need to be disclosed such as “soft dollar” benefits, extra-ordinary production quotas or incentives, referral fees, sub-commission etc. That submitter stated that standard 2 infers that if an AFA receives a commission he or she is not independent. It was submitted that this definition is inappropriate for insurance and risk management advice.

One submitter stated that it is simplistic to say that an adviser cannot be independent and objective without also deriving a commission from the same consumer at a later point. That submitter stated that where a financial adviser receives a percentage of client funds regardless of actual service/advice delivered, this is called a fee typically. That submitter stated that insurance brokers receive a trail commission as a percentage of the premium paid each year and they submitted that this is no different to a fee except that the insurer remits it to the broker rather than the money being taken directly out of the client’s funds. It was submitted that this is anomalous with the first situation being an “independent” one and the second a “commission” based one.

The submitter stated that under the IFA rules they must disclose commissions received. It was submitted that the majority of product providers pay the equivalent commissions. They strongly argued against the idea that by receiving commission an AFA is not independent.

One submitter expressed concern that the proposed definition of independence and objectivity would exclude almost all insurance and mortgage advisers. That submitter stated that an adviser who is not tied to a particular provider (i.e. offers a range of products), who has a duty to put the client first and who has appropriate safeguards and procedures in place to prevent conflicts should be able to call themselves independent, notwithstanding that they earn a commission.

One submitter suggested that clients should be able to easily distinguish between advisers who may merely receive commissions, but still provide impartial factual advice about insurance, and those who have quotas or receive “soft dollars.”

One submitter stated that AFAs who receive commission or payments must remain independent and objective in any case as the ethical behaviour principles (client first and integrity) state. It was argued that merely because such a payment exists does not mean the AFA cannot follow these principles. It was stated that an AFA can remain objective and independent when assessing a product even if there is a commission involved and disclosure is all that is required.

One submitter stated that one way to avoid the commission would be to place the investment on a platform where the adviser gets a fee when a client purchases a product. It was submitted that the adviser is no better off – he receives a fee rather than commission. However that submitter stated that clients often prefer the adviser to receive commission than pay a fee themselves.

One submitter suggested that receipt of commissions that help launch IPOs did not necessarily compromise the quality of the advice when they were accompanied by independent research.

One submitter stated that there are three different phases during any advisory project: planning, implementation and ongoing monitoring. It was submitted that an AFA can objectively and independently provide advice during the planning phase regardless of business structure and regardless of whether there is any intent to implement advice for a consumer and regardless of whether the adviser happens to be a salaried employee of a particular company. Once the plan is completed the consumer is able to do as they wish with the plan: do nothing, implement recommendations with the adviser, implement them through another adviser or buy solutions direct from a product supplier. It was submitted that none of these courses of action available to the consumer during implementation compromise the independence and objectivity of the initial advice provided. The submitter argued that if the same adviser does handle the implementation phase and derives a commission, it does not compromise the independence or objectivity of the initial plan (or advice).

That submitter stated that the critical issue is disclosure in advance so that the consumer can make informed choices regarding the adviser's competence, business methodology and conflicts of interests (real and perceived) prior to making a decision to proceed with engaging the adviser.

That submitter emphasised that the different phases of advice mean that independence is assured ie that independence is not required in the "implementation phase". It was submitted that in the insurance market the consumer cost is the full premium paid and that whatever benefits are received by the financial adviser are irrelevant. It was stated that "[d]isclosure of remuneration in non-investment products may well be a barrier to attaining the increased consumer participation in financial services". Therefore that submitter stated that they did not support the key term set out in on page 12 at (1)(a) of the consultation paper. However it was submitted that (1)(b) on page 12 is appropriate. The submitter however supported the key term in para (2) on page 13.

One submitter stated that there needs to be a clear understanding between financial advice that is given to the client prior to the final product recommendations being made. That submitter stated that a quality adviser will obtain information to understand a client's position and provide advice designed to assist the client meet their individual goals and the individual products are rarely discussed at this point. Once the financial plan or solution has been outlined then a discussion on appropriate products is conducted based on the range of products the adviser has at their disposal.

Receiving commission does not affect objectivity

Two submitters agreed that an adviser who received a commission could not be independent, but suggested that such an adviser could still act objectively.

One submitter took exception to the suggestion that receiving a commission prevents an adviser from being objective. In practice, the submitter suggested, advisers are not swayed from advancing their clients' interests by differing levels of commission.

One submitter agreed that receiving a commission or being aligned precluded an adviser from calling themselves "independent", but that does not mean they are not objective.

One submitter suggested that the adviser should be required to disclose any arrangement or obligation that limits his/her ability to be objective, but the fact that he/she is paid by commission does not limit that ability.

One submitter did not see the concept of objectivity as belonging here, and suggested that appropriate disclosure of alignments and relationships was most important.

Brokerage

One submitter stated that this proposal does not take into account the situation with many NZX firms where brokerage is paid by issuers for fixed interest and equity IPOs, and payment does not necessarily indicate a lack of independence or objectivity provided that it is disclosed.

Trail commission

One submitter pointed out that many advisers receive trail commissions, not up-front commissions, and that these vary little between products so there is little incentive to recommend a particular product for that reason.

Discussion of Key Term (1)(b) – AFA or connection of AFA is under an obligation, or is party to an arrangement that in any way limits the AFA’s freedom to provide the services

One submitter stated that key term (1)(b) is appropriate.

Another submitter suggested that advisers should be required to detail their associations.

One submitter suggested that tied or aligned advisers cannot be considered independent.

One submitter stated that if an adviser can provide a range of products, is not tied and has a duty of care to put the client first and has procedures in place to prevent conflict, then even if they receive a commission they should still be able to use the term independent.

One submitter stated that (b) is not necessarily appropriate for employed AFAs.

One submitter argued that care was necessary to ensure that key terms (1)(b) (party to an arrangement that limits an AFA’s freedom) and (3)(c) (entity in which the AFA or a family member has a financial interest) are not interpreted so as to preclude advisers with business relationships with dealer groups from being considered independent and objective. The submitter noted that while such groups do not impose service restrictions on members, there may be financial services activities which are not supported by the group, and this could be interpreted as a limitation on an AFA’s freedom.

Constraints on products offered

One submitter pointed out that very few advisers in New Zealand could be considered truly independent, but of necessity work within a given pool of products with which they are familiar.

One submitter suggested that independence should be judged according to whether an adviser has any arrangements that constrained the universe of available product selections.

One submitter suggested that advisers that promote products from a single provider would not be independent, and should not be considered “advisers” at all.

One submitter stated that for insurance advice, AFAs should be required by the Code to indicate when they have any restrictions imposed by their QFE or insurers they hold contracts with.

Quota and obligation to place percentage of business with a provider

One submitter stated that factors such as whether the AFA is under a quota sales system need to be disclosed.

One submitter stated that it was not necessarily a bad thing for advisers to have a close relationship with one provider. But that submitter suggested that, to describe themselves as “non-aligned”, an adviser would need to have no formal obligation to place a certain percentage of business with a given provider. In addition, they should not be permitted to place more than 60% of their business with one provider and should use at least three providers in total.

Value of research from providers

One submitter stated that emphasis on independence and objectivity could see favoured advisers being small operations staffed by 2-3 people without good links to research. It was submitted that this poses a much higher risk to investors than going to large investment advisory firms who pay for overseas research and have local research teams to review investments.

One submitter suggested that the definition of “independence” was too broad, so that any adviser that screened investments, worked from a research-based preferred list, short-listed candidates with a disciplined methodology, or that used a structure would be considered non-independent. That submitter suggested that thorough and disciplined means of evaluating and screening products was crucial to good quality advice, rather than compromising it.

Two submitters queried whether if a broking firm chooses to research the major listed property trusts, but not smaller trusts, would advisers be demonstrating full independence by only recommending those on which they can access research.

Key term (1)(c)

One submitter stated that they have no problems with sections 1(c).

Another submitter stated that (c) is vague and they queried the interpretation of “reasonably perceived as lacking full independence or objectivity”.

Key term (2)

One submitter suggested that paragraph (2) of the key terms of Standards 2–4 (page 13 of the Consultation Paper) should be reworded to eliminate the double negative.

PROPOSED STANDARD TWO

Proposed Standard 2: AFAs must provide independent and objective financial adviser services unless limitations on independence and objectivity have been expressly communicated and any appropriate safeguards in place

- (1) The financial adviser services provided by an AFA must be independent and objective unless any limitations on independence and objectivity have been expressly communicated to the client and any appropriate safeguards are in place.
- (2) Depending on the circumstances, safeguards may include:
 - (a) offering the client the opportunity to take independent advice and advising the client of the benefits of seeking independent advice; and/or
 - (b) implementing procedures to prevent or control the exchange of information between relevant persons with a conflict of interest.

SUMMARY (INCLUDING RESPONSES TO CONSULTATION QUESTIONS FOUR AND FIVE)

Many submitters made the point that disclosure should be the focus of proposed standard 2.

A number of submitters also suggested that objectivity should not be coupled with independence. Many stated that a lack of independence did not mean that an individual was unable to provide objective advice.

Others also made the submission that the Code should not allow AFAs to provide advice that is not objective as objectivity is a necessary incident of the client first principle (for instance the AFA cannot place the client's interests first unless they can also provide objective advice).

In response to consultation question four, the majority of submitters said that express consent to a lack of independence should not be required and that disclosure is sufficient. However many seemed to think the requirement for express consent was suitable. Several submitters stated that if express consent is required, this should be able to be combined with the disclosure statement.

A number of submitters stated that express consent was not necessary due to the requirement in s 34 of the FAA not to engage in misleading or deceptive conduct (and also in the Fair Trading Act 1986).

Safeguards

In response to consultation question five, most submitters stated that disclosure was sufficient. Several submitters also stated that safeguards should not be prescribed as the ways to protect consumers from lack of independence and conflicts of interests will be fact-specific

Safeguard (a) – offering the client the opportunity to take independent advice and advising the client of the benefits of seeking independent advice

Most submitters stated that providing the client with the opportunity to take independent advice would:

- be detrimental to public confidence;
- be too expensive so that only wealthy clients will avail themselves of this; and
- be too difficult to obtain given that most AFAs will not be "independent".

It was also pointed out that this safeguard may not be suitable for transaction-only services particularly where informed investors are merely requiring the AFA to purchase a product for them.

Some submitters did state that the safeguard would be appropriate in certain cases ie where there are conflicts of interest.

Safeguard (b) – implementing procedures to prevent or control the exchange of information between relevant persons with a conflict of interest

Most submitters did not express strong disagreement or agreement with this safeguard. A number of submitters requested guidance on how this safeguard should operate. A number of submitters endorsed the NZX Participant Rules requirement that all firms must produce a conflict of interest manual.

INDIVIDUAL SUBMISSIONS

One submitter stated that proposed standard 2 is appropriate.

One submitter stated that proposed standard 2 undermines the principle of placing the client's interests first. It was submitted that this points to an issue at the heart of the Code – that financial advisers often face a conflict of interest due to the way they are remunerated. It was submitted that any commission-based remuneration creates an inherent conflict of interest in selling particular products. That submitter stated that commissions are likely to be difficult for consumers to understand in terms of the impact they will have on their investments and will create difficulties for consumers wishing to compare prices between financial advisers.

One submitter questioned whether independence and quality advice were necessarily linked.

One submitter stated that AFAs should not be permitted to contract-out of the obligation to provide independent advice. That submitter stated that there is little point in positing independence as an over-arching principle only to undermine it in the standard. Therefore that submitter stated that standard 2 be amended to read "AFAs must provide independent and objective financial adviser services".

One submitter expressed concern that the operation of this standard – and the requirement to offer clients independent advice – could draw customers away from advisers employed by or aligned to institutions.

One submitter stated that this seems over-complicated. She suggested that since AFAs have a legal obligation not to mislead, confuse or be deceitful to their clients, standard 2 from the outset seems to add a further layer of complication to matters.

Focus should be on disclosure

One submitter stated that proposed standard 2 should focus on communicating the extent of alignment or conflicts of interest rather than on independence, which would be rarely achieved. It was submitted that any restrictions, commissions, or incentives should be disclosed to the client.

One submitter also stated that it would be difficult to ascertain which advisers would have complete independence. It was submitted that lawyers and accountants do not provide a disclosure of independence. It was, however, stated that conflicts of interest should be disclosed. It was

submitted that disclosure of how they are remunerated and any conflicts of interest should be sufficient.

One submitter also suggested that standard 2 should focus on communicating the extent of independence, rather than achieving independence, which in most cases will not be possible. It was submitted that:

- the starting point should be that AFAs must not imply or state that they are independent unless this is the case (proposed standard 4) which would create a meaningful division between “independent AFAs” and all other AFAs.
- the Code should set out the circumstances in which AFAs are not independent (as already explained in the Code);
- require disclosure by AFAs of any limits on the range of their services, and any direct or indirect benefits they receive; and
- require AFAs who cannot hold themselves out as independent to offer the client the opportunity to take other advice rather than “independent” advice, given that the pool of “independent” AFAs is likely to be relatively small.

That submitter stated that standard 2 should read as follows:

AFAs must not state or imply that their financial adviser services are independent unless that is the case. Financial adviser services provided by an AFA are not independent if:

- (a) the AFA, or a connection of the AFA, receives a direct or indirect benefit from the services; or
- (b) the AFA, or a connection of the AFA, is under an obligation or party to an arrangement that in any way limits the AFA's freedom to provide the services (for example, an employment agreement).

One submitter stated that independence is crucial. However it was noted that New Zealand has a minimal supply of financial product suppliers and the financial adviser profession is linked with most financial product suppliers in a way that precludes advisers from being totally independent in the traditional sense of the word. Therefore it was submitted that disclosure and appropriate safeguards should be sufficient and that independence may be waived with due disclosure and client consent.

One submitter stated that disclosure is sufficient and that it is the client's responsibility to seek out independent advice or cease to use the adviser if they wish.

Two submitters stated that the most appropriate method is to insist on full disclosure of all remuneration and alignment of products, related companies etc. It was submitted that in reality a client may prefer to be advised by a share broker who receives brokerage by the issuers of a new bond rather than paying a fee directly to the AFA.

Objectivity and independence should be de-coupled

One submitter agreed that the ethical behaviour principles are appropriate but submitted that the concepts of independence and objectivity are distinct, as a lack of independence does not necessarily result in a lack of objectivity, but rather a limited framework within which to work.

One submitter stated that the principles are very positive however they expressed concern that a lack of objectivity could be waived in some instances and appropriate safeguards be put in place. It was submitted that the overriding principle of client first and integrity should at all times be observed and objectivity would be a necessary incident to the client first principle. They stated that objectivity is paramount and must apply if acting in the best interests of the client. It was submitted that no appropriate safeguards could or should be put in place to justify a waiver of objectivity.

One submitter suggested that it was inappropriate to equate “independence” with “objectivity”. They stated that an adviser could be objective without being entirely independent, and there are differing levels of “dependency.”

One submitter stated that independence should not be linked to objectivity. He stated that an AFA can be objective even if the AFA is not independent. That submitter stated that if receipt of commission means that an AFA is not independent, then in relation to life insurance he doubted whether any adviser would qualify as independent or objective under the current definition. It was submitted that there are only a very limited number of life insurers and many agents would have agencies with all of them. It was submitted that this should not mean that they cannot be considered “objective”.

One submitter stated that very few advisers will be able to claim that they are independent. It was stated that “independence” in reality may be an unrealistic principle and therefore “independence” needs to be separated from “objectivity”. The submitter stated that the key point in giving investment advice is that the advice is objective. He submitted that provided that objective processes are used to assess client needs then non-independent advice is acceptable (ie a bank employee recommending a bank product). In this situation it was submitted that the AFA must disclose that he/she is offering in-house products.

One submitter stated that there is an assumption that an adviser who recommends an investment that pays a commission is not being objective. He submitted that if objective analysis of the investment options available identifies an investment paying a set amount commission is superior to other options then the investment should be recommended to the client.

One submitter stated that they believed that “independence” and “objectivity” need to be distinguished, and that so few advisers would qualify as “independent” that it could compromise the availability of advice. They submitted that a “non-independent” adviser could still provide objective advice.

One submitter stated that independence and objectivity are two distinct principles and that all NZICA members are required to perform all professional work with an objective mind. Therefore any conflict of interest that would impair objectivity must be dealt with by either removing the conflict or declining the work.

One submitter stated that where there are remaining conflicts that could be viewed by the client as impairing the objectivity of the member then these conflicts should be disclosed. That submitter stated that disclosure is not a sufficient response to manage and resolve conflict of interests. It was submitted that action must be taken to ensure that the conflict will not adversely affect the quality of the services provided to the client.

That submitter suggested that the standard be restated to require that the adviser must always perform professional work with an objective mind, although there may be a reason for restricting this requirement to advisers offering financial advice and performing financial planning services. It was submitted that merely making an investment transaction in line with the client’s express instructions should probably be viewed differently. It was submitted that where a conflict remains that could be viewed by the client as impairing objectivity then this should be disclosed and the client’s written consent obtained.

That submitter stated that the NZICA Code states that where effective safeguards are not available to reduce the risk to a member’s actual or perceived objectivity, then the member must not accept the

new engagement or must discontinue the existing engagement. Therefore it was submitted that standards 2-4 should distinguish between independence and objectivity.

One submitter referred to the coupling of “independence” and “objectivity” and stated that this is inappropriate. That submitter stated that “objective” means not influenced by personal feelings or opinions in considering and representing facts. Therefore it was submitted that an AFA who is not independent should still be required to be objective because, while alignment with a product or employer may affect independence, it should not preclude advice that is based on facts rather than subjective feelings.

That submitter referred to the NZICA Code as an example of a separate objectivity requirement that applies in all circumstances (in the NZICA Code, independence is a further requirement that also applies in some but not all circumstances):

“...the fundamental principle of objectivity imposes the obligation on all members to be fair, impartial and intellectually honest. Objectivity is essential for any member exercising professional judgement. It is as essential for members in employment as for members in public practice. Objectivity is a state of mind which has regard to all considerations relevant to the task in hand but no other.”

NZICA rule 3 states that “members must perform all professional work with an objective mind”.

That submitter also referred to NZICA’s comments on objectivity in relation to employment and provided a quote:

“although it may be more difficult for a member in employment to be, or to be seen to be free, of any interest which might conflict with a proper approach to the member’s professional work, this does not diminish the member’s duty to maintain objectivity in the performance of that work. The member must observe the high standards of conduct and integrity expected of members. Without the capacity of being fully independent of their employers, it is all the more important that members in employment should strive constantly to maintain objectivity in every aspect of their work. Therefore the interests of a member’s employer should not affect the objectivity of a member’s judgement.”

Two submitters noted that independence and objectivity were different concepts, and that an adviser could be objective even though the adviser receives a commission and is not “independent.”

One submitter stated that all AFAs should be required to act objectively regardless of whether they are independent or not and therefore independence and objectivity should not be merged.

One submitter stated that “objective” should not be confused with “independent”.

One submitter suggested that independence and objectivity do not necessarily go hand-in-hand, and that objectivity is better achieved by the adviser getting an in-depth understanding of their clients’ needs and then choosing appropriately matched investments.

QUESTION FOUR: Should proposed standard 2 include a requirement that the client must expressly consent to a lack of independence and/or lack of objectivity?

In favour

Five submitters stated that AFAs who are not independent and/or not objective **should** be required to seek clients’ approval to continue to advise them.

One submitter stated that the client should be required to express that consent in writing in their own words.

Another submitter agreed that when an adviser is tied to a provider or has targets then the client must agree in writing to the lack of independence and objectivity.

One submitter stated that express consent is appropriate but that guidance on what constitutes objectivity should be included in the Code.

One submitter stated that this is appropriate to protect the adviser rather than the client.

One submitter stated that there should be a requirement to seek the client's written consent. However the AFA should recognise that obtaining consent to proceed with the advice does not in any way diminish the other duties owed to the client under the engagement.

Two submitters suggested that consent should be contained in the adviser's disclosure document, and not required to be a separate document.

One submitter suggested that clients should acknowledge that they understand the lack of independence.

One submitter suggested that if an adviser is clearly aligned/tied to certain institutions and these alignments prevent them using other institutions then consent from the client should be obtained. That submitter noted, however, that clients would be unlikely to read disclosure statements "given that they hardly ever even read their insurance policies".

One submitter stated that the independence standards are difficult but that the standards could include a requirement that the client should consent to a lack of objectivity in the case where an adviser is representing only one company such as a banker or a tied insurance adviser or an adviser that mainly uses one platform or a limited number of insurance companies.

One submitter stated that there is a need to differentiate between those advisers that can provide unaligned advice as opposed to the adviser who is tied to a QFE or individual product provider and has sales targets or incentives which can compromise the advice given. It was submitted that regarding advisers who are under a QFE, tied or aligned, it is vitally important that they obtain express consent for lack of independence and objectivity.

Not in favour – disclosure requirements are sufficient

Six submitters merely stated that a client should **not** be required to expressly consent to a lack of independence/objectivity. Seven other submitters also agreed that express consent should not be required provided that there is full disclosure of interests.

One submitter stated that AFAs should not be required to expressly consent to a lack of objectivity.

One submitter suggested that if the adviser's Disclosure Statement accurately describes all conflicts, and clients acknowledge in writing that it has been received, then that should be sufficient.

One submitter pointed out that "non-independent" AFAs comprise the vast majority of, if not all, current financial advisers who will become AFAs. It was submitted that requiring express consent to non-independence will create unduly negative connotations that will undermine the confidence in

the majority of advice currently provided by financial advisers and it will not provide consumers with any additional protection. Instead disclosure requirements would sufficiently and clearly communicate to clients the limits on independence.

One submitter stated that it is sufficient if the AFA discloses all conflicts of interests. He stated that consumers need to be responsible for the decisions they make.

One submitter suggested that it should be sufficient for the adviser to show that s/he has disclosed to the client all relevant alignments and material relationships, and that the client has had the opportunity to discontinue the relationship if they wish.

One submitter rejected this suggestion, arguing that almost all advisers will lack independence to some degree and requiring express consent would be cumbersome. It was suggested that the better approach was for the adviser to disclose their relationships and potential conflicts to the client, act objectively, and refer the client to another adviser if the adviser cannot fulfil the client's needs.

One submitter stated that it is not necessary for a client to expressly consent to a lack of independence and/or lack of objectivity. The key issue is to ensure that the lack of independence/objectivity is disclosed to the client and then the client must make an informed decision on whether to proceed with that AFA. It was submitted that, in practice, if the client continues to receive financial advice from that AFA, the client is consenting. Therefore express consent is not necessary.

Four submitters also stated that requiring express consent "flies in the face" of the aims of the Act.

One submitter stated that requiring a client to expressly consent to a lack of independence immediately brings the adviser's competence and professionalism into question in the client's mind. One submitter stated that asking the adviser to communicate a lack of independence is appropriate, together with disclosure of all other relevant decision-making facts to the consumer. It is a step too far to ask the client to expressly consent to accepting that as a risk factor.

One submitter suggested that disclosure, but not express consent, should be required, although in practice most advisers would probably require the client's signed acknowledgment to protect themselves.

Another submitter stated that express consent should not be required and stated that under the current definition of independence, all NZX Advisors would require express consent as they are only accredited under the NZX Rules to provide services in relation to traded equities and debt or futures and options.

One submitter stated that express consent should not be required as the focus should not be on achieving independence. It was suggested that proposed standard 2 would require the majority of AFAs to state that they are not "independent or objective" and that this unduly impugns the services offered by AFAs especially if they were not holding themselves out as "Independent" in the first place. They stated that it also offers limited benefits to consumers as most consumers know that financial advisers employed by banks provide advice on behalf of their employers.

One submitter stated that AFAs who do not meet the proposed test for independence should:

- not be permitted to hold themselves out as "independent"; and
- disclose:
 - the benefits that may be received by them or their connections;

- the obligations and arrangements that may limit their independence; and
- how the AFAs will ensure the clients' interests are placed first; and
- offer the client the opportunity to take "alternative financial advice" (although not "independent advice" as there may be few independent AFAs).

One submitter stated that it would be inappropriate to require such consent as it would increase compliance burdens and complicate the process of providing advice. They submitted that there should be clear up-front disclosure of such matters, without the need for client consent. It was submitted that the most that should be required is a signed acknowledgement by the client that they have read the disclosure and have understood it.

One submitter stated that to seek consent would be to imply that not being independent was "dodgy" rather than the norm.

One submitter stated that there are six factors to bear in mind regarding insurance product commissions:

- initial risk assessment advice;
- advising which products are best;
- recommending a particular insurer or insurers;
- assisting the client with the placement of insurance;
- ongoing service including annual reviews, estate planning and especially the unpaid time assisting clients at claim time (this is a standard expectation);
- commission is not "earned" until a policy is in force for a period of up to 24 hours. If the policy lapses in that period, it is repayable and therefore an adviser receives nothing for the advice and time incurred.

That submitter also stated that the only element during this process where any issue of independence (conflict of interest) could arise is in recommending the insurer. Therefore it was submitted that a requirement for the client to expressly consent to a lack of independence is "absurd". However the need to acknowledge that commission is being received in lieu of professional fees is appropriate.

One submitter suggested that this requirement was "bordering on the bizarre", and failed to take into account clients who want a transaction-only service (assuming all clients are financially unsophisticated) or disclosure requirements.

Express consent should not be required for the wholesale market

One submitter considered that disclosure is the appropriate threshold of protection in the wholesale market. It was submitted that the requirement for a client to expressly consent to a lack of independence or objectivity is not appropriate in relation to institutional clients. It was stated that if a client is unhappy, they will not trade through that provider. To require express consent will impose an administrative burden on the client and AFA which will not provide a safeguard to the recipient of the financial service.

Express consent is unnecessary due to requirement not to be misleading or deceitful

Thirty submitters suggested that requiring written consent to a lack of independence or objectivity was an unnecessarily expensive addition on top of the requirement that AFAs not be misleading, confusing or deceitful. Another submitter also suggested that this requirement was unnecessary and confusing (particularly for less sophisticated clients) in light of the obligation not to be misleading.

One submitter stated that express consent should not be required as it would be difficult for an AFA to claim complete independence. That submitter stated that AFAs will be subject to the Fair Trading Act which requires that a service should not be confusing, misleading or deceitful. They stated that full disclosure of conflicts and remuneration methods should be sufficient. They recommended that this standard be deleted or clarified.

If express consent is required a separate document should not be necessary

One submitter stated that if the Committee decides that express consent is necessary, it should be sufficient for the AFA to obtain such “consent” by having the client sign an acknowledgement on the AFA’s disclosure statement, rather than having a separate document.

One submitter suggested that, instead, the adviser should give the client a “scope of practice” statement, which would outline the services that the adviser is able to advise on. They stated that this could form part of either the Adviser Business Statement or the Disclosure document.

One submitter suggested that it was unnecessary duplication to require express consent to a lack of independence when this matter was covered in disclosure documentation.

One submitter stated that if such a requirement was included, a signed client agreement between an NZX firm (not the adviser) and the client should be sufficient as this would set out clearly the limits and nature of the services provided by an NZX Advisor.

QUESTION FIVE: Are the safeguards listed in proposed standard 2(2) appropriate? Are there other safeguards that should be included?

Appropriate

Five submitters agreed that the safeguards in proposed standard 2 are appropriate.

One submitter recommended that the client be asked to sign a waiver confirming that they have been offered the opportunity to take independent advice and have been advised of the benefits of doing so, but have elected not to do so.

Inappropriate

One submitter stated that the safeguards are not appropriate.

One submitter criticised the proposed safeguards, and suggested that conflict management procedures and disclosure (not independence) is the solution.

One submitter stated that the safeguards are not appropriate. It was submitted that accurate disclosure backed by appropriate systems and processes within the AFA business would suffice. That submitter noted that NZX Participant Rules require NZX Firms to produce a conflict management manual and out of that manual procedures are designed for each firm to manage their respective conflicts. It was suggested that this should be considered by the Committee.

One submitter stated that the safeguards in proposed standard 2(2) are inappropriate and that disclosure of lack of objectivity and remuneration would be adequate.

One submitter stated that if the independence and objectivity standards are refocused as they suggested the only necessary safeguards should be disclosure of:

- the limits on the range of financial products or services that AFAs provide;

- the benefits AFAs, or their connections, receive from providing the services; and
- how AFAs will ensure that their clients' interests are placed first.

Another submitter stated that full disclosure of interests is sufficient.

One submitter suggested that disclosure of the reasons why the adviser was not independent, with written client acknowledgement, was a more appropriate safeguard.

One submitter suggested that initial, and perhaps continuing, disclosure would be sufficient protection.

One submitter suggested that it should be up to the client to decide how to act after being informed that the adviser is not "independent" in relation to a particular investment (or generally).

One submitter suggested that any lack of independence had to be explained in disclosure documents, and conflicts had to be managed so that they do not compromise clients' interests.

Two submitters suggested that clients often have several advisers and choose between them.

Safeguards should not be prescribed

One submitter suggested that the Code did not have to define procedures, and should be a governance document not a management manual.

One submitter suggested that the Code did not need to prescriptively list all the safeguards, and that this should be left up to the discretion of advisers. They stated that the Code should list the principles and the Committee should provide guidance notes.

One submitter suggested that rules in this area might need to wait until the structure of the industry was clear.

Safeguards should be more robust

One submitter suggested that the safeguards needed to be more "robust and structured", particularly to address the situation where a firm offers a wide range of potentially conflicting services (e.g. conveyancing, mortgage broking and trust administration).

Safeguard (a) – offering the client the opportunity to take independent advice and advising the client on the benefits of seeking independent advice

Safeguard (a) is appropriate

One submitter agreed that proposed standard 2(2)(a) is, in principle, appropriate.

One submitter stated that where there are conflicts of interests or potential conflicts of interest it is appropriate to offer the client the opportunity to take independent advice and explain the effects of doing so.

One submitter stated that when applied to the insurance industry, independence means non-allied to any particular insurer, having no imposed quotas, and in some situations not being a member of a QFE. Therefore it was submitted that those advisers whose contracts with insurers restrict their product recommendations must clearly disclose those constraints. It was submitted that lack of independence could be a problem when assisting with placement ie when their insurer offers non-

standard terms and they do not have the resources to obtain alternative options. They stated that this could also be an issue at claim time where an independent assessment may be needed where a claim is declined. They suggested that in these circumstances an AFA should offer a client alternative resources for seeking independent advice.

Safeguard (a) is not appropriate

One submitter stated that the safeguard in proposed standard 2(a) is not appropriate and would have a destructive influence on the industry. It was understood that the objective of the standard is to ensure consumers have full knowledge of the independence and objectivity of the adviser and that potential and actual conflicts of interest are managed appropriately. That submitter stated that referring potential consumers elsewhere does not achieve those objectives and it merely shifts the requirements to meet the standard to another adviser. It was submitted that adequate disclosure and documentation that is transparent and understandable will achieve the first two aspects of the proposed standard.

That submitter “vehemently” opposed the idea that an adviser who does not meet the proposed definition of independence must advise clients to find an adviser who is “independent”. It was submitted that proposed standard 2(a) would be detrimental to public confidence and that this could drive consumers to go to less ethical advisers who have a different “more favourable to regulators” business structure.

One submitter suggested that this requirement was symptomatic of an attempt to set the bar for client care too high, so that clients would be required to obtain “independent” advice when they feel that they are already being adequately independently advised by a team of professionals (e.g. their investment banker, lawyer and accountant).

That submitter stated that requiring advisers to constantly refer their clients to third party advisers could hinder attempts to foster a trusting relationship by creating negative impressions in the mind of an inexperienced investor.

One submitter stated that the safeguards are not appropriate. She submitted that suggesting that a client go to a competitor to seek similarly (or even less) independent advice is unlikely commercially, especially if this requires the client to pay second or third advice fees. It was submitted that conflicts of interests are best disclosed at the outset via the adviser’s disclosure statement and that this should be presented to the client, before the provision of advice.

One submitter stated that safeguard (a) is idealistic and not realistic. It was submitted that based on the interpretation of “independent” the client will need to pay someone who could provide this “independent advice”. It was suggested only the wealthy will do this and those who should get a second opinion will not have the opportunity.

One submitter stated that sending a client to a competing company to review the independence of an AFA is likely to result in serious conflict. It was stated that clients can choose the business model they deal with. It was submitted that if an AFA’s independence is to be reviewed, the individual should go to a lawyer. However it was submitted this would cost too much money.

One submitter disagreed with this proposal. It was stated that in the life and health insurance sector safeguard (a) is impractical. It was submitted that if a disclosure statement is provided clearly stating that the adviser is paid by commission and that he has no obligation to or limitation imposed by any

insurer on his ability to place insurance with any or all insurance companies in the market place – then that is sufficient.

Four submitters stated that the requirement for a client to seek advice from a potential competitor does not make sense and should instead be dealt with by disclosure upfront. Those submitters stated that in compliance with the NZX Rules, NZX Firms must produce a conflict management manual and out of that manual procedures are designed for each firm and its advisers to manage their conflicts.

One submitter stated that they are not sure that an offer is needed for the client to take independent advice. They stated “surely the client would have completed their ‘homework’ on the adviser which is often word of mouth referral”.

One submitter stated that offering the client the opportunity to take independent advice would not be practical. That submitter stated that referral elsewhere is acceptable where the advice is outside their key area of competence. It was submitted that this confuses independence with the need for an objective process and that disclosure is the key safeguard.

One submitter stated that a business should not be required to ask clients to approach competitors for advice.

One submitter questioned whether providing independent advice would always be an appropriate (or even sufficient) means of managing conflicts of interest and preferred strengthening disclosure requirements to requiring advisers to pass work to a competitor, whose second opinion may be based on personal preferences rather than objective factors.

One submitter rejected the suggestion that the adviser should be obliged to give the client the opportunity to seek independent advice. That submitter stated that the practicalities are not sufficiently thought through – for example, would the adviser direct the client to a particular “independent” adviser?

One submitter stated they do not think that the adviser should be obliged to specifically recommend independent advice.

One submitter stated that the independent advice requirement is not workable and would not be suitable for NZX Advisors.

Difficulties in finding an independent AFA

One submitter stated that offering the client the opportunity to take “independent” advice and advising the client of the benefits of seeking “independent” advice is impossible as he does not know of any insurance adviser that charges fees rather than accepting commission from the life insurer. That submitter also stated that he fails to see what the benefits of “independent” advice might be.

One submitter stated that although the safeguard is, in principle, appropriate, it is likely that there will be only a very small number of independent AFAs. Therefore it was stated that it may be impractical for some clients to obtain advice from an “independent” AFA. It was suggested that this needs to be reflected in proposed standard 2(2)(a).

Two submitters stated that it would be difficult to find an “independent adviser”. It was stated that given that the share market works on the principle of opposing opinions as to the value of listed

entities, it may well be impossible to seek “independent” advice, which would be corroborated by another adviser.

One submitter stated that safeguards are considered superfluous as there will be relatively few advisers who can accurately be deemed independent when selling their own or their employer’s products.

Four submitters pointed out that very few advisers will qualify as independent.

Twenty-one submitters suggested that whenever AFAs were remunerated there was the possibility of a lack of independence. Therefore they questioned the practicality of requiring an adviser to refer a client to a potential competitor and that any concern would be addressed by sufficient disclosure standards up-front.

Not suitable for transaction-only services

One submitter queried how clients who wish to receive a transaction only service without advice will be dealt with and suggested that it would be unworkable for AFAs to be required to tell clients to seek independent advice. They stated that the standard implies that because a stock broker is remunerated, there is a conflict of interest and the stock broker is obliged to send the client to seek independent advice. It was submitted that the standard makes no allowance for transaction only business and it also does not cater for the informed investor who wants to use a stock broker to source products.

Safeguard (b) – implementing procedures to prevent or control the exchange of information between relevant persons with a conflict of interest

One submitter stated that safeguard (b) is appropriate. Another submitter agreed that “Chinese walls” may be necessary to prevent conflicts of interest.

One submitter stated that clause 2(b) should be expanded to cover how conflicts are to be managed.

One submitter stated that 2(b) is best practice but they stated that they would expect these procedures to be in place to control the exchange of information between all clients, not only those with a conflict of interest. That submitter stated that it should not be seen as a safeguard to mitigate the threat to independence and objectivity.

One submitter stated that disclosure should be the principal safeguard against an AFA’s potential conflict of interest or lack of independence. That submitter stated that other conflicts of interest such as those relating to the use of confidential client information should be addressed in a separate standard. That submitter referred to rule 8.7 of the Rules of Conduct and Client Care for Lawyers.

One submitter stated that any potential conflicts should be in the adviser’s disclosure statement so the client can assess and query if advice does not appear to be objective.

One submitter suggested that this aspect can be partly addressed through adequate disclosure mechanisms, but strengthened with a requirement for continuous disclosure of conflicts of interest.

Twenty-one submitters endorsed the NZX requirement that each firm produce a “conflict management manual.”

Guidance required

One submitter stated that 2)(b) is slightly ambiguous and could be reworded so that it is clearer what the procedures could be.

One submitter stated that sub-paragraph (b) is difficult to understand. It was queried “should a life insurance adviser who is paid by commission not be able to ask all the necessary questions to enable him or her to give good advice?”

One submitter stated that it would be helpful if the Committee could provide some guidance around the nature of the procedures that will be required for the purposes of satisfying proposed standard 2(2)(b).

One submitter queried how standard 2(2)(b) requiring “implementation of procedures to prevent or control the exchange of information between relevant persons with a conflict of interest” could be reviewed and deemed appropriate.

Additional safeguards?

One submitter stated that no other safeguards should be included in the Code. However one submitter suggested as an additional safeguard that the adviser should ensure that “the appropriate steps” in relation to the suitability of their recommendation have been taken.

Duty of care relating to making recommendations

One submitter suggested that the proposed Code did not adequately distinguish between “advising” and “selling”, and that the tendency of many advisers to recommend products from within a very narrow range essentially fell into the latter category.

That submitter suggested that the safeguards set out will not protect consumers. It was suggested that “advisers” in that situation be barred from presenting their advice as “recommendations”, because it does not constitute proper advice. They suggested that this could be achieved by means of a duty of care, so that whenever a “recommendation” was made it had to be based on proper assessment of a wide range of products from a wide range of providers. It was stated that this will enable “advice” to be distinguished from “selling”.

PROPOSED STANDARD THREE

Proposed standard 3: AFAs must communicate lack of independence or objectivity and any safeguards that apply

Where the financial adviser services are not independent and objective, the AFA must fully and clearly communicate to the client:

- (a) the financial benefits that may be received by the AFA or an AFA connection, and/or the obligations or arrangements, that make the financial adviser not independent and/or objective; and
- (b) any safeguards the AFA will follow to ensure the client's interests are placed first.

SUMMARY (INCLUDING CONSULTATION QUESTION SIX)

Submitters re-emphasised the point made in relation to standard 2: that the focus should be on disclosure. Some submitters stated that there was overlap between standards 2 and 3.

In response to consultation question six, many submitters disagreed with the suggestion that an AFA be required to specify that they are "not independent" or that they are "aligned". It was thought that preventing those AFAs from using the term "independent" and requiring full disclosure was sufficient.

INDIVIDUAL SUBMISSIONS

One submitter stated that the level of disclosure required in proposed standard 3 should apply equally across all AFAs regardless of the level of independence.

One submitter stated that proposed standard 3 be deleted as AFAs should only provide services that are independent.

Another submitter stated that any matter affecting independence or alignment of the AFA must be stated clearly to the client and not merely implied by silence on the matter.

One submitter stated that in accordance with standard 3, they should be required to disclose:

- that they receive commission; and
- the nature of the benefits they, or their connections, receive.

That submitter suggested that proposed standard 3 should be altered as follows: "Where the financial adviser services are not independent ~~and objective~~, the AFA must fully and clearly communicate to the client:

- (a) any limits on the range of products/services;
- (b) the financial benefits that may be received by the AFA or an AFA connection, and/or the obligation or arrangements that make the financial adviser services not independent ~~and/or objective~~; and
- (c) ~~any safeguards the AFA will follow to~~ how they will proceed in providing financial services that ensure the clients' interests are placed first."

One submitter stated that objectivity is debatable and he prefers to see full disclosure of payments at the time advice is given.

Another submitter suggested that just because NZX firms may be paid a commission by issuers of fixed interest and equity IPOs did not mean that they could not provide quality advice, and that the remuneration is always disclosed by the adviser and in the prospectus released by the issuer. The submitter suggested that full and proper disclosure obviates the need for standard 3.

One submitter stated that the concepts of “independence,” “objectivity” and “alignment” should not feature in the Code outside the general requirements not to be confusing, misleading or deceitful, and that prescriptive requirements should not be imposed in relation to them.

One submitter stated that the inter-play between the disclosure required by the Code and the disclosure regulations should be considered. They stated that it would be helpful for AFAs if the Code Committee could provide some guidance around the nature of safeguards that would be appropriate for the purposes of proposed standard 3(b).

One submitter suggested that disclosure will be more useful to the consumer if the statement explains why the adviser is not independent but is objective.

One submitter suggested that guidelines were needed to assist advisers to prepare Disclosure Statements, and that they should be audited.

One submitter suggested that communicating safeguards to clients (as required under proposed standard 3(b)) was an example of disclosure that would be of little benefit.

One submitter stated that there is duplication between proposed standards 2 and 3.

QUESTION SIX: Is it sufficient for AFAs who receive commission or payments from financial product providers or others in addition to, or instead of, payments from clients cannot call themselves “independent” or “objective”? Or should AFAs be required by the Code to indicate that they are not independent by specifying that they are “non-independent” or “aligned” or some other similar term?

Agree that AFAs should be required to specify that they are non-independent or aligned

One submitter stated that this is not sufficient and AFAs should at a minimum be required to indicate that they are non-independent or aligned or some other similar term. That submitter would prefer to go further and require them to state that they are not qualified to provide independent or objective advice. It also was submitted that these “advisers” should not be permitted to call themselves advisers. That submitter stated that it would prefer that they only use prescribed terms that are more reflective of their services, such as “agent” or “salesperson”.

One submitter stated that AFAs should be required by the Code to indicate they are not independent by specifying that they are non-independent or aligned.

One submitter stated that a term for non-independence would be useful but also disclosure of how the adviser is paid should be made.

One submitter stated that their standards require a financial adviser to consider, for each financial advisory engagement, whether or not the adviser is able to undertake the engagement on an independent basis. They stated that this is regardless of whether or not the adviser holds themselves out as providing financial advice on an independent basis. They submitted that where the adviser concludes that the engagement cannot be undertaken on an independent basis, the

adviser must disclose the relevant circumstances to the client and obtain the client's informed consent to provide advice. Therefore at the level of individual clients, it was recommended that the Code require that advisers fully disclose their independence or non-independence.

One submitter stated that the key influence for consumers will be the AFA's provider relationships ie whether aligned or unaligned. They stated that an AFA who works for a QFE should therefore declare that they only work with one provider or QFE. Therefore it was submitted that one solution could be for an AFA linked to a QFE (or the QFE itself) to be required to notify the customer that if he/she wants additional and objective advice, they will need to speak to an AFA who is not aligned to just one provider.

One submitter suggested that AFAs be required to identify themselves as "aligned" or "non-aligned", which would be a more workable distinction than (non-)independent.

One submitter suggested that advisers receiving a commission should be required to advise their clients that they are not independent by means of a specific written disclaimer.

AFAs should not be required to specify that they are non-independent or aligned

Two submitters stated that AFAs should not be required to call themselves "non-independent" or "aligned". One of those submitters stated that AFAs who are not independent should be required not to use the word "independent".

One submitter agreed that it is sufficient that AFAs cannot call themselves "independent" and that they must fully disclose.

One submitter stated that AFAs should not be deemed "not independent and objective" as this places a negative connotation on advice provided by the vast majority, if not all, financial advisers.

One submitter stated that they do not support referring to AFAs who do not meet the independence test as either "non-independent" or "aligned". It was submitted that this does not appropriately describe the status of employed AFAs or the type of advice they provide. It was suggested that this will create an unduly negative connotation.

One submitter stated that no adviser would indicate they are non-independent or aligned. She stated that if a client rings a product provider for advice they will know the adviser is aligned. It was suggested that commission should be dealt with via full and up-front disclosure and that investors need to become sufficiently financially literate to read them.

One submitter stated that if there is clear disclosure there should be no issue about independence.

One submitter stated that the public can make their own decision about how "aligned" an adviser might be, and whether this is concerning to them.

One submitter stated that it is not necessary to require AFAs to call themselves "non-independent" or "non-objective" and that the rules will prevent them from saying that they are both independent and/or objective.

One submitter considered that it was sufficient that AFAs are not able to call themselves "independent" in these circumstances. That submitter stated that given the disclosure required by

standards 2 and 3 (and the disclosure regulations), it is unnecessary for AFAs to also be required to indicate that they are not independent.

One submitter stated that full up-front disclosure should cover these issues and it would be commercially unrealistic for advisers to call themselves non-independent.

One submitter agreed that AFAs who receive commission or payments (and also other non-monetary and soft-dollar rewards) should not be able to call themselves independent or objective. That submitter stated that the use of the terms “non-independent” or “aligned” would require elaboration or need to be accompanied by an explanation to the client of what they mean.

One submitter stated that it was sufficient if advisers who received commissions could not describe themselves as independent, and it was not necessary that they expressly identify themselves as “non-independent.”

One submitter stated that AFAs should not be required to label themselves as non-independent and objective as this places an unduly negative connotation on advice provided by the vast majority of financial advisers. That submitter stated that this could be addressed by the Code:

- setting out the circumstances in which it would be appropriate for an AFA to claim to be independent; and
- requiring disclosure of any limits on the range of products/services and any direct or indirect fees or other payments received.

Four submitters stated that no AFA will want to promote themselves as “non-independent” or to have their objectivity in doubt. They stated that best way to deal with this is to mitigate the situation by full up front disclosure of all remuneration, the alignment of products and links to related companies.

One submitter stated that only AFAs who meet the proposed test for “independence” should be able to call themselves “independent”. However they said there is limited benefit in requiring other AFAs who do not meet the test to call themselves “non-independent” or “aligned” and that requiring them to identify themselves as “non-independent” will undermine the advice provided by the AFA, no matter what their skills or qualifications. They submitted that the term “aligned” may be appropriate for employees of large FSPs, however it is less appropriate for AFAs who are connected to FSPs in other ways such as AFAs who advise on products provided by many different FSPs but receive payment by commission.

Nineteen submitters suggested that full disclosure, up-front, of all remuneration and alignment of products was the best way of mitigating any risks.

One submitter suggested that written notice of potential conflicts should be given at the outset, followed by verbal disclosure of any potential conflicts that are relevant to subsequent advice.

One submitter suggested that it was sufficient for the adviser to be forbidden from describing themselves as independent or objective, given that standard 2(2) requires them to inform the client of their lack of independence and of the client’s opportunity to seek independent advice.

Another submitter suggested that this was a “non-issue” as long as there was sufficient disclosure.

Proposed standard 4

Proposed standard 4: AFAs must not falsely assert independence or objectivity

An AFA must not state or imply that he or she, or his or her financial adviser services, are independent and/or objective unless that is the case.

One submitter suggested that a better approach is for the adviser to be required to disclose to the client the nature of their relationship to the provider – i.e. the size of the commission, if they earn one, or the targets they have to meet – so that clients can make an informed decision. They stated that if both commission-earning and tied advisers are barred from calling themselves independent, clients will have no way of knowing how they are not independent.

One submitter stated that proposed standard 4 should be re-drafted as follows:

“All AFAs must provide financial adviser services with an objective mind. Objectivity

(a) requires AFAs to be fair, impartial and intellectually honest; and

(b) is a state of mind that has regard to all considerations relevant to the task in hand but no other.

~~An AFA must not state or imply that he or she, or his or her financial adviser services, are independent and/or objective unless that is the case.”~~

One submitter stated that advisers are subject to the Fair Trading Act 1986 which prevents advisers from operating in a confusing, misleading or deceitful way. They argued that this is sufficient protection for clients as advisers are not permitted to use the words “independent” and “objective” in a misleading way. It was stated that while an adviser will always seek to provide an objective service, it is rarely practical to claim complete “independence” from providers. However it was stated that advice can be independent from the product solution.

One submitter suggested that the content of standard 4 was already adequately covered by existing legislation such as the Fair Trading Act.

Additional standards of independence, objectivity and managing conflicts of interest

One submitter stated that the Code should include a standard that addresses how AFAs should manage their own feelings and prejudices to achieve a proper balancing of each client’s interests. It was submitted that the new standard should require AFAs to be fair, impartial and intellectually honest and to approach all professional work with an objective mind (ie rule 3 of NZICA rules).

QUESTION EIGHT: Some overseas regulatory bodies have considered stopping financial advisers from accepting commission. The Committee would like to hear your feedback and submissions on whether you think such an approach would be appropriate in New Zealand (so that receiving a commission without rebating it to the client would be a breach of the Code). What effect would this have on consumers and the industry in various sectors: insurance, investment, financial planning, credit contracts and any other relevant sector?

SUMMARY

The majority of submitters expressed the opinion that commission should **not** be banned, however, there were still a significant number of submitters who expressed approval of a ban on commission.

In support

Submitters in support of banning commission reasoned that commission should be banned as it creates bias and conflicts of interest. Some submitters stated that banning commission would boost consumer confidence. Many of those in support of banning commission suggested that if a ban was to be imposed, the ban should be implemented in a transitional manner so that AFAs have an opportunity to change their business models.

Some submitters suggested that only certain categories of AFA should be banned from receiving commission:

- financial planners; and
- AFAs who sell investment products.

Not in support

Some of the submitters who were not in favour of a ban stated that consumer choice was important and that disclosure was sufficient to protect consumers. Several submitters suggested that banning commission may not result in higher quality advice.

It was also argued that commission provided the following benefits:

- motivation for AFAs; and
- reduction in costs for consumers thereby encouraging clients to seek financial advice.

Submitters also suggested that if commission was to be banned, many financial advisers will leave the financial sector resulting in a vacuum of experienced advisers. A number of submitters suggested that if commission was banned, the client would lose out and the product provider (who previously paid the commission) would benefit as they would no longer be required to pay commission.

Mortgage, insurance and share broking sectors

A number of submissions were directed to the impact of banning commission on the mortgage, insurance and share broking industries. In terms of the mortgage sector, several submitters stated that clients who are wanting advice on a mortgage are in need of cash and generally do not have spare money to spend on financial advisers' fees (unlike investors). Some expressed concerns that if commission in the mortgage sector is to be banned consumers will not pay for advice and may transact directly with lenders. One submitter also made the point that commission varied little

between providers in the mortgage sector and therefore there was little risk that brokers would choose particular mortgage solutions to maximise personal gain.

It was suggested that banning commission in the insurance sector will result in more frequent under-insurance and sales of unsuitable insurance policies as consumers will not pay fees to receive advice.

Share brokers made the submission that charging clients to access new share issues would affect the uptake of primary market offerings.

A number of those who were not in favour of a ban stated that banning commission is not an issue that the Code Committee should be dealing with, but a matter for Parliament.

Several submitters expressed the view that the approach to commission should be aligned with other countries' approaches.

INDIVIDUAL SUBMISSIONS

Commission should be banned

One submitter stated that AFAs should be under a duty to avoid conflicts of interest and this includes not being paid by commission.

One submitter stated that commission has the potential to affect the behaviour of a small number of advisers and that commission is the subject of on-going negative publicity. It was suggested that commission should be eliminated and rebated on investment products.

One submitter stated that AFAs should not receive commission of any type, on the basis that this will always threaten independence and objectivity and compromise the AFA's ability to put the interests of the client first. It was acknowledged that while such a move may result in higher fees it would result in renewed confidence in the industry. They stated that transparency is preferable to the current situation where the line between advice and a sales pitch has become blurred.

One submitter was considering aligning itself with the Australian position and removing the payment of commissions for savings products. Although the submitter does not believe that this will on its own improve the quality of the advice, they stated that it will improve public perceptions.

Another submitter suggested that New Zealand should follow the lead of other countries and ban commissions because they created an inherent conflict of interest.

One submitter endorsed the United Kingdom approach, and suggested that commissions engendered bad business practices from advisers. It was suggested that the Committee take guidance from the United Kingdom Financial Services Authority's Consultation paper.

Time for transition

One submitter suggested that a fee-based (as opposed to commission-based) model was preferable, but that it might take time to make the transition to that model and it was necessary to consider the time needed to make that transition from entrenched business models.

One submitter stated that it would be more appropriate for the issue of commission to be dealt with separately to the Code consultation process. However that submitter was generally in support of phasing out commission in respect of savings and investment products, though they considered that any such prohibition should not apply to existing businesses given that there will be existing binding contracts in place.

One submitter stated that they strongly support the stance the Code Committee has taken regarding the term “independent”. It was submitted that the preference of their working group would be to require independence as this is seen as a key aspect for the provision of high quality professional financial advice. That submitter stated that it is likely that the public’s expectations will be that they will act independently and deliver advice that is free from influence and ideally this would mean that they do not receive commission or if commission cannot be avoided that it is rebated fully to the client. However it was stated that a ban on commission at present would cause significant practical difficulties. It was submitted that commission is ingrained in the financial advisory industry and it would be very difficult to avoid commission without limiting the scope of practice and an adviser’s ability to compete/participate in advisory markets.

One submitter stated that fundamental changes to accepting commissions and moving to a fee-based system requires extensive consultation with the industry because the changes affect whole business models. They stated that there would need to be a transition phase.

One submitter supported a transition to a fee-based system, but argued that it was necessary to recognise the circumstances in which commissions served a useful purpose (e.g. where clients have modest funds to invest.) They stated that commissions are not necessarily a problem as long as full disclosure is made.

Another submitter suggested that a transitional period should be permitted for the investment industry, with a review in a few years’ time (and no change in the insurance industry in the meantime).

Financial planners should not be permitted to receive commission

One submitter stated that a prohibition on accepting payments from third parties should be included for financial planners, or “personal advice” advisers. It was also submitted that transaction-based fees should be prohibited for services such as financial planning, as remuneration is dependent on transactional activity – which may not be in the client’s best interest.

That submitter stated that fund managers and financial planners are two examples of financial advisers who should be paid on a non-transactional basis to avoid conflict. It was submitted that an hourly rate or a fee based on total funds under “administration” should be used.

Commission on investments

One submitter stated that commissions on investment products be banned, but that they be permitted for risk management insurance.

One submitter suggested that, for investments, a hybrid model could be used whereby the client had the choice of paying the fee or allowing the commission, with any commission that exceeded the level of the fee being rebated.

Another submitter supported banning commissions in the investment industry.

One submitter suggested that commissions for investments and savings products should be banned completely. That submitter suggested making an exception for KiwiSaver, but suggested that this would be problematic and should be transitioned-out.

One submitter stated that their preference is that commission attached to investment products should be replaced by an agreement with clients to pay a fee for investment advice. The medium term timeframe recognises that the most important thing (after disclosure) from a client perspective in relation to remuneration is the cost to them, rather than the form (fee or commission).

Independent advisers vs “sales”

One submitter stated that fiduciary or “independent” advisers should not be permitted to accept third party payments. It was submitted that advisers who are in effect salespersons and non-independent and representing themselves as such should be permitted to receive third party payments. It was submitted that rebates or concessionary rates should always be passed back to clients by independent advisers.

Neutral

One submitter stated that they did not have a position on whether commission should be discontinued. That submitter stated that they do not consider that any of its current advisers receive commission within the usual meaning of that term.

One submitter stated that their advisers do not charge commission for their advice. It was stated that bonus and incentive payments of advisers do not affect the level of fees payable to the client.

Commission should not be banned

One submitter stated that this approach is inappropriate. It was submitted that the object of regulatory reform and ongoing supervision should be to create standards and govern behaviour and to encourage professionalism. They stated that choosing a particular business model or form of remuneration and attempting to ban it when it is acceptable and desirable for the majority of consumers and industries is inappropriate and inequitable. It was submitted that bad law will inevitably be worked around.

One submitter stated that this would not be appropriate for New Zealand. It was submitted that it is not commissions that matter but integrity. It was also submitted that commission should not be banned. It was also stated that the implication appears to be that if you work on a commission basis then the advice is tainted or of no use. That submitter stated that banning commission would have a dramatic effect on the industry.

One submitter stated that product providers (finance companies) are wholesalers and advisers are retailers. It was submitted that retailers incur costs which must be reimbursed and that commission is a transparent way of making sales related compensation. They stated that the commission is paid as income to the adviser to cover his or her costs and it is not the property of any particular investor.

That submitter stated that to get rid of the word “commission” and its negative connotations, advisers could be recompensed via a distribution allowance ie a lump sum payment with a formula being detailed in the Investment Statement. It was suggested that those charged with approving investment statements must ensure a fairly level playing field between those marketing through advisers (exclusively or in parallel with in-house distribution).

One submitter suggested that commission is not the real issue and the real problem is poor advice and inappropriate portfolios. That submitter stated that banning commission will not necessarily lead to better advice.

One submitter noted that banning commissions in a share broking or bond trading environment could be very difficult, and requires further consideration.

One submitter suggested that commissions could not be banned until financial literacy among the public was increased, so that members of the public were willing to pay fees for independent advice. They stated that until then, banning commissions would just leave most non-wealthy clients to flounder.

One submitter suggested that, in the future, it might be appropriate to set commissions “across the board” so that the adviser receives the same commission regardless of the recommendation made.

One submitter pointed to the uninformed nature of much of the public discussion of commissions, and noted that KiwiSaver legislation places severe constraints on the commissions payable so the problems that have occurred in the UK, for example, cannot occur here. That submitter noted that upfront commissions are now relatively uncommon, and that they are often rebated. It noted that trail commissions vary little from one product to another, and argued that clients were protected if full disclosure was provided.

One submitter was resolutely opposed to this proposal.

Two submitters stated that they strongly opposed the proposal to ban commissions, and suggested that it would have a damaging effect on attempts to develop the country's capital markets.

One submitter suggested that, given the scope of the changes already being contemplated, banning commissions would be too drastic a step – and have too drastic implications for the provision of financial advice in New Zealand – to be done at the same time.

One submitter questioned the assumption that commissions necessarily created bias or conflict, and also pointed out that not all commissions are the same. They also suggested that it was only with non-bank deposit takers that there was a perception of commissions create undue pressure to place business with a particular provider. They stated that this perception did not apply to equity issuers.

Two submitters suggested that it would be grossly inappropriate to attempt to define acceptable revenue methods. Those submitters suggested that any attempts to define acceptable forms of revenue would lead participants to attempt to circumvent the rules.

One submitter suggested that there was also the potential for unintended consequences, so that brokers might become liable for underwriting fees, thus making them more keen to sell the products, creating a hidden conflict.

One submitter suggested that commissions *per se* were not the problem. On the basis of an analysis of the commissions paid by various failed finance companies, it was suggested that the problem was largely a certain number of “crooked” advisers, as well as “crooked” issuers. That submitter also noted that there was not necessarily a link between high commissions and rates of finance company collapse. They stated that some of the highest commissions are payable on managed funds (offered by banks, for example), and that the incentives that some companies offered were often soft dollars.

That submitter also noted that advisers often did not even know how much a commission would be (i.e. how much the client invests) until the credit appears in their account.

One submitter argued that at least 50% of the business of failed finance companies was done directly with clients, so they stated that the link between commissions and finance company failures is tenuous.

One submitter suggested that all forms of remuneration bear moral hazard, and referred to the blog entry for 4 December 2009 on the Goodreturns website.

One submitter suggested that commissions serve a useful purpose, and if he, as an investor, was happy with his adviser receiving a commission did not see why the Code should prevent that.

One submitter pointed out that current legislation requires financial advisers to make sure the product is fit for purpose and that this reduces any concerns regarding bias with regard to commission.

One submitter stated that the issue is more complex than simply banning commission. Her recommendation was that issuers should ensure that commission is commensurate with the level of risk and that this is disclosed to the investor. That submitter stated that where an adviser charges a fee, the commission should be rebated to the consumer but above all, the risk profile of the security

should be made clear. She submitted that it should be compulsory for AFAs to provide a view of the security including the risks associated with the investment.

One submitter suggested that detailed research on advisers' actual revenue streams be done before imposing requirements. They stated that if commissions were banned, the transition would have to be managed carefully and the public's financial literacy improved.

Customer choice

One submitter stated that how the adviser is paid should be left to market forces.

Another submitter noted the risks posed by advisers receiving commissions but suggested that it was for the investor to decide what risks to run.

Banning commission will not necessarily mean higher quality services

Three submitters questioned whether a fee-based service would guarantee high quality services.

One submitter stated that with regard to investment advice she fails to see the connection between stopping commission and providing better advice to clients. It was submitted that it is the integrity of the adviser and the qualifications of the adviser that matter.

One submitter suggested that banning commissions would have a particularly damaging effect for firms that provide research, analysis and market knowledge. They stated that these firms will be forced to increase the fees charged to consumers, which may cause them to take their business to low cost firms that provide a less complete service. They suggested that this would increase, rather than decrease, the risk to consumers.

Disclosure should be sufficient and commission should not be banned

Seven submitters stated that robust disclosure of remuneration should be sufficient and a ban on commission is not required.

One submitter suggested that, as a client, it did not matter that her advisers were being paid by commission, provided that everything was done transparently.

One submitter stated that all AFAs should be required to disclose the existence of commission, incentives or restrictions in product offerings to the consumer.

One submitter stated that provided commission levels are disclosed to the consumer and substantial differences exposed, the consumer will have the information to make appropriate decisions.

Another submitter suggested that disclosure must be clear and complete particularly regarding commission or other payment or rewards (whether in cash or in kind) associated with the selling of particular products.

One submitter stated that at this point, the best approach is full disclosure rather than requiring purely fee-based services or full rebate of commission.

One submitter stated that this is an issue when the client is unaware of the commission, the size of the commission or the conflict of interest. If a commission is payable, the AFA is not providing independent advice and the client must be made aware of that.

One submitter suggested that as long as the client was fully informed of the different commissions payable, s/he could make an informed decision.

One submitter stated that AFAs should be required to disclose the costs and let the clients choose.

One submitter stated that their disclosure statement fully discloses any of these arrangements and under the new regulations, for financial products, advisers are required to advise of any remuneration that might be received.

One submitter stated that if proper disclosure is made that should be acceptable. It was submitted that receipt of commission alone does not make the conduct of a financial adviser unprofessional.

One submitter stated that they feel strongly that banning AFAs from receiving commission is inappropriate. They stated that disclosure is the key for both investment and risk. It was submitted that this allows the client to make an informed decision.

One submitter suggested that how an adviser gets paid is a matter for agreement between the adviser and their client, and that transparency of remuneration should be more important than its source.

One submitter recommended that disclosure of commission simply indicate the commission percentage rather than the dollar value if the Committee considers it necessary to require this.

Benefits of commission

Motivation for AFAs

One submitter stated that commission and performance-related bonuses can be effective ways to motivate and reward financial advisers and this is a fundamental element of how many financial advisory services operate. Prohibiting such remuneration would impose serious efficiency costs on the industry to the detriment of the client. Another submitter agreed that commission is a means by which a product supplier rewards its distributors.

Commission reduces costs for consumers

One submitter stated that the consultation paper presents an over-simplified stance which does not reflect each service within the financial services industry. It was submitted that if a client fee model is adopted to replace the current commission model those that can least afford to pay for advice will be affected.

One submitter suggested that, after full disclosure had been made, it might still be in the client's best interests to use an AFA who receives commission (if the client cannot afford an upfront fee).

Another submitter stated that banning commission may lead to a fee structure that would be too expensive for clients who only have \$50,000 to \$100,000 to invest. It was submitted that this would affect the investment and financial planning sectors particularly.

One submitter stated that banning commission would increase the cost of products and services for consumers.

One submitter stated that consumers are reluctant to pay fees for advice and this does not reflect the standard of the advice, it is a reflection of the culture of the country ie DIY attitude. It was submitted that the majority of clients choose commission instead of fees. It was also stated that banning commission would reduce consumer use of financial service products and would cripple the advisory capacity of the industry.

One submitter also noted that investors with modest incomes would not be willing to pay adequate fees upfront, but the only workable solution is for fees to be paid over a number of years, which enables the adviser to earn adequate revenue from the client and for the client to obtain full continuing advice.

One submitter stated that New Zealanders generally are not prepared to pay for financial advice, but they are quite happy to allow a product supplier to pay commission or brokerage or trail commission. They submitted that unsophisticated investors, which the Code Committee is trying to protect, often do not have a lot of money and simply will not be able to afford to pay for any advice and will not buy the financial and insurance products that they so desperately need.

One submitter stated that abolition of commission would be replaced by fees which may not be the best outcome for clients.

One submitter stated that clients generally do not object to commission and it is an effective option for the client. It was submitted that clients would not pay fees to cover the time spent and many clients would go without advice. That submitter also stated that this is a cheaper option for product suppliers as without commission product providers would need to employ people on salaries.

One submitter stated that the client would end up paying more if commission is banned.

One submitter argued that banning commissions would have a negative effect on customers who could not afford to pay fees.

One submitter stated that if commission is banned then a free service becomes a costly one. That submitter stated that to avoid additional administration costs (eg platform) and/or tax disadvantages, there should be a provision for clients to agree that the adviser/adviser's company will receive specified commission in lieu of a fee. He submitted that any change should not prevent consenting parties entering into a mutually agreed arrangement.

One submitter stated that banning commission will make investment and risk advice too expensive for many clients and many clients will resort to DIY investing.

One submitter suggested that banning commissions would detract from the FAA objective of securing "efficient delivery of financial advice" because consumers would be unwilling to pay fees upfront.

Another submitter suggested that charging commission is a valid business model and is very popular among clients. He stated that clients are fully informed of the adviser's sources of remuneration but value the fact that they are not charged personally.

One submitter suggested that this would be "ludicrous" and would make advice too expensive.

One submitter suggested that brokerage is a less expensive option for low-net worth clients.

Encourages clients to take financial advice

One submitter stated that commission/brokerage is disclosed to the clients and the key factor for clients is that they do not need to pay. It was suggested that stopping AFAs from receiving commission will stop DIY investors from seeking advice and stop them from seeking access to the investments they want.

One submitter referred to Chris Lee's brokerage business model and stated that Chris Lee does not charge clients but receives brokerage and commission from product suppliers. The submitter stated that they changed their business model to match this.

One submitter stated that banning commission may lead clients to go straight to the product supplier without financial advice and that the Code should encourage consumers to seek financial advice.

One submitter stated that if higher fees are charged then clients will seek to make investments without taking advice which is risky.

One submitter stated that if broking services became more expensive, there is a risk that clients would choose to do the analysis themselves, using a firm only to effect the transaction, thus creating *more* risk for investors rather than less.

Commission enables AFAs to provide a range of products

One submitter stated that commission is a very efficient and appropriate method that suppliers of financial services have used to remunerate contractors. It was submitted that this enables contractors to provide a range of products that can be tailored to meet the client's needs. By virtue

of having a range of suppliers as long as production levels are not mandated, the consumer can have confidence that product selection will remain independent and appropriate to their needs.

Without commission the number of AFAs will be reduced

One submitter stated that if commission is banned the number of AFAs would be reduced and would result in an environment that only suits the large corporate players.

One submitter referred to a survey done in New Zealand several years ago which indicated that the public were prepared to pay approximately \$38 per hour for financial adviser services. That submitter stated that banning commission would “annihilate” the livelihoods of financial advisers. The submitter stated that his company would bill less than \$5,000 per annum via an hourly rate.

One submitter stated that many experienced advisers will leave the industry due to the dramatic change to their business model.

Rebates of commission mean that the product provider ceases to pay

One submitter stated that if commission is banned then product providers will benefit from cost savings. In this situation steps should be made to ensure that product providers are required to pass the cost of savings on to the consumer by way of higher returns and/or lower fees.

One submitter stated that any rebating procedure will only mean that the product provider will cease to pay and the client will pick up the cost.

Another submitter suggested that if commissions were banned, then only the issuer would benefit because they would no longer have to pay brokers a commission and the broker’s costs would be passed on to the client in the form of fees.

Impact of commission in different advising sectors

One submitter stated that if commission was banned in the AFA sector then it should be banned in all other sectors. (However he submitted that it is not the payment method that has caused the problems in this sector.)

Mortgage broking

One submitter suggested that the fact that a mortgage broker’s clients were seeking to take on debt – not invest funds – meant that they did not have money to pay fees, which made commissions important. That submitter suggested that, in its experience, the commission paid by lender partners does not influence the products chosen, which are selected on the basis of an analysis and review of the client’s needs. The fee paid by lenders is said to be in consideration for a “well presented and complete application form.”

One submitter stated that removing the ability for advisers to earn commission would be disastrous for the mortgage and insurance advisory industries in three ways:

1. These industries are largely decentralised and have structured their business to enable advisers to distribute their products. The proposed change would lead to a reduction in independent advisers and a corresponding increase in tied advisers, which would in turn lead firms not capable of structuring their business in that way to go out of business.
2. The increase in tied advisers will mean more advisers offer limited advice on a limited range of products and will be driven by their sales targets. While ties will need to be disclosed, clients will still accept inferior advice because it is free.
3. Mortgage clients will generally be unwilling or unable to pay fees, so will resort to obtaining free advice from tied advisers. Clients’ needs will no longer be assessed and an appropriate product chosen for them, because the focus will be on selling.

One submitter stated that banning commission would undermine the entire mortgage broking industry and that it would force clients to transact directly with lenders, who would be likely to structure the loans to suit their interests. That submitter suggested that commissions varied little between providers, so there was little scope for brokers to inappropriately prefer one provider over another solely to maximise personal gain.

That submitter stated that innovative mortgage products, such as 100% home loans, were traditionally promoted by non-bank lenders and if they were deprived of the broking distribution channel the public would be deprived of these innovations. It was submitted that this would only exacerbate the dominance that the large banks have in the lending market.

Insurance

One submitter noted that insurance brokers earn a major portion of their income through commissions tied directly to the sale of particular insurance products and also earn more as a result of selling higher volumes of particular products (step-up). They stated that it is essential that these arrangements are fully disclosed to brokers' clients. They stated that on their reading of the Act, there is nothing that would require insurance brokers to be subject to the Code.

One submitter commented in relation to the effects on life and health insurance and submitted that this approach would be wholly inappropriate and would risk significant reduction in the life and health insurance uptake in New Zealand.

One submitter criticised the financial planning focus of the proposals, whereby insurance advisers would be required to become AFAs, and would be barred from earning commissions, when this is not necessarily appropriate.

Another submitter stated that life insurance is sold not bought and he submitted that few people would be prepared to pay fees to an adviser who sells life insurance. He submitted that banning commission could result in under-insurance.

One submitter expressed support for commission especially in the risk and mortgage sector commission provides a win-win and practical solution for all parties. It was stated that:

- Commissions empower customers who could not otherwise afford to pay;
- Commissions are only generated if the policy proposal proceeds;
- Commissions are renewable but they are not income. Commission only represents an adviser's gross revenue;
- Commission can be linked to reward systems such as production bonuses for advisers but this does not normally affect premiums paid by consumers;
- Commissions enable advisers to build self-sustaining practices and enable them to represent a number of providers in the interests of consumers ie when advisers prosper there is more choice for consumers in the marketplace;

That submitter stated that consumers would resist paying fees and that this would increase under-insurance and decrease financial literacy due to less advice being tendered.

One submitter stated that removing commission would be detrimental to the insurance sector. That submitter stated that consumers are unlikely to pay for insurance advice as many people are not aware that they need it.

One submitter argued that banning commissions for risk insurance would lead to a reduction in insurance in New Zealand, adding to the country's "under-insurance".

One submitter stated that commission in life insurance policies is “ridiculously high”. She stated that the industry has forced a change by no longer taking whole of life but focusing on term policies. She submitted that this has helped to reduce the commission however some insurance brokers continue to offer products to customers based on commission because the rates of commission vary much more widely than they do in the investment arena. She submitted that in the insurance arena, a summary of the policy and the level of commission should be disclosed to the public.

That submitter also noted that trail commissions are important in life insurance due to the annual review process and the “post-purpose” view of the insured particularly with regard to health insurance where the insured may not have used the policy at all. It was submitted that up-front commissions on insurance policies should be higher than the trail. Some providers may attempt to increase the commission by bundling policies under one provider whereas specialist providers may not be able to bundle to increase commission.

One submitter pointed to the potential for under-insurance if commissions were removed, because this would remove incentives to sell it.

One submitter pointed to the risk of under-insurance and therefore suggested that life risk advisers should be permitted to receive commissions. They stated that any change would have to be implemented slowly to avoid a mass transfer of fees on to consumers, which would discourage them from taking out insurance.

One submitter suggested that commissions were necessary for risk products.

One submitter suggested that, in a low-income area, insurance brokers would sell no insurance if they could not obtain commissions.

Share broking

One submitter stated that banning commissions would impact most on NZX participants, rather than financial planners, who primarily use a fee-based structure. They suggested that charging clients to access new issues would represent a significant change in business model and that this could have significant effects on the uptake (and therefore success or failure) of primary market offerings. They stated that it would have the effect of forcing consumers, rather than issuers and advisers, to pay for the costs of raising capital.

One submitter also raised the question of how commission in the broking and real estate sectors will be dealt with.

One submitter referred to the obligation that AFAs must not be misleading, confusing or deceitful. She stated that there will be instances where due to new issues of shares or bonds, investments are offered without payment of brokerage. She submitted that this is akin to a bank deposit where the depositor is not charged any brokerage. If the investment meets the required investment criteria then this is good as the consumer does not pay brokerage. She stated that often this is seen as “bad” as the adviser is remunerated by the issuer and therefore there must be a conflict of interests. However it was submitted that if an investor makes a decision to transact and an adviser assists, then an appropriate fee/commission should be payable. She submitted that the payment of a fee does not mean that the service lacks independence or objectivity as a good adviser would have undertaken all the necessary research before making a recommendation or it could be execution only.

One submitter suggested that the loss of revenue streams from IPOs would have a drastic effect on the ability of NZX firms to fund many of their services, particularly expensive research.

One submitter noted that, in NZX firms, generally the only commissions received are for initial public offerings of either debt or equity securities, where the issuer pays the brokerage. These commissions are fully disclosed, and are usually the same as the brokerage that would be charged if

it were a secondary market transaction. They stated that in the case of fixed interest securities, the selling fee may be higher (because the firm itself underwrites the issue).

Definition of commission

One submitter would like to know what would be included in the definition of “commission”. It was submitted that although the employees of their members are typically under no obligation to sell their products, members do take on the role of fund manager, trustee or statutory supervisor – all of which gives them the right to take fees for undertaking duties and obligations of that role. They stated that commission is usually defined as “a sum paid to an agent in a commercial transaction” and therefore the above example would not constitute “commission”.

One submitter stated that what is meant by “commission” should be clarified. It was submitted that as a formula for remuneration a commission based fee is acceptable for many services, e.g. services based on transaction advice, such as stock broking.

One submitter suggested that before banning commissions, an appropriate definition of “commission” is required.

Matter for Parliament/separate consideration

Twenty-two submitters made the comment that this is not an appropriate issue for the Code Committee and should be for Parliament.

One submitter stated that this is an issue for higher authorities as it has wide-ranging impact on how financial advisers are to be remunerated (especially the unlisted sector where most investor problems have occurred). It was noted that in the United States market there is greater depth of product and a better understanding of the importance of advice and that in the United States both commission and fee-based remuneration models co-exist.

One submitter suggested that this was a matter for the Government, which could consider the policy implications of consumers being forced to pay for advice personally and the potential for other remuneration arrangements to take the place of commissions.

Two submitters stated that consideration of this issue is inappropriate for the Code. It was submitted that because of the “wide-ranging consequences to the structure of the entire securities industry” it is a matter that should be considered at parliamentary level.

One submitter stated that commission falls outside the main scope of the Code Committee’s proposed standards. They stated that discussion on commission is an unwelcome distraction from the higher priority matters affecting consumers such as competitive issues flowing from the QFE model and structural changes in the industry.

One submitter stated that steps to remove commission should be only undertaken in a separate regulatory process with dedicated analysis and consultation. Therefore they said that the code should focus on transparency of commissions by requiring disclosure of all forms of remuneration.

One submitter suggested that these proposals would affect advisers’ business models and potentially exceed the scope of the Code’s role under s 86 of the FAA.

One submitter suggested that the consequences of the change required consideration separate from the main Code formulation process.

Alignment with overseas standards

One submitter stated that New Zealand should be aligned with international standards but the Code Committee should assess what works and what does not from other overseas markets before considering any action.

Another submitter suggested that regard should be had to consistency with Australian developments, where commissions have not yet been banned.

QUESTION NINE: Do you consider that non-financial benefits should be taken into account in determining whether an AFA is independent and objective?

SUMMARY

The majority of submitters agreed that non-financial benefits should be taken into account in determining whether an AFA is independent and objective.

One submitter noted that although some non-financial benefits (ie seminars and training) are beneficial in terms of elevating the quality of advice, it would be too difficult to distinguish between non-financial benefits that will provide an indirect benefit to the consumer and non-financial benefits that are purely designed to incentivise AFAs to sell the provider's products.

A number of submitters stated that there should be a materiality threshold for taking non-financial benefits into account. Some suggested a monetary limit ie \$100.

Some submitters stated that taking non-financial benefits into account is inappropriate and that disclosure is sufficient.

INDIVIDUAL SUBMISSIONS

Yes non-financial benefits should be taken into account

Twenty-five submitters agreed that non financial benefits should be included.

One submitter stated that AFAs cannot provide independent and objective services based on high levels of consumer protection, if they receive incentives, and this includes non-financial benefits.

One submitter stated that non-financial benefits should be taken into account to the extent they would be regarded as an influencing factor.

One submitter stated that "non-financial benefits" should be taken into account in determining whether an AFA is independent or objective. It was stated that non-financial benefits such as training, research and analytics, Bloomberg screens, phone lines etc have the same potential as commission to create a conflict of interest. They noted that if non-financial benefits are not regulated there is a risk that existing financial benefits will be repackaged as non-financial benefits to circumvent the rules and this would not be consistent with the aims of the FAA.

One submitter stated that non-financial benefits should be given the same weight as financial benefits in the assessment of independence and objectivity.

One submitter said that non-financial benefits have the ability to be a significant threat to an adviser's objectivity and independence and agreed that non-financial benefits should be taken into account. They submitted that certain types of benefits could be beneficial to the quality of advice offered ie software, support services, ongoing education. Therefore they stated that there could be an argument to limit the non-financial benefits to those that have no reasonable link to the provision of quality advice, ie those that are clearly designed to solely act as incentives for delivery of increased business volume. However that submitter did not recommend that approach as:

- it would be difficult to distinguish between the two classes of benefit; and
- while certain benefits may not affect the AFA's independence, users may not appreciate that the benefit is actually "good" and therefore independence would still be perceived as

affected. Clients only see that the adviser is receiving something presumably as a reward for the level of business being written.

One submitter agreed that non-financial benefits should be taken into account but that non-financial benefits need to be defined for greater certainty.

One submitter stated that disclosure of non-financial benefits should be taken into account when the AFA communicates the extent of independence or alignment. It was submitted that non-financial benefits should be treated the same as financial benefits eg subsidised software costs, offshore conferences etc.

One submitter stated that if reference is being made to benefits such as staff training, overseas conferences, corporate entertainment, then they agree as these can cause conflicts of interests.

One submitter suggested that proposed standard 3 should be expanded to capture indirect remuneration in the form of "soft dollars", professional association dues and office cost subsidies.

One submitter stated that there are circumstances where non-financial benefits should be considered.

One submitter stated that material soft dollar commissions ie trips or conferences should be fully disclosed. If an AFA does receive non-financial benefits, this should be taken into account in assessing whether the AFA meets the test of independence. They stated that they do not consider the receipt of non-financial benefits alone should prevent an AFA from being considered to be objective.

One submitter noted that gifts from suppliers are common in different occupations, but they can seriously affect a person's objectivity.

One submitter suggested that any benefits, material or non-material, ought to be disclosed to clients.

One submitter suggested that non-financial benefits were particularly concerning when they were triggered by a client transaction involving a particular lender.

One submitter stressed that identifying and quantifying non-financial benefits and "soft dollar type support" was very difficult (especially compared to commissions). The submitter therefore suggested that receipt of any such benefits would compromise them and preclude them from claiming independence or objectivity.

One submitter suggested that non-financial benefits were relevant, subject to its reservation as to the use of the term "independent."

Two submitters suggested that all benefits must be disclosed, but definitions and clarification are needed.

Insignificant or remote benefits

One submitter stated that non-financial benefits should be taken into account provided they are not so remote or insignificant that they cannot be reasonably regarded as likely to influence the person providing the services.

One submitter agreed that non-financial benefits should be taken into account in determining whether an AFA is independent. However it was suggested that there should be a materiality

threshold. They submitted that non-financial benefits should only be taken into account to the extent they are provided in return for the AFA providing valuable consideration to the person providing the financial benefit (such as the AFA selling certain products or agreeing to sell a specified amount/proportion of certain products). For example, the provision of a newsletter containing useful information to advisers by a provider should not compromise independence unless the adviser is required to do something in return for receiving that letter. They also noted that the receipt of benefits (financial or otherwise) does not necessarily mean that an AFA cannot give objective advice.

That submitter stated that given that an AFA may potentially receive a wide range of non-financial benefits from a relatively large number of product providers, it will be necessary to ensure that disclosure requirements do not lead to lengthy statements that are too complicated for consumers.

One submitter stated that a threshold should apply for non-financial benefits so as to exclude minimal benefits, such as being taken out to lunch – the limit should be \$500 per item.

One submitter suggested that small gifts, worth less than \$100, should not be required to be disclosed provided they are irregular and not tied to any targets.

Four submitters suggested that only *material* non-financial benefits ought to be disclosed.

One submitter suggested that non-financial benefits (such as IT support, soft dollars, marketing support, holidays, travel concessions, etc), including those accruing to the adviser's aggregator group, should be disclosed, but that there should be a materiality threshold.

One submitter suggested that only *material* non-financial benefits should be taken into account, because many potentially-captured services may not be material: for example, a provider may make a free presentation about a new product, which it is necessary for the adviser to attend in order to accurately advise on the product. That submitter noted, on the other hand, that benefits such as prizes for directing a certain quantity of business should qualify as material. They noted that the distinction was difficult to draw and guidance should be provided so that advisers are able to make a judgement.

One submitter stated that a materiality threshold (e.g. \$100) would be required.

Another submitter suggested that the term "financial benefits" in (3)(a) be replaced with "material benefits, whether monetary or otherwise" and that materiality be defined according to whether there is a link to sales volume.

One submitter pointed to the example of a free presentation by a provider, and suggested that this should not necessarily mean that an adviser was not independent or objective.

Non-financial benefits should not be taken into account

One submitter stated that non financial benefits should not be taken into account. It was implied that it will be difficult to draw the line ie where a broker is invited to a briefing and is given lunch or a bottle of wine at Christmas.

One submitter stated that non-financial benefits should be disclosed but should not be taken into account in deciding whether an AFA can call themselves independent.

One submitter suggested that disclosure was all that was necessary.

One submitter responded "no".

Non-financial benefits are irrelevant

One submitter stated that the type of remuneration is not particularly pertinent in determining the ability of an adviser to provide advice that is objective and independent. Therefore it was submitted that non-financial benefits are just as irrelevant in deciding whether an AFA is independent as any other form of remuneration.

Taking account of non-financial benefits of the AFA's family is inappropriate

One submitter stated that provided non-financial benefits are disclosed, the obligations are fulfilled. He submitted that including non-financial benefits of members of the AFA's family including children, parents and grandparents is too much.

General comments

One submitter suggested that inducements were difficult to judge, but that all benefits should be considered (and disclosed to the client) when objectivity was being assessed.

One submitter suggested that very plain language was required in the adviser's disclosure statement.

One submitter questioned whether this standard was intended to encompass renewal commissions on life policies.

One submitter suggested that non-financial benefits should be disclosed, but should not necessarily disqualify an adviser from being an AFA.

Another submitter suggested that "non-financial benefit" should be clearly defined, and could include training, product accreditation, software/system support, research, conferences and gifts.

One submitter stated that it would depend on what the non-financial benefits were and their value. They said that it is usual for most organisations to have employment contracts and policies that prevent and/or restrict employees from receiving either financial or non-financial benefits in the course of their employment (other than salary).

QUESTION TEN: Do you consider an AFA is independent and objective if his or her financial adviser services are limited to financial products available through a particular platform where the AFA and all connections of the AFA have no financial interest in the platform?

(A platform in this context is any defined range of financial products made available by a particular financial service provider, or any form of portfolio administration or reporting service.)

SUMMARY

Although there were a number of submitters who gave a clear “yes” or “no” answer to this question, many submissions stated that the answer to this question depended on the conditions of the platform.

The crux of the matter is that not all platforms create the same risk to independence/objectivity. The greatest risk to independence/objectivity in relation to platforms was thought to arise where the platform:

- obliges the AFA to solely advise and recommend products that form part of the platform; and/or
- provides benefits (financial/non-financial) to the AFA in return for sales of those platform products.

A number of submissions suggested that the fact that an AFA uses a platform purely for “administrative efficiency” should not affect independence where there is no obligation to advise and recommend solely those platform products and where there are no benefits or incentives received by the AFA to sell those platform products.

Submitters also discussed the issue of limited product selection in general. It was observed that it is not possible for AFAs to advise on the whole world of products and it would not be desirable for AFAs to attempt this as it is not feasible for an AFA to be an expert on every product. But it was suggested that to be independent a “sufficient range” of products should be on offer. Many commented that AFAs who only provide products from a single provider could not be considered to be “independent”.

A number of submitters suggested that provided the AFA discloses the nature of the platforms, the fact that the products on offer are limited to those available through that provider/platform should not affect the AFA’s status as independent/objective.

Some submitters argued that an AFA may, in this situation described in question 10, not be independent but can still be objective.

Several submitters suggested that this issue is either a scope of services issue or an issue that should be dealt with by the AFA and the client.

INDIVIDUAL SUBMISSIONS

Yes the AFA is “independent”

Three submitters stated that if an AFA is limited to financial products available through a particular platform then he or she is still independent and objective if the AFA or their connections have no financial interest in the platform.

One submitter replied with a qualified yes, because such an adviser can still be independent if they only charge a fee to the client, and can still be objective while utilising a product platform provided they properly assess suitability and inform clients if they believe a product is unsuitable.

One submitter stated that they should be considered as independent and objective as they stated that AFAs can have independence within the framework of a particular platform. They stated that NZX Advisors for instance are associated with a particular platform (the NZX Markets). It was submitted that given the high standard of advice the standards require, very few advisers would have the experience and/or qualifications to provide comprehensive advice across multiple platforms.

One submitter said “yes” if the adviser uses a wrap system like Aegis or One Answer which has a wide range of products from various providers.

Another submitter said “yes” they are independent. They stated that ethical and professional advisers regularly display objectivity towards the consumers even when providing a limited product or service offering.

Objectivity

One submitter stated that such an AFA (as described in question ten) would be independent, but objective only to the extent or range of financial products available through that particular platform.

One submitter stated that where an adviser uses a “platform” with a set range of products, he or she is not independent but can still provide objective advice. It was stated that disclosure of a limited range of products should be mandatory.

One submitter stated that provided an insurance adviser adequately discloses such limitations, they can still be objective. For example, most international brokers have limitations on what insurers can use based on financial stability. It was stated that to infer that they are not independent would be inaccurate as they have set their standards in the clients best interests. Objectivity should be separated from independence.

One submitter stated that using a platform did not necessarily compromise objectivity and it depends on whether the adviser’s choice was constrained.

Disclosure is sufficient

Three submitters suggested that this matter be dealt with through disclosure.

Two submitters stated that limitations should be disclosed if the AFA cannot provide a wide range of products.

One submitter stated that as the product range will be restricted, the AFA should disclose the extent of the alignment.

One submitter suggested that, instead of referring to independence and objectivity, the standard should require that the adviser is “able to manage potential conflicts of interest.” For an adviser working with a platform, this would require disclosure of that fact as well as the nature of any relationships with the platform provider, such as an agreement to direct all clients to given products.

No the AFA is not independent/objective

One submitter stated that if an AFA subscribes to a particular platform, this should be disclosed and another description used as the AFA could not be completely independent or objective.

Two submitters stated that an AFA is not independent if he or she is limited to financial products available through a particular platform.

One submitter said “no” as in order to be independent, the adviser must have access to all products available in the market place.

One submitter stated that this situation could affect the adviser’s objectivity. They stated that the adviser is only able to be objective if he or she feels able, after obtaining all the necessary background information on the client, to advise against acquiring the limited range of products available. In this situation the submitter stated that it is important that the client fully understands the situation.

One submitter responded “no”, because the advice will be dependent on the platform. The submitter suggested that the appropriate solution was not to use the term “independent,” but to require full disclosure.

Another submitter suggested that this would impact on independence to an extent.

Perception of independence

One submitter stated that in all cases this situation would affect the AFA’s independence. This was because independence is more than actual independence but also equally important is the appearance of independence. It was submitted that there would always be questions in the mind of an outsider whether – if the adviser had access to all financial products, would the advice have been the same?

Key question relating to independence is whether there is an obligation/incentive to sell the product

One submitter pointed out that many financial advisers settle on their own recommended range of products because they believe they are the best and/or most suitable for the clients they deal with. Therefore the key factor should be whether a business obligation exists that restricts the ability of the adviser to offer objective advice.

One submitter stated that an AFA is independent and objective even if the services are limited to financial products available through a particular platform. That submitter stated that this is because the AFA or connection of the AFA:

- would not receive a direct or indirect benefit from the services; and
- is not under an obligation or party to an agreement that limits the AFA’s freedom to provide the services.

One submitter stated that although the AFA’s range of products will be limited in such circumstances, a distinction needs to be drawn between such a situation where an AFA uses a platform because they receive a financial incentive to do so (which in the submitter’s view would mean they are not independent) and where an AFA uses a platform for other reasons such as efficiency (ie the platform may enable client reporting to be a more straightforward process). They stated that there should be a distinction between relatively open platforms which are open to almost all investments and closed platforms, where the investment menu is constrained for any reason related to remuneration.

One submitter stated that the test for independence should focus on what financial and non-financial benefits the AFA receives and the contractual limitations on the range of financial adviser services that the AFA provides. They stated that if an AFA advises on a platform of products but is not contractually bound to advise only on those products, nor receives any benefit from them, the AFA should not be prevented from describing themselves as independent.

One submitter suggested that a distinction ought to be drawn between open platforms, that may be used for administrative efficiency, and closed platforms, where the range of available investments is constrained for reasons relating to remuneration.

One submitter suggested that the scope of this provision needed to be narrower (so that the test for an adviser using a platform to call themselves independent and objective was more rigorous). The submitter suggested the following additions: “Provided that the only payments for service comes from the client (either directly or indirectly from the client’s account on the platform)”; the “Provider of the platform should be indifferent to the product selection process other than on a demand basis by users / advisers”; and the “Provider must not offer the platform on the basis that products have been selected on any qualitative or quantitative performance basis.”

Another submitter suggested that if the use of a platform reduces the AFA’s backroom costs then that creates a conflict, and there is a conflict if the platform provider also provides products or where not all benefits flow through to clients.

Effect of limited product range (no obligation to sell particular amount nor incentive/benefits received)

Not possible to have knowledge of all products

One submitter pointed out that it is not possible for an AFA to be expert in every single product, so the range of products an AFA may advise on will always be limited to an extent but that does not mean that the AFA is not “independent”.

One submitter noted that the mere fact that the range of investments that an adviser offered was constrained was not necessarily a concern, because advisers could not be expected to be expert on all products.

Sufficient range of products is required for “independence”

One submitter stated that an AFA cannot be deemed independent or objective if the platform that provides the product range is from a single product provider.

One submitter stated that an AFA is not independent if they only supply one group of products. They stated that if an adviser gets paid to sell something (ie a wage or salary or receives any type of non-financial benefit) then they are not independent. It was submitted that they are selling their company’s preferred product range.

One submitter suggested that if an adviser is required to place *all* of their business through one platform, then they should not be considered independent.

One submitter suggested that whether an adviser uses a platform or not should not be determinative – what should matter is whether they are able to access an appropriately wide range of products through the platform so that they are not effectively aligned.

Two submitters suggested that having access to a platform would not necessarily compromise objectivity, as long as the range of products is wide enough and contains providers that the AFA does not have a financial interest in. Those two submitters suggested that if an AFA could only provide products from a provider with which they were aligned, then this should be disclosed to the client.

One submitter suggested that an adviser could hardly be considered independent if the range of products they could offer was predetermined by a third party and stated that disclosure is the only solution.

One submitter argued that independence and objectivity cannot be maintained if an adviser is limited to products from a particular platform.

One submitter suggested that an adviser cannot be independent if they use just one platform, particularly where the platform severely limits the range of products available (although this is not the case with most products.)

One submitter suggested that if an adviser was restricted in the products they could offer then they should not qualify as independent.

One submitter noted that platforms and custodial services vary widely in the investments that they are able to accommodate: for example, the AEGIS platform will accommodate any listed security on any recognised global exchange. In such cases the use of the platform can have no meaningful impact on an adviser's objectivity. That submitter suggested that where, on the other hand, a platform only accommodated a few options, particularly from a particular provider, then this should be fully disclosed to the client.

One submitter suggested that, in the mortgage and insurance market, having a panel of lenders or insurers does not necessarily compromise the quality of the advice because mortgage and insurance product providers are more "homogenous." They stated that provided the panel has a sufficient range of products to cater to all clients, the advice need not be compromised.

Scope of services issue not an "independence" issue

One submitter stated that the issue of limited platforms should not be seen as a conflict of interest issue and that rather it goes to the type of service being provided by the adviser and the duty to exercise reasonable care. It was submitted that there is a need to ensure that advisers are not forced into advising on areas outside their expertise. They provided the example of stockbrokers who should be able to offer advice on particular stock without being forced to provide more general "planning" or investment advice. They stated that it should be made clear in the contract the type of advice that is being offered.

Depends on which type of service is being provided

One submitter stated that if an AFA is limited to a particular platform or suite of products by virtue of an obligation to a supplier or manufacturer, then the AFA is not independent. The over-riding business obligation to recommend only (or predominantly) that suite of products nullifies the ability to consider product solutions objectively. However if an AFA is able to offer advice and is not necessarily being asked for particular product recommendations, then they are able to be independent. It was submitted that if an investment portfolio is sought then the adviser cannot be objective or independent as they subscribe to a particular platform. However if the client wanted a strategic financial plan, then the planner can objectively provide advice that is independent of their business obligation with that particular platform.

General comments

One submitter stated that an independent AFA should provide a client with products appropriate to their circumstances. It was submitted that most platforms do not limit investment choice.

Five submitters stated that they do not agree with the use of the word "independent". They stated that where there is a limitation due to the service provider's platforms or range of products, this must be disclosed.

One submitter stated that provided an adviser is compliant with their other duties (eg to be properly resourced, to exercise reasonable care) they should be considered to be independent.

One submitter stated that such AFAs are independent provided they do not receive commission.

One submitter suggested that these proposals would be too difficult to implement and for the public to understand, and that instead the adviser's disclosure statement should clearly state product sources, alignments, revenue streams, benefits received, etc.

One submitter rejected the concept of "independence," noting that an adviser offering a limited range of products can still be objective.

Four submitters suggested that this was a matter that ought to be left to advisers to disclose to their clients. One other submitter suggested that it should be for the client to decide.

QUESTION ELEVEN: Are the definitions of “connection of the AFA” and “member of the AFA’s family” appropriate? If not, why not?

It is proposed that the following will be regarded as a **connection of the AFA-**

- (a) a member of the AFA’s family; or
- (b) a trust of which the AFA, or a member of his or her family, is a beneficiary; or
- (c) an entity in which the AFA, or a member of his or her family, has a financial interest; or
- (d) a business partner or prospective business partner of the AFA; or
- (e) an employer or prospective employer of the AFA.

It is proposed that the persons who will be considered to be a **member of the AFA’s family** will be his or her spouse, civil union partner, de facto partner, child, parent or grandparent.

SUMMARY

Submitters suggested a variety of changes to these definitions. A number of submitters approached the question from the point of view that the key issue is whether the relationship with the “connection of the AFA” or “member of the AFA” is likely to influence the AFA in some way. A number of submitters referred to the definitions in the NZX Rules which focus on “influence and benefit”.

Member of AFA’s family

A number of submitters suggested that siblings should be included in the definition. Several submitters stated that family members such as aunts, uncles, cousins and grandchildren should be included.

Other submitters stated that the definition is too broad and includes people that in reality may have a very limited connection with the AFA ie grandparents who live overseas. Along with other suggested changes to this definition: some stated that grandparents should not be included in the definition and some suggested that only dependant family members should be included.

Connection of the AFA

Several submitters stated that including “prospective business partners” and “prospective employers” in the definition was a step too far and would be too difficult to police. Some suggested that a time period should be attached to this limb of the definition ie prospective employer in the last year.

Several submitters suggested that compliance may be difficult as AFAs may not in fact have access to information about the investments of family members or connections of the AFA. It was submitted that this definition presumes that an AFA would legally and practically be able to disclose the identity of their clients and information about them to all parties.

INDIVIDUAL SUBMISSIONS

Definitions are appropriate

Eleven submitters agreed that these definitions are appropriate.

Definitions are inappropriate

One submitter stated that the definition placed undue restrictions on some people who in reality have nothing to do with the AFA concerned.

Type of relationship/influence over connections of AFA and members of AFA is the key issue

One submitter stated that the definitions may or may not be appropriate depending on if the adviser has influence over these individuals.

One submitter stated that the definitions assume (sometimes wrongly) that the AFA has influence over the person concerned. That submitter stated that instead the definition should simply capture those people who can, or are deemed to be, influenced by the AFA with respect to financial decisions.

One submitter suggested that some kinds of connections will be common given New Zealand's size, but that influence should be taken into account.

One submitter suggested that the prescriptive definition was not appropriate, and that the standard should just refer to those who can be, or are deemed to be, influenced by the AFA with respect to financial decisions.

Two submitters suggested that it would be simpler to deal with this issue by targeting those that would benefit directly or indirectly from a financial transaction.

One submitter suggested that the Code should be less prescriptive, and instead the definition of connection should be "any party (including the originating adviser) that benefits directly or indirectly from a transaction." They stated that this would be both wide enough and not too wide.

NZX Definitions should be used

One submitter stated that the NZX Rules define these well and the NZX definitions should be adopted.

Nine submitters stated that the definitions are not appropriate and that the NZX definition should be utilised which relies on the litmus test of "influence and benefit". The question asked is whether the AFA has influence over and above that of a normal client/adviser relationship and is there any beneficial ownership for the AFA.

One submitter stated that the definition "connection of AFA" and "member of the AFA's family" are too broad and that the definitions should be line with the NZX standards. The submitter stated that they expect conflict of interest policies and training for industry accreditation or QFE employment conditions will require advisers to declare familial connections.

One submitter referred to the definition of "Prescribed Persons" in the NZX Participant Rules.

“Member of the AFA’s family”

One submitter stated that they are comfortable with the definition of “member of the AFA’s family” even though given the nature of family units today, the definition may have a very broad reach. They stated that it may be better to limit it.

Should be broadened

Six submitters stated that it would be appropriate to include siblings of the AFA in the definition of “family”. Another submitter noted that siblings are not mentioned, but that this could well constitute as much of a conflict as a parent or grandparent.

One submitter agreed that the definitions are appropriate but suggested that consideration should be given to including aunts, uncles and cousins of the AFA.

One submitter suggested casting the net wider to encompass siblings and cousins, but that this should be subject to the adviser enjoying a benefit.

One submitter stated that the definition could also include spouse, children and grand-children.

One submitter suggested that the definition should be expanded to include “any persons or entities associated with his or her spouse, civil union partner, de facto partner, child, parent or grandparent”.

Too broad

One submitter considered that the proposed definition of “member of the AFA’s family” is too broad and will include a very large number of people who in fact have limited actual connection with an AFA. For instance, under the current proposal adult children of the AFA will be included as an AFA connection regardless of the extent to which the adult children are dependent on the AFA. They stated that similarly grandparents of an AFA will be “connections” even if they do not live in New Zealand or otherwise have limited contact with the AFA. It was submitted that the proposed definition will severely restrict the actions and activities of people with relatives in the financial services industry. Accordingly they submitted that the persons who will be considered to be a “member of the AFA’s family” should be limited to an AFA’s spouse, civil union partner, de facto partner or dependent child.

One submitter agreed that the definitions are generally appropriate but submitted that including children and parents/grandparents is too wide. They stated that the definition should exclude parents and grandparents. They suggested that the width of the definition becomes less problematic if the primary obligation is to avoid conflicts that are likely to influence the adviser and the prescriptive definitions operate more as guidelines that require the AFA to disclose particular relationships.

One submitter stated that the definition of “member of the AFA’s family” is too broad and should not include grandparents. They submitted that neither the Crown Entities Act 2004 (s 62) nor the Companies Act 1993 (s 139) consider board members to have an interest in a matter if their grandparents have an interest.

Dependant family members

Four submitters suggested that only dependent family members should be included.

Two submitters suggested that only in cases of financial dependency or relevant business relationships should relatives become involved.

Two submitters stated that only dependent children should be included in the definition.

“Connection of the AFA”

One submitter considered that the definition of “connection of the AFA” is appropriate provided the definition of “member of the AFA’s family” is restricted and their proposals in Part 3 of the submission are adopted. If the proposals in Part 3 are not adopted, it was submitted that the definition of “connection of the AFA” will lead to considerable difficulties for AFAs who are employed by registered FSPs.

One submitter stated that they have concerns relating to the definition of “connection of the AFA”. They stated that this concern arises from the roles that their members take on as statutory trustees ie fund manager, trustee or statutory supervisor. They stated that all of these roles give the right to receive fees. There is also the range of roles/positions additional to these that are set out under section 7(2) of the Trustee Companies Act 1967. The submitter stated that the key terms used in standards 2-4 should be reconsidered to appropriately deal with the unique position of their members.

One submitter suggested that the definition of “connection” was both too broad and unnecessarily complex, and should be replaced by “any party that benefits directly or indirectly from a transaction”.

Prospective business partners and employers

One submitter stated that the definition of “connection of the AFA” goes too far to be practical for advisers and for regulation. They said that “prospective business partners” and “prospective employers” are too uncertain as it cannot be known whether a possible connection may inhibit the “independent” status. It was submitted that this is a tenuous connection that would be difficult to police and it was submitted that AFAs will ignore this.

One submitter stated that the use of the word “prospective” in the context of employer or business partner is arguably too broad and needs to be qualified in an appropriate manner.

Two submitters suggested that a “prospective” employer or business partner would need to be defined and a time period added.

An entity in which an AFA, or member of his or her family, has a financial interest

One submitter suggested that this limb of the definition was very broad, and that a materiality threshold would be useful.

Access to financial information of connections of AFAs/members of the AFA’s family

One submitter suggested that it was inappropriate for relatives that have no financial dependency on an AFA to disclose personal financial information to enable the AFA to fulfil his or her requirements.

One submitter stated that the definitions presume that an AFA has access to information about the investments of spouses, civil union partners or employers. They stated that this also presumes AFAs would legally and practically be able to disclose the identity of their clients and information about them to all these parties.

One submitter stated that this will lead to compliance difficulties as many AFAs will not know the financial interests of their wider family members, or even their parents.

General comments

One submitter suggested that the Committee should look at the practice adopted by firms for guidance.

One submitter noted that there was precedent in securities law for the definition of “related parties.”

One submitter noted that an adviser may have interests in “widely held” financial assets that are not covered by the definition, although the submitter noted that 2(b) may cover that situation.

One submitter suggested the definitions of “connection of the AFA” and “member of the AFA’s family” should not impinge on an adviser’s ability to transact or provide advice, subject to full disclosure.

One submitter suggested that these definitions were too detailed.

Another submitter sought a definition of “business partner.”

One submitter responded “probably”.

One submitter stated that family details should be required to be disclosed in the event of financial dependency or material business relationships when dealing with a client. Otherwise there should be no requirement to disclose such information.

Another submitter responded that the definitions were not appropriate, because the prescriptive approach clouded what matters, which is identifying potential sources of conflicts of interest. The submitter suggested that a focus on practical connections or the likelihood of practical influence or financial benefit was more important. They stated that a principle-based standard would be preferable to a prescriptive one.

QUESTION TWELVE: Do you agree that the proposed standards concerning lending and borrowing to/from, and joint investments, with clients (set out in standards 5-6) should be included in the Code? Are there any other standards concerning dealings with clients that should be included in the Code?

Proposed standard 5: AFAs must generally not borrow money from clients or lend money to clients

- (1) An AFA must not borrow, and must ensure that any connections of the AFA do not borrow, money or assets from the AFA's client, unless:
 - (a) the client is a connection of the AFA; or
 - (b) the client is in the business of lending money.
- (2) An AFA must not lend any money to a client, unless the client is a connection of the AFA.

Proposed standard 6: AFAs must not enter into joint investments with clients unless conflict of interest safeguards are in place

- (1) An AFA must not enter a joint investment with a client, unless:
 - (a) the investment involves securities that are offered to the public under the Securities Act 1978; and
 - (b) the AFA:
 - (i) ensures that the joint investment is on terms which are fair and reasonable to the client; and
 - (ii) clearly explains to the client the following:
 - (A) the risks of the joint investment;
 - (B) the conflict of interest involved; and
 - (C) any other relevant information necessary to make the joint investment fair to the client; and
 - (iii) recommends that the client take independent financial advice and advises of the benefits of taking advice; and
 - (iv) only proceeds with the joint investment if the client has either taken independent financial advice or expressly waived the opportunity of doing so.

SUMMARY

Restrictions on lending and borrowing to/from clients and restrictions on joint investments with clients were generally considered to be appropriate, however, several issues were raised in relation to the standards.

Standard 5

Some submitters stated that they were uncomfortable with AFAs borrowing money from clients but were not concerned about AFAs lending to clients.

Several submitters were concerned that standard 5 may prohibit AFAs from working for an employer who borrows money from the AFA's clients. The example provided was of banks who are in the business of *borrowing* money from customers as all bank accounts, term deposits and other debt securities are technically borrowings.

Some submitters pointed out that the standard's focus is on whether the client is in the business of lending money, however, it overlooks the situation where the AFA or AFA's employer is in the business of borrowing money. Therefore standard 5 should provide an exception so that AFAs can work for employers (employers are a "connection of the AFA") who are in the business of borrowing money. It should be noted that in this example the client may not be a connection of the AFA and would not be in the "business of lending money" as they are merely an individual wanting to make a deposit into a bank account.

Several submitters stated that standard 5(2) should be amended to make it clear that nothing prevents an AFA's employer from lending money where that employer is in the business of lending money.

Standard 6

A number of submitters stated that joint investments with clients should not be permitted as they create a conflict of interest.

Some submitters stated that "joint investment" needed to be defined. Some submitters made the comment that the explicit carve out of securities offered to the public under the Securities Act implies that many other investments will be considered to be "joint investments" ie such as belonging to the same KiwiSaver scheme.

A number of submitters stated that care needed to be taken to ensure that AFAs would not be prevented from belonging to the same KiwiSaver scheme or registered deposit taker, unit trust, life insurance policy or listed company as their client. It was stated that the key issue is to ensure that the AFA is not in a business or investment relationship with the client.

One submitter suggested that the safeguard in standard 6(1)(b)(iv) should be extended to require the AFA to present to the client a written document stating that the client must seek independent advice or in alternative that the client must sign a waiver stating that they do not wish to seek independent advice. On the other hand another submitter stated that requiring the client to take independent advice or expressly to waive it undermines the relationship of trust. That submitter stated that recommending that the client take independent advice is sufficient.

Several further standards were suggested ie dealing with leveraged investments; dealing with payment of a client's premium and advice pertaining to purchase of a client's property.

INDIVIDUAL SUBMISSIONS

Appropriate

Ten submitters agreed that these standards are appropriate.

One submitter agreed that the standards should be included in the Code and stated that these standards would assist in defining potential conflicts of interest. It was agreed that independent advice needs to be provided to the client if an AFA is lending to or borrowing from a client.

One submitter agreed that proposed standards 5-6 are appropriate but that it was suggested that it should be made clear that these are merely examples and an over-arching duty to avoid conflicts prevails.

One submitter agreed that the Code should outline standards in these areas to provide a benchmark for AFAs to adhere to.

One submitter agreed with the standards but stated that the structuring of an investment should be made clear, ie right of survivorship in respect of a true joint investment.

Six submitters believed that these matters should be dealt with by the Code.

One submitter responded “yes,” and argued that an AFA should not benefit from a client’s funds other than in respect of fees due to the AFA or as a co-beneficiary under a trust.

Another submitter endorsed these standards, and suggested that as adviser-client relationships could become close over time, it was the adviser’s responsibility to draw the line.

One submitter endorsed the standards but stressed that special care needed to be taken not to affect legitimate lending activities.

Inappropriate

One submitter stated that this should be disclosed. It was stated that people may have the idealist view that there should not be business involvement with AFAs or their firms but in practise this does occur. For instance advisers often give advice on shares which the adviser also owns. They stated that the fact that the adviser has shares in the same company should not prevent them from providing advice, it should merely be disclosed at the time.

One submitter suggested that related party transactions required greater examination, and suggested that the investor be required to sign a written acknowledgement whenever a transaction they are making involves a related party of the adviser. That submitter stated that, in general, increased transparency is required.

One submitter suggested that these issues were more suitably dealt with by means of a principle-based standard focused on managing conflicts of interest rather than a prescriptive standard. They noted that the scope of the standard was unclear, and in particular it was unclear whether it captured the situation where funding is provided by an entity associated with the AFA, such as their employer (which would be too restrictive.)

One submitter stated that standards regarding lending/borrowing and joint investments with clients should not apply to wholesale customers. That submitter stated that different standards apply where money is lent to, or borrowed from, “wholesale” customers as compared with retail customers or for AFAs whose core business includes lending money to clients.

One submitter stated that while they support the general content of the standards, they stated that these should be incorporated within the general conflicts of interest section as guidelines.

Standard 5

Seven submitters stated that AFAs should not borrow or loan money from clients.

Lending money to clients

One submitter stated that he is not keen on the idea of borrowing from a client, but does not have a problem with lending money to clients.

Three submitters simply replied that advisers should not borrow money from clients.

One submitter supported the prohibition on borrowing from clients, but rejected the prohibition on lending to clients, noting that often a broker will settle a contract before the client’s money has been received, which would technically count as lending.

One submitter stated that they fully support the principle that AFAs should not be permitted to borrow or loan money from/to clients. However they stated that recognition should be given to the fact that lending facilities (ie margin lending) should be available and are appropriate for certain types of clients.

Another submitter suggested than an exception should be made for firms undertaking margin-lending facilities for clients.

One submitter stated that these standards disadvantage clients as he has lent money to clients on three occasions (with no interest charged and nothing in writing).

One submitter suggested that this would prevent advisers from assisting clients by purchasing securities personally and then transferring these to a client.

One submitter stated that the definition of “connection of an AFA” causes problems with proposed standard 5. Standard 5 requires AFAs to ensure their “connections” do not borrow money or assets from the AFA’s clients. That submitter stated that in a bank with such a varied and broad customer base, this standard would be unworkable, not to mention would result in a breach of confidentiality regarding disclosure of client base to an AFA’s connections (including prospective employers).

Borrowing money where the AFA is in the business of borrowing money

One submitter expressed concern that standard 5 may be interpreted to prohibit AFAs from working for an employer who borrows money from the AFA’s clients. They stated that banks, for example, are in the business of borrowing money from customers, as all bank accounts, term deposits and other call debt securities are technically borrowings. Accordingly they proposed that standard 5 be amended to allow AFAs, or connections of AFAs, to borrow money from clients, provided that the AFAs, or their connections, are in the business of borrowing money.

One submitter stated that proposed standard 5(1) should include an exception for AFAs or AFA connections who are in the business of borrowing money. Without such an exception, the proposed standard would mean that AFAs could not work for FSPs that take investments in the form of borrowings (such as debt securities) as the definition of AFA connections includes employers.

One submitter queried whether the Committee has considered the application of this standard to depositing funds and debt products and whether an exemption is required.

Lending money to clients where AFA is in the business of lending money (standard 5(2))

One submitter agreed that AFAs should generally not lend to, or borrow money from, clients. However, they stated that the current standard does not allow an AFA to lend money to a client, even if the AFA is in the business of borrowing or lending money, which appears inconsistent with some of the other exemptions in the standard.

One submitter stated that a carve-out is needed from proposed standard 5(2) to make it clear (for the avoidance of doubt) that nothing in that standard prevents an AFA’s employer (or a related company of the AFA’s employer) from lending money where that employer/related company is in the business of lending money. Otherwise, the submitter agreed that standard 5 is appropriate.

One submitter stated that standard 5(2) should be expanded to include “or the AFA is in the business of lending money”.

Life insurance – premium funding

One submitter stated that standard 5 would decimate an essential service offered within the financial services industry. It was submitted that many advisers provide premium funding options for clients in insurance products and it is a service demanded by many consumers. It was also submitted that many solicitors, investment bankers, accountants and wealthy individuals form relationships with financial advisers and that these consumers are commercially sophisticated and may not be in the business of lending money but do lend on occasions to business acquaintances. It was submitted that these loans are generally commercial in nature but in effect are private loans. Therefore they stated that proposed standard 5 should not be included in the Code. It was also submitted that this area is separately regulated by legislation.

Standard 6

One submitter stated that clarification is needed regarding how joint investments will operate where an AFA may be a trustee or shareholder in a company with their clients.

One submitter suggested that joint investments were not always undesirable as sometimes the adviser's advice is paid for by a "free carry" in the investment, always after a fee negotiation between the adviser and the client and sometimes on the client's insistence. The submitter suggested that such arrangements should be permitted.

One submitter suggested that "joint investment" needed to be defined and be subject to a materiality threshold.

Joint investments should not be permitted

One submitter stated that joint investments create a conflict of interest that prevents the AFA from putting the client's interests first and that these transactions should not be permitted.

One submitter considered that a prohibition on joint investments is important because an AFA should not be both a client's financial adviser and a client's business or investment partner. That said, they stated that an AFA is not a business or investment partner with a client simply because they invest in the same KiwiSaver scheme, unit trust or listed company. They submitted that this is in line with settled legal principles that define when property is jointly owned.

Three submitters suggested that advisers should be prohibited from entering into joint investments with clients.

Changes to standard – para (1)(a) carve out of securities offered to the public under the Securities Act

One submitter stated that despite this, because proposed standard 6 does not define the term "joint investment", it is possible the standard will be interpreted to prohibit certain types of investments. Moreover, they stated that paragraph (1)(a) expressly exempts securities offered to the public from the meaning of "joint investment" if certain actions are also taken by the AFA, which implies that such securities would otherwise be considered a "joint investment". They stated that if this is the case, AFAs would be considered to enter "joint investments" with their clients in a large variety of circumstances, including if they were members of the same KiwiSaver scheme or hold shares in the same listed company as their client (or perhaps even have accounts at the same bank).

One submitter stated that AFAs should only be prohibited from:

- jointly purchasing a financial product with a client; and/or

- making a “joint investment” with a client, provided a “joint investment” does not include any independent investment by the AFA in the same KiwiSaver scheme, registered deposit taker, unit trust, life insurance policy, or listed company as a client.

That submitter suggested that the prohibition would still achieve the policy objectives that underpin proposed standard 6, namely to prevent an AFA from being in a business or investment relationship with a client. However, they stated that this solution would also recognise that AFAs make full disclosure of any such connections, and that any conflicts are appropriately managed.

One submitter stated that the limitation in proposed standard 6(1)(a) (limiting the carve-out to securities offered to the public under the Securities Act 1978) should be deleted. If the AFA complies with the remainder of proposed standard 6, the other requirements in the Code and the requirements in the FAA, it should not be necessary to limit the carve-out in such a way. They stated that an AFA will need to be especially careful in managing conflicts of interest and making sure that the client is fully informed in these circumstances.

One submitter stated that with regard to proposed standard 6, there should be a definition of “joint investment” because as currently drafted, the standard is confusing. The proposed requirement that an AFA must “ensure that the joint investment is on terms which are fair and reasonable to the client” suggests that the AFA and/or the client can set the terms of the investment, which implies that the definition of joint investment will be narrowly interpreted. However, the submitter stated that the standard’s exclusion of investments that involve securities that are offered to the public implies that, but for the exclusion, such securities would otherwise be “joint investments” and therefore within what must be a very wide definition of “joint investment”. Accordingly they submitted that investments that involve securities that are offered to the public should not be considered to be joint investments.

Safeguards in standard 6(1)(b)

One submitter asked for clarification regarding the conflict of interest safeguards and how consistency would be ensured across the board.

Independent financial advice – standard 6(1)(b)(iv)

One submitter stated that proposed standard 6(1)(b)(iv) should be extended to require the AFA to present to the client a written document recommending that the client should take independent advice and if the client declines to do so requiring the AFA to obtain a written waiver which the client signs.

One submitter stated that proposed standard 6 is a reasonable safeguard that would not appear to conflict with any other legal requirements, with the exception of sub-paragraph (1)(b)(iv) which requires the client to take independent advice or expressly waive the opportunity of doing so. That submitter stated that this requirement undermines the relationship of trust. It was submitted that (1)(b)(iii) is sufficient to protect the client (which requires the adviser to recommend that the client take independent financial advice and advise of the benefits of taking advice).

NZX Advisors

One submitter stated that the joint investment standard requiring advisers to recommend that the client take independent advice and a waiver of such where there is a joint investment will create unreasonable burdens on NZX Advisors. They stated that many advisers have their own portfolios and the standards would require them to recommend independent advice and receive a waiver

every time they recommend a product they are also interested in. That submitter stated that the NZX Rules have specific provisions in relation to employee trading which are designed to ensure all employee trading is monitored and approved by the Compliance Officers of the NZX Firm (NZX Rule 10.7.1). That submitter stated that this adequately addresses any concern regarding joint investments.

Further standards needed

Two submitters stated that no other standards concerning dealings with clients need be included.

One submitter stated that other situations that should be covered are:

- payment of a client's premium provided it is advanced as a loan only; and
- advice pertaining to the purchase of a client's property and associated ethics, and conflicts of interest.

One submitter suggested that there was an opportunity here to deal with the situation where an AFA is working for a business that sells leveraged investments and is essentially arranging finance for an investment, but suggested that this would require significant expansion of this part of the Code.

QUESTION THIRTEEN: Do you consider that the Code should include standards governing AFAs who take on personal trusteeships and act as directors or corporate trustees of family trusts? If yes, what standards should be included?

SUMMARY

A number of submitters stated that no further standards should be added as trustees' duties are sufficiently covered by existing law. Another group of submitters stated that this issue should be dealt with by the AFA via a conflicts management procedure without the Code prescribing any standards.

Some submitters, however, suggested various standards that the Code could include:

- a standard on trustees' duties;
- a standard prohibiting AFAs from providing financial adviser services to a trust if the AFA is also a trustee of that trust:
 - several submitters suggested that an exception to this standard should be included for the AFA's own trust.
- a standard allowing AFAs to act as trustees provided the AFA fully discloses this and has conflict of interests management procedures in place.

It was also submitted that lawyers should not be required to comply with any duties regarding trusts as lawyers are already strongly regulated and have their own ethical standards.

INDIVIDUAL SUBMISSIONS

Standards should be included

One submitter stated that the Code should include standards for AFAs who take on personal trusteeships and act as directors of corporate trustees or family trusts.

One submitter stated that the Code should include standards governing AFAs who take on personal trusteeships and act as directors of corporate trustees if those organisations handle client funds or are responsible for providing advice in respect of the funds the client is providing. They said that a standard should exist with an over-arching principle that external auditing is a minimum requirement. The regulator should be able (on enquiry) to obtain the corporate's minutes to understand the use of company funds and to ensure that consumer funds are protected.

One submitter agreed and stated that the standards should require that the AFA must never be a sole trustee or sole director of a corporate trustee.

One submitter stated that it did not believe that the standard should apply to trust accounts and funds where one of the statutory trustee corporations (as defined in the Trustee Act) is a trustee.

Trustees' duties

One submitter stated that at the very least, the duties and responsibilities that apply to company directors need to be included.

One submitter stated that the Code should include standards that meet the requirement in the proposed Trustees Amendment Bill s 29A(2) requiring the exercise of care, diligence, and skill that a

prudent person engaged in the trustee's profession, employment or business would exercise in managing the affairs of others.

One submitter stated that the Code should only make reference to the AFA obligations/responsibilities of a trustee and referred to the Trustee Amendment Act 1988.

Prohibition on providing financial advice to a trust if the AFA is trustee

One submitter stated that if an AFA is a trustee they should not be permitted to offer investment advice to the trust and independent advice should be sought.

One submitter stated that it would be unwise for most advisers to be trustees of family trusts. The submitter said that some standards should be set not only for the client but also for the adviser.

One submitter stated that financial advisers should not be directors or trustees of corporate trusts they are providing advice for. It was submitted that the essence of trusteeship is personal disinterest in the benefits of the trust (apart from reasonable remuneration specifically allowed in the trust deed). It was also submitted that trustees should obtain external advice to ensure prudent supervision of the trust's investments as required under the Trustee Act 1956.

One submitter stated that AFAs should not be permitted to be personal trustees or directors of corporate trustees as it creates a conflict of interest.

One submitter suggested that advisers should be prohibited from taking on trusteeships or positions of control over entities that own assets that the adviser gives advice on.

Another submitter suggested that AFAs should not be permitted to act as trustees for clients to whom they also offer investment advice and that the same rules should apply to corporate trustees.

Six submitters stated that an AFA should not be prevented from being a trustee of their own family trust and providing financial adviser services.

One submitter stated that financial advisers have skills which mean they can usefully serve as a trustee. They should not, however, be permitted to be both trustee and beneficiary unless the trust was settled by a connection of the adviser.

However another submitter stated that AFAs should be permitted to provide financial advice to a trust that they are a trustee of except where the AFA is a beneficiary of the trust.

One submitter stated that personal trusteeships should be permitted as long as they are in a personal capacity and the adviser is not a beneficiary.

AFAs should be permitted to be trustees provided there is full disclosure

One submitter stated that if good practice is followed there should be no problem with an AFA being a trustee. It was submitted that if AFAs are prevented from being trustees, costs may be raised for consumers as they may need to pay a private trustee.

One submitter stated that they already have such guidance in place for its own employees. However, they stated that rather than a prohibition on AFAs acting as trustees or directors, the principal requirement should be that AFAs make full disclosure of any such connections, and that any conflicts are appropriately managed.

One submitter stated that the only area of concern is with regard to disclosure obligations and any conflicts of interests an AFA may have in assuming the role as a trustee.

One submitters said “yes” and stated that these are the disclosure requirements.

One submitter stated that AFAs should be allowed to provide advice to trusts that the AFA is a trustee of or is a director of a corporate trustee of, if the AFA discloses his/her potential conflict of interest to all trustees of the relevant trust and the trustees give informed consent.

One submitter stated that the Code should include standards governing AFAs who take on personal trusteeships and act as directors of corporate trustees of family trusts. They stated that such standards should focus on transparency and redressing the apparent conflicts that exist in such situations.

One submitter pointed to the potential confusion as to whether an adviser-trustee was advising the trust in their professional capacity. They stated that this uncertainty could be dealt with in terms of engagement.

One submitter suggested that the standards need only be concerned with potential conflicts of interest in relation to advice they are providing.

Another submitter suggested that conflict of interest procedures should be sufficient, given the adviser’s duty of care and the trust’s freedom of choice.

One submitter suggested that mandatory disclosure should be required and this disclosure should detail the nature of the conflict and its implications, including influence over investment decisions, financial interests in entities held or contemplated by the trustees, and the degree of control or influence.

Entrenchment of trustees

One submitter stated that where an AFA is a trustee, they should not be entrenched and unable to be removed. They stated that New Zealand Guardian Trust (NZGT) is often appointed Trustee/Executor under a will written by NZGT for clients and is unable to be remove and investments are held in NZGT Investment Funds. It was submitted that they should not be permitted to entrench themselves as the professional trustee, and invest in their own investment products. They submitted that the conflict of interest and all costs should be disclosed to all trustees and beneficiaries, and there should be a mechanism for removal (eg for poor performance).

Standards should not be included

One submitter took issue with the implication that taking on a personal trusteeship role is an inherent conflict of interests. That submitter stated that the opposite may be true. It was submitted that the fiduciary obligations of an AFA are almost identical to those of a trustee and that this is akin to a lawyer or accountant acting as a trustee and therefore there is no reason to distinguish.

One submitter did not support additional standards with regard to trusteeships by AFAs. It stated that the general principles are enough to ensure professional conduct.

One submitter stated that no specific provisions should be developed.

One submitter suggested that, as a potential conflict of interest, this should be incorporated into conflicts of interest guidelines rather than being dealt with separately and prescriptively.

One submitter supported the rationale behind regulating this matter, but suggested that strict adherence to the principles in standard 1, along with appropriate disclosure of potential conflicts of interest, should be sufficient.

One submitter suggested that the principles of independence and conflicts of interest probably adequately cover this matter, but a “reminder” under this heading could be useful.

Covered by existing law

One submitter stated that this issue should not be covered by the Code as there is specific legislation governing the requirements of all trustees regardless of their occupation.

One submitter expressed concern that any proposed standards on this subject will not take into account any of the common law and statutory duties that trustees and trustee companies remain subject to. They stated that a raft of legislative and non-legislative obligations apply to trustees (Trustee Companies Act 1967, Trustee Act 1956). Further a range of statutes (including securities legislation) incorporate requirements in terms of initial and ongoing disclosure that apply. The submitter also stated that there are presently separate reviews underway in respect of the laws of trusts and securities legislation and a Bill to introduce a trustee supervisory model has also been introduced in Parliament.

One submitter stated that there should not be standards covering this as the current law sufficiently covers it ie Trustees Act. She also stated that personal disclosures of relationships, possible conflicts of interest, related parties are already in the Investment Advisers Disclosure Act. She argued that there are already even more rigorous requirements in the NZX Participants Rules.

One submitter stated that no specific standards are required given the requirements of the Code and the FAA (and other legislation and law applying to trustees).

One submitter referred to the Trustee Act and stated that the provisions of the Act are sufficient and the proposed standards should not include anything further.

One submitter stated that if an AFA accepts a personal trusteeship the applicable standards should be those imposed on that trustee under equity not standards imposed by the Code. It was submitted that attempting to prescribe trustee standards will inevitably cause confusion.

One submitter noted that trustees already have clearly-defined legal responsibilities

One submitter suggested that the provisions of the Trustee Amendment Act 1988 provided sufficient protection by requiring higher standards of professionals.

Two submitters suggested that trustees’ obligations are already sufficiently well-defined, particularly in sections 13A to 13Q of the Trustee Act.

One submitter pointed to the extensive legal obligations already existing, and suggested that any extension of these should be via a principle-based standard with a guidance note.

Addressed by conflict management procedures

Twenty-five submitters did not believe that specific standards were required and that this could be dealt with by advisers’ conflict management procedures.

Lawyers and Registered Legal Executives

One submitter stated that no such standards should be included. They submitted that in the case of lawyers, there is a strong argument that given the number of lawyers who act as trustees and administrators of estates that the lawyer exemption (s 12 FAA) should apply to the services provided in the course of those activities. However, they stated that as the position is not certain for lawyers providing such services, no additional standards governing AFAs who are lawyers should be imposed.

In other words the ethical standards should not apply to lawyers involved in such activities upon the basis that lawyers are strongly regulated and have their own ethical standards.

One submitter stated that the standards governing registered legal executives who take on personal trusteeships would be better covered in the Lawyers and Conveyancers Act (Lawyers: Conduct and Client Care) Rules.

General comments

One submitter stated that this is an area that is likely to be potentially confusing for advisers. It was submitted that guidance will be needed on when they will be subject to the legislation and that this may or may not require formal standards.

One submitter stated that he has been asked to act as trustee on behalf of a client's grandchild on the basis that he will outlive the grandparents. In these cases the child's mother is also a trustee. He stated that he has also been asked to become a trustee on the death of someone's spouse "to keep children (predators) at bay". He stated that he is not a beneficiary and a requirement to report to beneficiaries would be a possible safeguard.

One submitter stated that with an aging population, many clients have long-term relationships with advisers and many often act as trustees with very few instances of abuse.

One submitter suggested that firms maintain a register of such positions and have appropriate conflict management policies.

One submitter suggested that breaches in this area were common and that there was a case for the Code to regulate lawyers and accountants who are involved in advising investment scheme promoters and private clients.

One submitter suggested adopting the standards set out in the CCH Handbook or the Fiduciary material available via "F1360".

One submitter suggested that it would be simpler to ban the practice.

QUESTION FOURTEEN: ARE THERE ANY OTHER GOOD CONDUCT STANDARDS THAT SHOULD BE INCLUDED IN THE CODE?

SUMMARY

Roughly half of the submitters who answered this question stated that no further standards were required. Standards on particular topics were recommended for inclusion in the Code by some submitters:

- a standard requiring AFAs not to use the complaints or disciplinary process for an improper purpose;
- a standard setting out confidentiality duties of AFAs; and
- a standard requiring an AFA to follow the advice process that forms the core practice standard of the National Certificate.

Several submitters expressed the view that the good conduct standards are appropriate.

INDIVIDUAL SUBMISSIONS

Further standards

No further standards required

Five submitters stated that no further good conduct standards are required.

One submitter stated that there may be other good conduct standards but they could well be covered by other proposed standards.

Another submitter stated that the proposed good conduct standards, when combined with the requirements of the FAA are sufficient.

One submitter stated that proposed standard 1 is sufficient.

One submitter stated that further good conduct standards are not necessary given that professionalism and courtesy are included in proposed standard 9.

Two submitters stated that the good conduct standards are appropriate.

Other standards recommended

One submitter recommended the standards of the NZ Law Society.

One submitter suggested that compulsory reporting of misconduct should be considered and AFAs should not use any complaints or disciplinary process for an improper purpose.

One submitter was disappointed that the concept of confidentiality was not included as a standard. That submitter suggested that there should be a specific requirement to follow the advice process that forms the core practice standard of the National Certificate. Otherwise an adviser could obtain the National Certificate and then immediately drop the practice s/he has learned.

General comments

One submitter stated that the focus should remain on conflicts of interests and the means for disclosure of these.

One submitter reiterated their support for a principle-based approach rather than a prescriptive one.

One submitter stated that the ethical behaviour standards should be the basis for good conduct standards.

One submitter stated that disclosure of relevant interests should be made.

One submitter suggested that AFA status should be protected and valued, and substantial fines (cf. >\$30,000 under the NZX Rules) should be imposed.

Professionalism

One submitter stated that the good conduct standards should comply with the over-arching principle of professionalism.

Another submitter stated that it could be said that many of the client care principles and standards relate to good conduct, in particular professionalism. It was stated that the important point is that these standards are included, not what heading they are placed under.

One submitter stated that the Code will have the necessary conduct standards to promote professionalism and public confidence. That submitter encouraged the Committee to ensure that the code is appropriate for the industry sectors involved in the financial services industry.

QUESTION FIFTEEN: Should the Code include a good conduct standard which restricts the ability of AFAs to criticise other AFAs or include other standards which regulate dealings and interactions between AFAs?

SUMMARY

Submitters did not in general object to the sentiment behind this proposal. However, although a number of submitters stated that an explicit standard should be included, other submitters made cogent arguments as to why there should not be such a standard.

Some submitters felt that that this issue should be included within a general standard on AFA behaviour and many felt that this had been achieved via standard 7 (which requires AFAs not to bring the financial advisory profession into disrepute). Others suggested that this type of behaviour would be prohibited by the client care standard requiring professional behaviour (proposed standard 9). Several submissions also expressed the view that existing defamation law provides suitable protection.

Some concerns were expressed regarding the need to preserve freedom of speech and the utility of professional criticism. Many submitters stated that if such a standard was to be included, the Code Committee should ensure that it does not interfere with what was referred to as the whistle-blowing standard (standard 26).

Several comments were also made in relation to standards 7 and 8.

INDIVIDUAL SUBMISSIONS

Such a standard should be included

One submitter agreed that the Code should include a good conduct standard which restricts AFAs from criticising other AFAs.

One submitter agreed that such a standard could be included but that it would be very difficult to enforce.

One submitter considered that this is an integral requirement if the Committee is to achieve the government's aim of creating an AFA profession.

One submitter stated that the Code should prohibit AFAs from criticising fellow AFAs (or FSPs who employ AFAs) as such conduct could bring the AFA profession into disrepute or undermine public confidence in the financial adviser industry.

One submitter stated that if one of the objects of the exercise is to make financial advisers more professional, then he would agree that there should be some restriction on public criticism. It was suggested that some complaints mechanism by AFAs would be a good idea.

One submitter said "Yes".

One submitter stated that AFAs should not be able to publicly criticise other AFAs. Another suggested that criticism of other advisers should be restricted.

One submitter suggested that while this standard could be useful, it should be clarified and should not prevent an adviser that has been asked to comment on another's plan or statement of advice from doing so.

One submitter suggested that it was never good practice to criticise a competitor, so it was probably good to regulate this.

Such a standard should not be included

Three submitters stated that there should not be such a standard.

One submitter stated that criticism of other AFAs should not be specifically prohibited but comparative promotional activities should compare like with like – particularly those involving competing investment products.

One submitter stated that such standards are not required as it is arguable whether such standards are relevant to the overall objective of the legislation.

One submitter was strongly opposed to such a standard, because criticism of other AFAs (provided it was honest and factual) could be a valuable service provided by an AFA.

General standard should cover this

One submitter stated that clear and reasonable good conduct standards should negate the need for specific standards which regulate dealings and interactions between AFAs.

Nine submitters stated that detail need not be provided on this issue and it should be captured in a general standard.

Standard 7 covers this issue

Four submitters stated that this issue is adequately covered by proposed standard 7 and that a further standard is not required.

Professionalism

One submitter stated that this is implicit in and addressed through the client care principle “professionalism”. Another submitter also stated that the over-arching principles of professional conduct would cover this matter.

One submitter rejected any specific prohibition, preferring a general requirement that AFAs act professionally to avoid unnecessarily limiting business interaction and stifling innovation.

Law of defamation sufficiently covers this

One submitter was strongly opposed to a standard restricting an AFA’s ability to criticise other AFAs, which “smacks of ‘closed shop’ thinking.” The submitter believed that the law of defamation was sufficient.

One submitter suggested that the law of defamation provided sufficient protection.

One submitter stated that there should not be such a standard. They stated that if an AFA chooses to criticise another AFA, she or he is subject to the law as it stands and there is no need for any further regulation.

One submitter stated that there are already standards (eg defamation) so they question the need for duplication.

Freedom of speech

One submitter stated that the Code should not limit a person’s freedom of speech.

One submitter stated that there should not be such a standard. The submitter stated that there should be constructive criticism between AFAs as long as it is founded and not of a vexatious nature. They stated that criticism, provided that it is delivered in a professional manner and forum, is beneficial to the industry.

One submitter said that there should not be such a standard but that there should be a requirement to act professionally towards other AFAs. They stated that a requirement that restricts the ability of AFAs to criticise a colleague may breach the Bill of Rights freedom of speech.

One submitter did not believe standards governing criticism of other AFAs were justified and that free speech should prevail, subject to the law of defamation.

Another submitter suggested that freedom of speech should not be restricted, and nor should interactions between AFAs.

Two submitters questioned why advisers should be denied their ability to express their opinion.

Interference with whistle-blowing requirement in proposed standard 26

One submitter replied “no,” because such a requirement would be inconsistent with standard 26 and is not necessary in light of defamation laws.

One submitter suggested that any express prohibition on criticism could interfere with the whistle-blowing requirement in standard 26, and should come within the general requirement not to bring the industry into disrepute.

Two submitters suggested that AFAs should not publically criticise each other, but noted that there should be provision for “whistle blowing”.

One submitter noted that the Code should not restrict AFAs from alerting appropriate authorities of possible illegal activity or breaches of the Code (proposed standard 26).

One submitter stated that there should be an ethical obligation for AFAs to report factual information to the disciplinary committee. This should only occur where there are reasonable grounds to suspect another AFA of misconduct or unsatisfactory conduct. They suggested that the Committee should provide guidance on what is a material breach.

One submitter stated that there is no basis for this principle. However it was submitted that there should be a requirement to report breaches of the Code by other advisers.

One submitter stated that they have no strong views on this but supported the spirit of standard 26.

General comments

One submitter stated that this is a good idea in principle but one aspect that should be considered is how would it deal with an AFA who used the media to criticise another AFA or other AFAs without being named or referred to by the journalist.

One submitter suggested that an AFA should not be quoted in the media in such a way as to bring the industry into disrepute.

One submitter stated that good conduct should be acknowledged in any professional organisation and organisations should be able to defend their business.

One submitter stated that the Code should protect AFAs from malicious or uninformed commentary from another AFA but the Code should not restrict open dialogue that enables AFAs to differentiate themselves.

One submitter suggested that a standard that prevents AFAs criticising other advisers by name might be appropriate, but this needed to be balanced with an ability to promote their points of difference.

One submitter suggested that no specific rule was required, because as soon as a rule is introduced interpretation difficulties arise. The submitter suggested that “peer pressure” was the best control.

One submitter suggested that there should be a clear requirement to use “objective” and “professional” language.

Another submitter suggested that there should be a protocol for AFAs to make complaints about other AFAs.

Standard 7

One submitter suggested that there should be a requirement for AFAs to inform the relevant authority if an AFA might be bringing the financial advisory profession into disrepute.

Two submitters endorsed a general obligation not to bring the industry into disrepute.

Standard 8

With regard to proposed standard 8 (AFAs must not misrepresent or exaggerate the effect of being an AFA), one submitter stated that the Code should not include standards over and above the restrictions in the FAA and the Fair Trading Act 1986.

QUESTION SIXTEEN: Should the proposed standards of good conduct (or any other section of the draft Code) include standards providing guidance on advertising or marketing of financial adviser services over and above the restrictions in the Financial Advisers Act? If so, what should the standards require?

SUMMARY

The overwhelming response was that sufficient guidance on advertising and marketing was already provided in existing law:

- Financial Advisers Act 2008;
- Fair Trading Act 1986;
- Securities legislation; and
- Advertising Standards Authority Code.

INDIVIDUAL SUBMISSIONS

There should be a standard

One submitter stated that it would be appropriate for the Code to include guidance on advertising and/or marketing of financial adviser services similar to that produced by the Securities Commission in its guide released in respect of new provisions under the Securities Markets Act 1988.

Another submitter stated that the ethical behaviour standards and professionalism should apply to advertising and marketing of AFA services.

There should be no such standard

Three submitters stated that no extra standards should be imposed.

One submitter stated that guidance on advertising and marketing of financial advisers' services would be better placed in a separate publication.

One submitter said no – any prohibition on advertising applied by the Code will only apply to AFAs and not FSPs. Therefore this would create an unfair distinction between AFAs who cannot advertise and FSPs who can advertise their products and non-AFA advisers.

Other legislation sufficiently covers this issue

One submitter stated that the Code should not include standards over and above the restrictions in the Act and the Fair Trading Act 1986.

One submitter stated that existing legislation should suffice.

Two submitters stated that they did not support the inclusion of standards concerning advertising over and above those already imposed by law.

One submitter suggested that the requirements in the FAA and general consumer law were sufficient.

One submitter said no because it considered that the legislative provisions are sufficient when combined with the principles of ethical behaviour and professionalism.

One submitter stated that other legislation addresses this issue and pointed to the Fair Trading Act and the Securities legislation.

Two submitters suggested that this was already adequately covered by existing legislation such as the Fair Trading Act.

One submitter stated that this area is adequately covered in the FAA and other legislation such as the Fair Trading Act. Another submitter stated that other Acts such as the Fair Trading Act would probably cover this so perhaps a reference to these Acts would be sufficient.

One submitter did not think that any specific standards of advertising are required as this is already covered by the FAA, other legislation (ie the Fair Trading Act) and the Code (ie proposed standard 8).

One submitter stated that this is adequately covered by the Code for Financial Advertising and other legislation.

Two submitters questioned the need for a standard on advertising or marketing, given the protection offered by existing legislation.

One submitter suggested that advertising and marketing were already sufficiently regulated by the Consumer Guarantees Act, the Fair Trading Act and the Securities Regulations Act 1983, and noted that any Code regulations would have to be consistent with these statutes.

One submitter stated that no additional restrictions should be imposed as other legislation covers this and ensures protection from inappropriate marketing.

One submitter had no strong views but stated that it is already sufficiently covered by other law.

One submitter said no – the Fair Trading Act provisions on advertising, and the existence of the Advertising Standards Authority provide sufficient protection for consumers.

One submitter suggested that this would create duplication, and that it was best to rely on the standards in the FAA and general law.

One submitter suggested that existing legislation (including fair trading legislation) was sufficient.

One submitter stated that this should be left to the standards prescribed in various Codes issued by the Advertising Standards Authority. It was submitted that the Code should just ensure that those standards are understood and observed by AFAs.

Ten submitters stated that the FAA sufficiently covers this issue.

One submitter did not agree with the inclusion of standards on advertising or marketing over and above the restrictions in the FAA. They stated that if AFAs cannot advertise themselves and their services to the public, they will be at a strong disadvantage compared to other financial service providers, such as banks, insurance companies and lending institutions, which will still be allowed to advertise their products.

General comments

One submitter suggested that a “watch-dog” body was required to prevent stretching of the truth in advertising.

One submitter suggested that AFAs should be able to advertise that they are AFAs and that they are independent, if they are.

Another submitter suggested that the existing legislative requirements were sufficient, and that disciplinary actions and dispute resolution (e.g. through the Advertising Standards Board) would over time provide adequate guidance on boundaries.

One submitter suggested that this should be regulated by the marketplace.

CLIENT CARE STANDARDS

QUESTION SEVENTEEN: Do you consider the proposed over-arching client care standard is appropriate (proposed standard 9)?

Proposed standard 9: AFAs must provide a professional standard of client care

- (1) An AFA must provide a professional standard of client care in providing financial adviser services and, in particular, must ensure:
 - (a) communication with the client is clear and expressed in terms the client is able to understand; and
 - (b) the AFA is courteous, open and honest with the client; and
 - (c) the services are provided promptly.
- (2) An AFA must not agree to provide financial adviser services to a client unless the AFA is satisfied he or she is able to provide client care of a professional standard.

SUMMARY

The overwhelming majority of submitters supported this standard. Some small alterations were suggested:

- removal of the term “courteous”;
- alteration of term “promptly”. Suggestions included:
 - “in a timely manner”;
 - adding words such as “taking into account the particular circumstances”;
 - “within a reasonable time”.

It was suggested that standard 9(2) should be altered to explicitly state that an AFA may only offer financial adviser services in areas where he or she is competent.

INDIVIDUAL SUBMISSIONS

Appropriate

Thirty-eight submitters agreed that the over-arching client care standard is appropriate.

One submitter agreed it is appropriate and stated it could also include consistency in dealings with clients.

One submitter agreed that the over-arching client care standard is appropriate. They requested some guidance (although not necessarily in the Code itself) as to what the Committee considers professionalism to mean in practice. For example when will an AFA be considered to have taken sufficient steps to provide advice “in terms the client is able to understand”.

One submitter stated that they are particularly supportive of proposed standard 9(2). They stated that they presume this includes resources, training, competence and research.

One submitter agreed that the over-arching client care standard is appropriate but that NZX Advisors are already required at all times to maintain the standard of professionalism (NZX rule 9.1(c)). Therefore they submitted that this rule should not apply to NZX Advisors.

One submitter, while supporting the proposed over-arching client care standard, suggesting that delivering a professional service was about more than “tokenistic behaviours.”

Another submitter responded “yes,” and suggested that an adviser will not last long in business if they fail to appropriately care for their clients.

One submitter endorsed the standard, but noted that professional behaviour usually involves more than communicating well, being courteous and acting promptly. They suggested that the principle-based paragraph can stand on its own without the additional explanatory paragraphs.

Inappropriate

One submitter expressed concerns about the vires of this standard as they stated this might override the standard prescribed in the Act.

Suggested changes

Removal of “courteous”

One submitter suggested that it was going too far, and being too emotive, to require in the standards that advisers be “courteous.” Another submitter suggested that the terms “courteous” and “open” were too subjective and that “respectful”, “transparent” and “honest” be used instead.

“Promptly”

One submitter also suggested that the reference to “promptness” should be qualified so as to take into account the particular circumstances existing at the time. Another submitter noted that the requirement for “promptness” should take account of the particular circumstances. One submitter suggested replacing “promptly” with “diligently.”

Only offer advice where the AFA is competent

One submitter suggested that sub-paragraph (2) would be better expressed by requiring an AFA to restrict their advice to areas where they can demonstrate competency. The submitter commended the wording of the Institute of Financial Advisers’ Rule 25: “A financial adviser shall offer advice to clients only in those areas in which he or she is competent. In areas where the financial adviser is not competent, the financial adviser shall seek the counsel of, and/or refer clients to, qualified professionals.”

One submitter stated that “professional” implies a level of expertise whereas there is no mention of competency or proficiency. It was suggested that (1)(c) could be amended to read “the services are provided promptly and competently”.

Removal of objective standard in standard 9

One submitter agreed in general with proposed standard 9 but recommends a more objective test ie that “a reasonable person in the position of the client should understand”.

One submitter suggested that standard 9 be expanded to read “...in terms the client could *reasonably be expected to understand*” so as to remove subjectivity.

General comments

One submitter suggested that “client” needed to be defined.

One submitter suggested that this standard has doubtful value because words like “professional” are open to different interpretations.

One submitter stated that “openness” should take account of professional behaviour standards and confidentiality.

QUESTION EIGHTEEN: DO YOU AGREE THAT A STANDARD CONCERNING SCOPE OF SERVICES SHOULD BE INCLUDED (PROPOSED STANDARD 10)?

SUMMARY

This requirement was generally endorsed as a useful safeguard. Some submitters suggested that the disclosure ought to go further, however, and disclose the scope of options that have been considered in developing the advice. Other submitters stressed that advisers should disclose the support and resources they have to call on in providing the advice.

A number of criticisms were raised:

- it was suggested that the standard should be subject to reasonable limits;
- that the requirements should only apply to retail (not wholesale) customers; and
- that the customer and the adviser should decide what kind of (ongoing) disclosure is required.

A number of submitters also commented on practicalities. It was suggested that the scope of services could be disclosed as soon as reasonably practicable after the beginning of the engagement, and that the scope of services could be included in the disclosure statement or Adviser Business Statement.

Several submitters suggested that the requirements were not appropriate for certain sectors, including insurance advisers, KiwiSaver and NZX Advisors. It was also suggested that where FSPs complied with the obligation, it should not be necessary for individual AFAs to do so also.

A number of specific textual amendments were suggested (see individual submissions below).

INDIVIDUAL SUBMISSIONS

General observations and endorsement

Forty-nine submitters supported the requirement for advisers to disclose at the beginning what services they could and would provide, enabling clients to differentiate between the specialisations of different advisers. This, it is submitted by some, should include an explanation of the adviser's ability to provide the services.

One submitter agreed that the Adviser Disclosure Statement should disclose the range of services that the adviser is able to provide. That submitter also suggested that, when providing recommendations to a client, an adviser should disclose the scope of the options that have been considered.

One submitter generally agreed with the proposed standard, because it was important that clients could ascertain the qualifications, skill level and experience of the adviser. That submitter said that the disclosure document should also state what range of products are available to the adviser, what research the adviser has access to, what fees will be payable and by whom, what fees may be passed on by the adviser, and what trail fees will be payable.

One submitter suggested that this was an important element, and that examples should be included in the Code (and introduced in the educational standards).

Two submitters stressed the importance of advisers only providing services within the scope of their expertise and denigrated a "jack of all trades" approach.

One submitter endorsed this requirement, and noted that it was more important than an abstract concept of independence.

One submitter noted the advantages of ensuring that all parties are clear about the scope of the service being offered.

Two submitters endorsed the proposal, and suggested that an important part of the scope of services an adviser can provide is the (research) support they enjoy. The submitter suggested that lack of support, rather than greed, may have been behind many of the recommendations of unsuitable finance company investments.

One submitter agreed that this standard is appropriate. It was stated that given the wide range of services, it is important that a clear record of the agreement reached between the adviser and client is provided. They stated that this would minimise possible misunderstandings between the adviser and the client and provide certainty and protection for both parties.

Criticism

One submitter approved of this standard provided it was not taken too far (e.g. requiring an adviser to notify clients when a public company's directors voted to increase their remuneration).

One submitter suggested that standard 10(2) was totally inappropriate, and was an unjustified attempt to impose a management process in a governance document.

One submitter stated that proposed standard 10 is impractical and should only apply to the provision of financial planning services to "retail" customers:

- "Retail" customers only need a communication as to the scope of services to be provided when receiving financial planning services and customers should be able to opt out of this requirement via written terms of engagement.
- They stated that ongoing materiality of the client's portfolio and definition of "materiality" (changes) should be determined between the AFA and the client and not by the Code. For instance the submitter stated that the down-grading of a bond from "AAA" to "AA" does not necessarily mean that the bonds in question are no longer a good investment. The submitter stated that it will depend on the customer's particular financial position whether this is the case.

That submitter provided the example of the bank issuing an email to certain clients advising that an infrastructure company is issuing bonds (category 1 product). Clients then phone a bank employee to get more details (terms price etc) and may purchase bonds on the spot. However the submitter stated that it would be impractical for the AFA to communicate to the client at that time, the scope of services, including any express restrictions, and to then provide that in writing.

That submitter made the following comments with regard to "wholesale" customers:

- they do not need a scope of services statement to be provided.
- they have access to their own internal and external financial and legal resources as well as having expertise by reason of their key personnel's' experience in financial markets.
- they do not need or want the same level of service as "retail" customers.

That submitter stated that the level of monitoring of the client's portfolio (the scale and frequency of review) should be determined between the customer and the AFA, not by the Code as some clients will want closer management and communication than others. It was submitted that in their

company, they have situations where the employer monitors the portfolio and reports to the adviser and that this would need to be clear in the agreement with the client.

One submitter suggested that the client should decide.

Practicalities

One submitter recognised the utility of clarifying the scope of services provided, but questioned whether a written statement was required in all circumstances.

One submitter agreed with the standard, but suggested that what should be required to be disclosed should be set by disclosure regulations rather than the Code itself.

Two submitters agreed with the proposal, suggesting that if the scope of services was not communicated to the client at the time it should be communicated as soon as practicable thereafter.

One submitter supported the presence of a scope of service standard, however did not agree with the wording. It was submitted that (1)(a) is too difficult to adhere to due to timing. One submitter queried: "how does the adviser know what the scope of services are that are to be provided before engaging in the advice process?". It was suggested that the standard should read as follows: "As early as possible in the advice process, an AFA must clearly communicate..."

One submitter suggested that this should be included in the Adviser Business Statement and disclosed upfront.

One submitter suggested that it would be simpler to define AFAs as parties that would benefit directly or indirectly from a financial transaction.

Three submitters noted that the required disclosure statements (if produced properly) should cover this aspect.

One submitter agreed that a scope of services standard should, in principle, be included. However it was stated that consideration needs to be given to how this relates to an AFA's disclosure statement and terms of engagement. There could be significant duplication leading to confusion.

Specific situations

One submitter questioned whether a scope of services statement is necessary for insurance advice.

One submitter stated that the scope of service is a critical way that the adviser can provide advice but if a client does not want any advice it is important to have a complete scope of service and this should define exactly the level of service being provided. It was noted that some clients just want an execution only service.

One submitter supported the inclusion of proposed standard 10, but submitted that AFAs working for FSPs should be excused from the requirements if their FSP has previously communicated that information to the client. They stated that in many cases, AFAs within large FSPs will be working as a team to provide each client with financial adviser services, and/or may only have brief contact with a particular client. Accordingly, they submitted that if a FSP has complied with standard 10 on behalf its AFAs then that should be sufficient.

It was submitted that clients will consider themselves to be clients of the FSP rather than each individual AFA and if the AFA leaves the employment of the FSP, that AFA's clients generally remain the clients of the FSP. They stated that this is especially the case with banks and insurance companies. Therefore it was submitted that if an FSP has complied with proposed standard 10 on behalf of its AFAs, those AFAs should not need to also provide terms of engagement.

One submitter stated that a standard concerning scope of services should be included. However they submitted that AFAs who are employed by FSPs should not be required to provide a scope of services if their respective employers have already provided that information to the client.

Two submitters stated that except where specific exceptions apply, all NZX Advisors have written agreements with their clients setting out the scope of their services (NZX Rule 9.6).

Specific textual amendments

One submitter suggested that "appraise" should be replaced with "advise". They also submitted that (2)(b) be expanded to read "portfolio *risk management requirements* or...". Further they stated that (3) be expanded to read "investment *or risk products* in a timely manner...".

One submitter stated that sub-paragraph (3) is questionable and that the term "material change" is difficult as the standard of materiality may vary from client to client and is therefore too uncertain. It was suggested that this should read: "Where an AFA receives any form of trail commission or monitoring fee, the AFA must provide ongoing advice in a timely manner".

One submitter said yes but stated that 10(2)(a) is "very general or narrow" and that the words "risk" or "insurance" should be inserted more often rather than the generalised term of "financial position".

QUESTION NINETEEN: Is it appropriate to require that where trail commission or a monitoring fee is charged, the AFA must provide ongoing proactive advice?

SUMMARY

Submitters were generally in favour of this requirement, subject to a significant qualification: many submitters stressed that there is a difference between a monitoring fee, which is expressly charged in consideration for the supply of an ongoing service, and a trail commission, which may be a continuing payment for the original service (which may be more palatable for the client).

Submitters stressed that this question ought to be subject to the agreement reached between the adviser and the client, and as long as the client is properly informed there was nothing inherently wrong with a trail commission that was not associated with ongoing proactive advice. The submitters did recognise, however, that where an adviser had agreed to provide ongoing advice they had to comply with that obligation. It was also suggested that clarification as to what “ongoing proactive advice” constituted was required.

INDIVIDUAL SUBMISSIONS

General endorsement

Twenty-one submitters endorsed this requirement (at least where it is practical to do so).

One submitter said “yes” that ongoing fees must only be paid for ongoing services that can be proven have been provided.

Another submitter said “yes” provided the person remains a client of the AFA.

One submitter stated that where an AFA receives monitoring fees, reporting to clients on changes relevant to their investment is essential.

One submitter stated that if an AFA is charging a monitoring fee then it is incumbent on the AFA to provide service for that fee. Accordingly they submitted that it is reasonable to require the AFA to appraise the client of material changes relevant to their investment. It was also important that the client clearly understands the extent of the service provided for this fee.

One submitter responded “yes” suggesting that an adviser receiving a monitoring fee should be required to monitor the client’s financial position on a regular basis. They stated that standards for the frequency of monitoring and what constitutes a “material change” should be included in adviser competency standards.

One submitter felt that ongoing proactive advice was required, but noted that clients would often not be aware of trail commissions but would be aware of monitoring fees. He stated that full disclosure of both should be required.

One submitter stated that when monitoring fees and trail commissions are charged, ongoing service to the client should be provided unless the service is expressly declined by the client.

One submitter suggested that an ongoing fee was justified as long as it was properly explained and some service (not necessarily ongoing advice) was provided.

One submitter suggested that, in their experience, companies did not generally ensure that an adviser was in contact with his or her clients on a regular basis. They stated that when a client does not hear from an adviser for a number of years complaints often arise.

One submitter endorsed the receipt of proactive advice in exchange for ongoing fees in the investment context, but noted that “ongoing proactive advice” will have to be defined.

One submitter said yes but it submitted that a definition of “ongoing proactive advice” is required ie would it include a quarterly or annual customer call or visit or a newsletter.

One submitter agreed that ongoing advice should be provided but submitted that the word “proactive” suggests that something must be specifically advised. It was submitted that this might exclude advice such as “hold what you have” ie do nothing. It was also suggested that the wording “ongoing advice in a timely manner” is sufficient.

One submitter stressed that the two concepts were different, but that payment of a monitoring fee should obviously entitle the client to ongoing proactive advice, while a trail commission should entitle a client to a lesser level of ongoing advice.

General disagreement

Twelve submitters did not believe that AFAs should be able to receive a commission at all.

One submitter disagreed that there is a need to provide ongoing proactive advice. They stated that the Code should not be unduly prescriptive and the contract between the provider and adviser responsible for trail commission is where the obligations and rights should remain.

One submitter did not believe that a specified ongoing service should be mandatory when such a fee was paid. The submitter gave the example of businesses that cater to the “DIY” market, rather than providing advice, where such fees were for marketing products or in lieu of distribution costs.

One submitter suggested that it was too prescriptive to regulate this, and that client service and competition between businesses would be sufficient – provided disclosure was made.

One submitter suggested that proactive advice should not necessarily be required, but that the adviser should be available.

Distinction between trail commissions and monitoring fees

One submitter stated that often the trail brokerage compensates the adviser for the fact that they have not been recompensed well for the amount of effort and advice put in at the time of implementation.

One submitter stated that in the case of trail commission, they do not agree that this should automatically require the AFA to provide ongoing advice. They stated that often these are historical in nature and relatively minor and the adviser may have no ongoing contact with the client, nor would the client expect ongoing advice.

One submitter stated that in the mortgage and insurance industries the trail commission is a contractual payment from the product provider to the adviser for services completed and then an ongoing expectation of managing the client’s needs relating to that lender. They stated that this should not be confused with a payment the client is making for ongoing advice.

One submitter stated that under the insurance/risk implementation, an adviser may opt to receive ongoing renewal commission at a higher rate than standard renewal commission, in return for a lower up-front commission.

One submitter responded “no”, arguing that a trail commission may be a legitimate alternative to an up-front payment that satisfies the interests of all parties by drip-feeding payment. The submitter regarded this as inappropriate interference with an AFA’s freedom to structure their own business.

One submitter argued that this blurred different concepts: monitoring fees relate to the investment industry while trail commissions relate to the life risk industry.

One submitter stated that the payment of a monitoring service fee should entitle the client to receive proactive advice. However they submitted that the payment of a trail fee would not entitle the client to receive the same level of service but it would entitle the client to receive a reduced level of ongoing service.

One submitter stated that ongoing service should not be compulsory. It was submitted that trail commissions are sometimes paid from the institutions margin (not necessarily the client’s funds) and these provide small recompense for the work sometimes done.

One submitter stated that trail commissions are about providing access to advice in the future. They stated that trail commissions and ongoing fees should be disclosed and this provides sufficient notification and protection for consumers.

One submitter suggested that in general ongoing service should be provided in order to receive an ongoing commission, except in the case of risk commissions. In that situation the broker forgoes an upfront commission in return for an ongoing renewal commission for the life of the policy.

Allow client and adviser to agree

One submitter stated that the proposed standard should be revised so that it instead simply requires an AFA to provide the services that it has agreed with the client it will provide. They stated that it should not be assumed that a client wants or expects additional services based on the fees/commissions an AFA may be receiving. They also stated that if there is a requirement linked to the receipt of such commission/fees the requirement should be to provide a monitoring “service” as opposed to advice.

One submitter stated that this is too prescriptive as it dictates the contract of service between the two parties. They submitted that the parties should remain free to contract as they see fit. However they noted that the problem with trail commission, is not whether an adviser provides fair value or services commensurate with remuneration, but whether receiving trail commission should be disclosed and/or paid to the client in order to satisfy the adviser’s client obligations (whether fiduciary or codified). It was submitted that the Secret Commissions Act is also relevant.

One submitted that this point illustrated the danger of being too prescriptive and suggested that it was a matter best left to the parties to agree by contract.

One submitter stated that this is an aspect of an AFA/client relationship that should be agreed as between those parties.

One submitter suggested that this would depend on the level of the fee, and should be left up to negotiation between the client and the adviser.

One submitter stated that where trail commissions or monitoring fees were paid and the adviser had agreed to provide certain services in response: the adviser must specify the services to be supplied in consideration; if no services are to be provided this must be disclosed, and where the specified services are not supplied recourse be available through dispute resolution procedures.

One submitter stated that it is not appropriate that trail commission be linked to the provision of ongoing proactive advice. Instead trail commissions should be treated like other commissions and be fully disclosed. As to whether trail commission should require ongoing obligations, the submitter stated that what services AFAs must provide for clients should be determined by the Code and each AFA's terms of engagement, not by how AFAs are to be remunerated. In this regard, they noted that the purpose of trail commissions can vary and it is not necessarily to facilitate the provision of proactive advice. In the insurance industry, they stated that trail commission encourages advisers to assist clients when they make claims under a policy which is reactive rather than proactive advice.

One submitter stated that if the client and the AFA have agreed that the AFA should provide ongoing proactive advice in return for which a client pays a monitoring fee, then that is appropriate.

One submitter stated that all initial and on-going brokerage is disclosed and the client signs an acknowledgement.

One submitter stated that disclosure and client choice should dominate.

One submitter endorsed the suggestion that advisers could conduct a review of a portfolio to compare its performance against its starting point, and that the cost of this would have to be negotiated with the client.

Other matters

One submitter stated that it receives a form of trail commission from some of the financial products they sell. They stated that whether or not AFAs should receive trail commissions, and what services they should provide in consideration for those commissions, is an issue that should be addressed by the Committee when it considers commission generally.

One submitter stated that if a standard of the nature proposed is included in the Code, it should not apply to arrangements entered into before the commencement of the Code. They stated that many product providers will be party to existing contractual arrangements under which they have agreed to pay trail commission to an adviser. It was submitted that the adviser may no longer have a relationship with the relevant client so it would not be possible to provide ongoing advice/services. However they stated that the product provider is contractually obliged to pay, and the adviser is entitled to receive the trail commission.

One submitter referred to the disclosure documents utilised by Certified Financial Planners.

Different sectors / different clients

One submitter noted that in the insurance and mortgage contexts trail commissions are paid for responding to client enquiries, helping client retention and providing ongoing advice to the client. It was argued that it was difficult to see what further "ongoing proactive advice" could be given. The submitter suggested that perhaps regular reviews could be required.

One submitter questioned what ongoing advice could be provided in the mortgage and insurance broking context. The submitter suggested that answering client queries and regular reviews should be required.

One submitter suggested that the level of ongoing advice required to be given to a client will depend on the client, and most will not (for example) need to be continually provided with market updates.

Practical difficulties

One submitter stated that any standard must consider the many situations where compliance is not possible or practical.

One submitter stated that the intent is noble but not all clients have emails addresses or a current physical address. It was submitted that a de minimus clause should apply to trail commission ie \$200 pa or more per client.

One submitter suggested that there may be many reasons why it is neither practical nor appropriate to require ongoing proactive advice. For example: the adviser may have lost touch with the client, but has no control over the receipt of the fee; and the adviser may not be receiving sufficient information from the client or the provider to provide the advice. That submitter noted that in some circumstances it will be obvious that ongoing proactive advice will not be provided, such as with a transaction service.

One submitter stated that the concept of proactive advice is again difficult as unless the consumer is willing to pay for this type of service it exposes the adviser to an unfair level of risk.

One submitter stated that ongoing trail commission or monitoring fees should be disclosed at the time of implementation. He stated that if it relates to an investment product, there is a need to be careful with what constitutes "ongoing proactive advice". He cited the example of KiwiSaver advisers who have almost gone 'broke" by concentrating on this market. He noted that the initial remuneration is very small but may become more reasonable once clients have large balances. He queried how much ongoing proactive advice must be given if a client has \$20,000 invested in KiwiSaver and pays a brokerage of \$50. He questioned whether an email newsletter constitutes proactive advice or does the offer of free ongoing reviews at the client's request, constitute proactive advice. He stated that generally clients do not want advice more than every few years at the most but his company does send newsletters, review sheets and letters to clients periodically.

QUESTION TWENTY: Should there be a standard requiring written terms of engagement with clients?

SUMMARY

Submitters were generally in favour of this proposal, noting that there were significant advantages in requiring written terms of engagement. In particular, they offered protection to the client and the chance to forestall any disputes in the future. A significant minority did, however, suggest that although written terms of engagement served a useful purpose, they should not be made mandatory.

The bulk of the submitters' criticism was based on a perception that the requirement to have a (written) contractual arrangement with the client from the beginning of the relationship should be sufficient. Others were concerned that a number of the required documents (terms of engagement, scope of services, disclosure) should be combined in a single document to avoid overwhelming clients.

Submitters also proposed several qualifications and exceptions, in particular for employees of FSPs and wholesale advisers.

INDIVIDUAL SUBMISSIONS

General endorsement

Thirteen submitters agreed that there should be a standard requiring written terms of engagement, enabling the client to select the level of service they require and resolving matters of proof.

One submitter stated that written terms of engagement should be given to clients. It was pointed out that lawyers and legal executives are required to do this under the Lawyers and Conveyancers Act (Lawyers: Conduct and Client Care) Rules (rule 3).

One submitter agreed with the general principle of requiring written terms of agreement and commented that they already require signed client agreements unless the client is an institutional client or it is a one-off sale and sets out minimum standards for client acceptance (rule 9.6). They stated that the standards are appropriate for NZX Advisors and additional requirements should not be imposed on them.

One submitter said "yes", and suggested that the terms should be tailor-made by each adviser.

One submitter endorsed the requirement for written terms of engagement, and suggested that they should include the scope of service and be signed and sent to clients before commencing the engagement, with a note that clients should inform the AFA if the terms are not acceptable. They suggested that it should not be mandatory for the terms to be signed, but that this will be best practice. The submitter suggested that the terms of engagement could be in a simple, standardised, "check box" format when appropriate. They stated that it should specify fees payable, any commission or other remuneration to be received by the adviser and any conditions under which such payment will be received.

One submitter responded “yes” and suggested that the Code Committee take guidance from the NZX Participant Rules.

General disagreement

Five submitters flatly disagreed with this requirement and suggested that it be left to industry participants.

One submitter said no and pointed to other professions such as the legal, accounting and medicine professions for which verbal agreement to engage in services is adequate. She submitted that the NZX Participant Rules do require terms of engagement for the protection of client assets and that the current adviser disclosure statement requires terms of engagement for the range of services offered, money handling and complaints procedures.

One submitter stated that written terms of engagement may be “good business practice” but should not be mandatory if advice is to remain practical and affordable for all New Zealanders.

One submitter said no as clients need change regularly and this will be burdensome ie some clients go into an administration service when they go overseas.

One submitter stated that there should not be written terms of engagement but the code could identify the topics that should be covered in the terms of engagement.

One submitter suggested that the range of situations and relationships is too broad to impose a blanket requirement that there be written terms of engagement.

One submitter noted that the NZX did a great deal of research on this matter in relation to wholesale and institutional clients, determining that international practice was not to require written agreements with such clients.

One submitter suggested that this would not be necessary for some insurance advice: for simple life insurance only a scope of service might be required, while if a customer is just seeking quotes no advice may be given at all.

One submitter suggested that this should not be a requirement for all AFAs, noting that the terms of a transactional relationship change frequently and it would be cumbersome to document these changes in writing. He conceded, however, that written terms would sometimes be appropriate.

The requirement for a contractual agreement/scope of service document is sufficient

Eighteen submitters stated that the adviser and the client have a contractual agreement when they complete and open an account so there is no need for another one.

One submitter suggested that requiring written terms of engagement for one-off clients would be impractical and very expensive to implement, indicating that NZX-mandated Client Agreements were sufficient.

One submitter stated that any terms of engagement should be written and also signed by the client. They suggested that this could be covered in a scope of service document which is individually tailored to the client and provided in writing. Having a separate term of engagement would be an unnecessary step. Two other submitters expressed similar sentiments.

One submitter supported an increase in the level of documentation required on the part of AFAs. However they expressed concern that there are too many documents (the adviser disclosure statement, the potential terms of engagement, suitability of advice statement and statement of advice) and that clients could be overwhelmed. It was submitted that there is a risk that clients may use execution only services as they are put off by the quantity of mandatory but overlapping documents.

Proposed qualifications to the rules

One submitter agreed that it is appropriate for AFAs to have written terms of engagement. However, such terms should only be required to be provided to clients at the commencement of the adviser/client relationship (and not each time an AFA receives an instruction from the client) and then only as and when the terms of engagement are amended.

One submitter stated that consideration should be given to the appropriateness of the written agreement for the specific type of client and product offered ie engagement of an AFA for a one-off sale of estate assets or for institutional clients.

One submitter noted that, in general, written terms of engagement were useful. It noted, however, that terms of engagement may not be appropriate for those who assist clients to make transactions (rather than providing a full financial planning service).

One submitter stated that maybe there should be a requirement for written scope of services, but it should be standardised for all advisers.

One submitter endorsed this requirement, but suggested that it should not go beyond standard 9(1)(a) which requires clear communication in terms the client can understand.

Exceptions

One submitter agreed that there should be a requirement to provide clients with standard written terms of engagement, but submitted that AFAs who are employed by FSPs should be excused from the requirement if their employer has already provided terms of engagement. It was submitted that clients of many AFAs who work for FSPs will consider themselves clients of the FSP, rather than the individual AFA. They stated that in many cases AFAs within large FSPs will be working in a team environment and may only have limited contact with particular customers especially when performing investment transactions on behalf of a customer. Therefore they stated that if a FSP has already provided written terms of engagement to a client, it may be inappropriate and unnecessarily burdensome to require each individual AFA who works for that FSP to also do so.

One submitter stated that this does not reflect commercial reality and this requirement should only apply to financial planning services to “retail” customers.

One submitter expressed support for written terms of engagement. However they stated that AFAs whose employers have already provided clients with terms of engagement should be excused from the requirement to provide those terms as well.

One submitter stated that clients of an AFA who works for an FSP will often consider themselves to be clients of the FSP. Further due to the wide definition of “financial advice”, clients may have only fleeting contact with a particular AFA. Accordingly they stated that if an FSP has already provided the terms of engagement, there will be little benefit in each AFA also doing so.

One submitter suggested that requiring written terms of engagement was an unnecessary burden on NZX firms and ultimately consumers, because NZX-mandated Client Agreements adequately cover the essence of standard 10.

QUESTION TWENTY-ONE: Should AFAs be permitted not to undertake a suitability analysis (see proposed standard 11)? The Committee seeks your views on two different options:

- (a) Should AFAs always be required to carry out a suitability analysis and provide advice that is suitable for the client?; or**
- (b) Should AFAs be permitted not to carry out a suitability analysis and to provide services that are not necessarily suitable for the client, provided that the benefits of the suitability analysis are clearly explained to the client and the client consents in writing not to receive such advice?**

Proposed standard 11: AFAs must ascertain whether a financial adviser service is suitable for the client before providing the service unless the client expressly consents otherwise

- (1) Before providing any financial adviser services to a client, an AFA must ascertain whether the service will be suitable for the client by:
 - (a) making reasonable enquiries to determine what the client's financial needs and objectives are; and
 - (b) making an informed assessment of the client's risk tolerance, financial situation, investment portfolio and needs; and
 - (c) reasonably researching and considering any financial advice or plan to be given; and
 - (d) providing and implementing only financial advice or plans that are suitable for the client.
- (2) In deciding what are reasonable enquiries for the purposes of subparagraph (1)(a), some of the factors that must be taken into account are:
 - (a) the potential impact of providing inappropriate financial advice or plans to a client; and
 - (b) the subject matter of the financial adviser service; and
 - (c) the complexity of the financial adviser service; and
 - (d) the financial literacy of the client; and
 - (e) the express wishes of the client regarding the scope of services they wish to engage.
- (3) An AFA is always required to undertake a suitability analysis unless:
 - (a) the AFA has clearly explained to the client the benefits of a suitability analysis and that the financial adviser services sought may not be suitable for the client without such an analysis; and
 - (b) the client consents in writing to the provision of the financial adviser services without a suitability analysis being undertaken.

SUMMARY

Although the majority of submitters recognised the value and purpose of the suitability analysis generally, this question attracted a significant amount of comment and criticism. The general thrust of the criticism was that an overzealous implementation would require suitability analyses to be carried out in inappropriate circumstances.

A small group of submitters expressed concern at the prospect that suitability analyses could be contracted out of in any circumstances, while an even smaller number endorsed option (a).

Of the submitters that expressly endorsed one of the alternatives, option (b) received overwhelming support. Submitters stressed the importance of allowing customers the freedom to opt out of receiving a suitability analysis. Significant criticism was directed at the perceived assumption that all customers were unsophisticated clients seeking a full financial planning service, and many submitters stressed the importance of allowing experienced investors, or those only seeking a limited (generally

transactional) service to opt out. A number of submitters also stressed that, for various reasons, a client may not wish to disclose full details of his or her financial position to an adviser, and that a suitability analysis may not be possible in those circumstances.

A number of submitters rejected both options. The reasons presented were generally similar to those raised in support of an opt-out provision, but some submitters regarded the extra compliance costs associated with the opt-out process itself as being unjustified.

Certain groups suggested that special “light touch” rules ought to be applied in some sectors, such as insurance, KiwiSaver or share broking. It was also suggested that suitability analyses should not be required at all for wholesale clients.

A number of practical difficulties were identified with the proposed standards. Some submitters were concerned that the information required for the suitability analysis would only be collected by the time the advice process itself was almost complete. Likewise, a number of drafting changes were suggested, in particular to better recognise the distinction between financial planning and other financial advice.

INDIVIDUAL SUBMISSIONS

General endorsements of suitability analyses

One submitter agreed that unless the client declines in writing, a suitability analysis should be carried out in each instance. They stated that the client should be given the option to make direct investments if they expressly decline a suitability analysis.

One submitter agreed that generally a suitability analysis should be carried out at all times. However he stated that the phrase “services that are not necessarily suitable for the client” needs to be defined. For example an AFA may choose a lower level of insurance cover because the client cannot afford what is recommended. He stated that some cover ought to be better than none. It was also submitted that in the case of investment an AFA may give full advice but the client may only want to implement part of it. The submitter, however, agreed that an AFA should not be permitted to provide advice that is absolutely unsuitable for a client.

One submitter agreed that within the competence requirements, the lack of suitability can be outlined to the client and the reasons why. She agreed that in many cases this may be because the investment fits within a suitability framework (ie Statement of Investment Policy) agreed to previously.

One submitter agreed that a suitability analysis should be required when providing a financial planning service. They submitted that because the steps outlined in standard 11(1)(a)-(c) are necessary elements of a financial planning service, suitability analyses could be done before or as part of a financial planning service (rather than just before, as the current standard states).

Problems with an opt-out provision

One submitter expressed concern regarding the suitability standards and in particular with the possibility of opting out of the suitability analysis. They suggested that the Committee should examine the Australian experience. They stated that s 945A of the Corporations Act (the equivalent of the suitability test) has been criticised for allowing advisers to make recommendations despite knowing that there are better alternatives available. The submitter stated that Australian Securities and Investments Commission has noted that this does not meet the expectations of consumers who

see advisers as similar to lawyers and accountants in terms of duties and professionalism. The submitter stated that a suitability analysis should always be made and AFAs must inform clients and not provide services if the financial services are unsuitable.

One submitter stated that it is difficult to envisage why a client should ask that the AFA not undertake a suitability analysis and therefore AFAs should always undertake a suitability analysis and provide suitable advice. They stated that if this is not complied with, the AFA would be acting contrary to with the client first and integrity standard.

One submitter stated that an AFA's ability to carry out a suitability analysis and provide advice is a critical component in ensuring appropriate advice. It was stated that within the mortgage and insurance sectors, the analysis of the information collected is an important part of the AFA's role. It was also submitted that the ability to contract out of the suitability analysis is concerning and should be carefully monitored to ensure client protection. They stated that the risk profile in mortgage and insurance is different to investment and the responsibility in the investment area clearly sits with the AFA.

One submitter rejected any suggestion that advisers could contract out of their duty of care and duty to be objective.

Rejection of both options and criticism of suitability analyses generally

One submitter did not support either option. They submitted that the proposed standards relating to needs analyses should only apply to the provision of financial planning services. It was submitted that option (a) will require suitability analyses to be carried out in all situations, even when analyses are impractical, costly, time consuming or not wanted by clients. Examples of when an analysis may fit into one of those four categories, is when:

- (a) a client asks an AFA for simple over-the-counter financial advice in relation to a product the AFA's employer sells, such as "is it better to pay the premium monthly or annually"; or
- (b) an AFA performs an investment transaction without client contact.

That submitter stated that option (b) offers no improvement, because it still requires a written warning to be provided that explains why an impractical, costly, time consuming or unwanted suitability analysis was not provided.

That submitter also stated that some AFAs only work in transactional roles and either provide incidental advice during the transactional process, or indeed do not provide financial advice at all. They noted that despite this, standard 11 still proposes that if the client opts out of receiving a suitability analysis, they must receive a written warning. They submitted that in such situations, written warnings may be inconvenient and not treated with respect by the client, which will have the effect of undermining public respect for the Code.

Five submitters stated that they are strongly opposed to the suitability analysis being mandatory. They submitted that both options do not recognise the various types of consumers and do not provide sufficient flexibility to allow consumers to choose the financial services that best meet their investment needs based on their own level of sophistication and financial literacy. They also submitted that the Committee assumes that all consumers are financially illiterate. They stated that the standards should allow for sophisticated clients who simply want an execution only transaction and that it is ultimately the client that makes the decision.

One suggested that the Code Committee had assumed all investors to be financially illiterate, and had not considered the different kinds of investors (in particular sophisticated investors who only require the adviser to execute their decisions). They stated that a failure to be flexible and accommodate different types of clients will create unnecessary compliance costs.

One submitter disagreed with the concept of the suitability analysis and thinks that it would be unworkable and would create unnecessary burdens on NZX Advisors.

One submitter stated that they are strongly opposed to any mandatory suitability analysis for all members of the investing public. They stated that the options proposed do not recognise the various types of investors and provides insufficient flexibility for them to choose the financial services that best meet their investment needs based on their own level of sophistication and financial literacy. They stated that this suggests that the Code Committee thinks investors are not capable of making good decisions. She submitted that the focus should be on better education and secondary schools should include financial courses covering budgeting, investment and borrowing. She submitted that it is critical that investors should be encouraged to increase their own knowledge base with reputable advisers to assist them.

One submitter stated that she does not agree with either option as there is a range of clients and all have varying understanding of financial products. It was submitted that some are very experienced and would just require broking services but others might have a specific query regarding a particular investment. It was also submitted that a full analysis would be inappropriate in either instance.

One submitter stated that AFAs should not be required to carry out a suitability analysis when providing financial advice. It was submitted that this does not reflect commercial reality. They stated that:

- the principle of suitability should only apply to a financial planning service;
- option (b) would add unnecessary compliance to the system;
- many customers wish to call up and purchase category 1 products and in that situation it would be impractical for that customer to receive a full financial plan matching the product to the client. It was submitted that the Code must allow AFAs to give advice on a product without providing a financial planning service;
- standards 11 and 12 should only apply to financial planning services for “retail” customers; and
- that clients should be able to consent in writing to not receive a suitability analysis.

One submitter stated that they are strongly opposed to any mandatory requirement for a suitability analysis. They stated that neither option is appropriate as the options do not recognise the various types of consumer and that the options provide insufficient flexibility to allow them to choose the financial services they need based on their own level of sophistication. That submitter stated that the standards fail to allow for those who simply want an execution only service.

One submitter stated that both options are inappropriate as different types of financial adviser services require different levels of suitability advice.

One submitter stated that this requirement is overly intrusive, and that the nature of the service sought by some clients will make a suitability analysis inappropriate or unnecessary. The submitter stated that the client and the AFA should be free to agree whether a suitability analysis will be provided as part of their terms of engagement.

One submitter did not endorse either option, because they stated that the options fail to take account of the range of clients and differing needs. The submitter suggested that consumers should not be forced to wait for a suitability analysis to be conducted before finding out whether the adviser can provide the service they have requested, and that often consumers will be in a better position to determine the suitability of a given course of action than the adviser.

One submitter also suggested that the cost of the suitability analysis could deter investors from seeking financial advice at all.

One submitter rejected the prescriptive nature of the rules on suitability (and independence), and suggested that it should be left up to the client and the adviser to decide.

One submitter rejected both options, and resented the suggestion that a suitability analysis should necessarily be foisted on educated sophisticated investors.

One submitter suggested that the parties should determine whether a suitability analysis is needed, and customers are free to leave if they do not think they are receiving, or will receive, a satisfactory service.

One submitter suggested that from experience in both financial planning and NZX investment, a suitability analysis should not be required in all cases. The submitter suggested that the proposed standard fails to take account of the different kinds of consumer and the different services that they may require. The submitter also stated that the Committee had made the “gross assumption” that all members of the public are financially illiterate, failing to take account of those sophisticated investors who seek advice while retaining some control.

One submitter suggested that given the impact this will have on consumer access to services, it should be considered by the Government and not the Committee.

Endorsements of option (a)

One submitter stated that option (a) is most appropriate. However they also stated that there should be an exclusion for wholesale/professional clients if the recommendation in this submission to divide the Code into two parts is not adopted. Another submitter suggested in relation to (a) that a suitability analysis should be mandatory when providing risk recommendations. One other submitter endorsed option (a).

Endorsements of option (b)

Seven submitters endorsed option (b).

One submitter stated that proposed standard 11 negates the consumer’s right to not seek comprehensive advice. It was submitted that there are many instances where a consumer does not wish to receive a full planning process but wishes an adviser to arrange a transaction. They stated that often share brokers, mortgage brokers, general insurance and life brokers are asked to source a particular solution and the consumer does not wish to engage in a comprehensive advice process.

One submitter stated that the suitability analysis is an important step for an AFA to undertake if an investor elects not to receive the suitability analysis. They stated that if a client consents in writing not to receive a suitability analysis that should be respected. It was submitted that it is particularly important in the stock broking arena where often wealthy individuals do not want to reveal information to the adviser and therefore it is important to provide an opt out.

One submitter cited the example of an individual who walks into an AFA's office off the street and wants to buy \$10,000 of Auckland Airport Bonds which is paying 7% for five years with brokerage being approximately \$75. It was submitted that proposed standard 11 would require a full 22-page financial plan which may take a week to prepare and cost approximately \$500. It was submitted that the client would also be required to seek independent advice from another AFA according to standard 2(2). Therefore it was submitted that clients should be permitted to opt out of the suitability analysis.

One submitter stated that requiring sophisticated clients to have a suitability analysis is unnecessary. In completing the opening account documentation, the client should be required to choose whether this is an "execution only" or is it an "advice" client.

One submitter anticipated that, in practice, some clients may not wish their adviser to carry out a suitability analysis in all situations. It was also submitted that there may be situations where a suitability analysis is not necessary (ie where a client asks for advice in relation to whether it is a good time to sell or purchase shares in a particular company). Therefore they submitted that an AFA should be able to provide services without carrying out a suitability analysis in the circumstances described in option 2 of question 21. They also suggested that there should be a "unless it is not practicable" qualifier to the requirement to obtain written consent.

One submitter stated that they prefer option (b) as this would enable the AFA to deal appropriately with a client that simply sought a particular product and did not wish to receive advice.

One submitter stated that AFAs should not always be required to carry out a suitability analysis and that option (b) should be chosen.

One submitter stated that option (b) is appropriate. It was noted that from time to time some clients have insisted on only a limited service and have declined the recommendation that they would be better served by having a detailed analysis.

One submitter stated that AFAs should be permitted not to undertake a suitability analysis. They submitted that AFAs should not always be required to carry out a suitability analysis and provide advice that is suitable for the client and therefore option (b) is suitable.

One submitter stated that AFAs should be permitted to not undertake a suitability analysis if not required by the client. That submitter stated that client financial literacy varies and some do not require this service. They suggested that if such an analysis was compulsory it would be cumbersome, costly and would reduce market access.

One submitter stated that AFAs should carry out a suitability analysis and especially when giving insurance advice or recommending a product (ie when a client's health is poor they should determine the suitability of any product before subjecting the client to probable rejection by the insurer). They stated that option (b) is also appropriate and that AFAs should only provide services that they are competent to provide by disclosing this in their scope of services statement.

One submitter stated that clients should be given the option and clearly a full financial plan requires a suitability analysis. However for a small lump sum, a suitability analysis may not be required.

One submitter opposed a mandatory suitability analysis and submitted that ongoing or proactive suitability analyses may be impractical and a waste of resources. They stated that this should be governed by the adviser-client engagement and not prescribed by the Code.

One submitter stated that option (a) was unnecessary and unworkable, and option (b) was only acceptable if written client consent was applicable to future advice.

One submitter suggested that, if the client agreed, an adviser should be permitted to perform limited services without a suitability analysis (this would particularly include “execution only” services). They suggested that the adviser should nevertheless retain an obligation to inform the client if the proposed transaction was not suitable for the client, and carefully consider whether to go through with the transaction if the client insisted.

One submitter supported option (b), which would permit advisers to undertake “execution only” work or provide limited advice without a suitability analysis with the specific written permission.

The importance of recognising particular kinds of clients

One submitter stated that where a client will not give the information needed or the client expressly does not want a suitability analysis, allowance must be given for the adviser to disclose and disclaim this requirement accordingly.

Three submitters stated in relation to proposed standard 12 that it is not always appropriate to disclose personal and private information in order for the financial adviser to conduct a suitability analysis to determine whether or not they will perform the service requested.

One submitter stated that standard 11 presumes all clients want a full financial advice service and assumes that all clients want to disclose full details of their situation to an adviser. There is, however, a substantial amount of transactional broking business. It was submitted that proposed standard 11 is taking away the client’s freedom to choose the level of service they want.

One submitter stated that often clients do not want an “inquisition” by an AFA and they just want instructions carried out and do not want to provide their private information. They also submitted that clients often do not want to fill out forms consenting not to receive advice. It was submitted that legislation should make allowance for the public to make their own decisions and for AFAs to carry out their wishes.

One submitter stated that many clients favour a transaction-only service. It was submitted that habitual investors are not interested in providing their financial information prior to placing the order for them. It was submitted that this might be seen as an invasion of their privacy and may discourage them from investing in the market. They stated that there should be an allowance for a transaction-only service without a suitability analysis being required as these transaction-only events need to be made quickly without delay and without instructions in writing. It was submitted that this proposal takes away the client’s right to choose.

One submitter stated that AFAs should not be required to undertake a suitability analysis before making an investment transaction, because undertaking a suitability analysis necessarily involves giving financial advice. They stated that it is clear from the FAA’s separation of investment transactions and financial advice that the intention was to allow AFAs to provide execution-only services without giving advice.

Twenty-one submitters were strongly opposed to a universal suitability analysis requirement.

Two submitters strongly rejected a blanket requirement that a suitability analysis be required for all clients, and suggested that different clients will choose to receive different levels of advice. The

submitter suggested that many financially literate customers would be irritated at this “interference.”

One submitter suggested that it should be easy for the investor to contract out of the requirement for a suitability analysis.

One submitter noted that, given that advisers often charged a percentage annual fee on all the client’s declared assets, clients may understandably be unwilling to disclose full details of their assets, which would make a suitability analysis impossible.

Two submitters suggested that they often seek advice from people with narrow specialisations on particular issues. They stated that these advisers would often not be in a position to conduct a suitability analysis, and such an analysis would likely be unnecessary and expensive.

One submitter suggested that the range of clients and services required needed to be taken account of, rather than assuming that all clients were financially illiterate. He noted that a suitability analysis will require full disclosure from clients, and some will be unwilling to do this. It was suggested that the suitability analysis be constrained if a client has made a specific request for advice on a particular matter, such as an equity security.

One submitter noted that complications would ensue if a client does not give sufficient information to the adviser and suggested that advisers warn clients that their suitability analysis is based only on the information available.

Retail and wholesale customers

One submitter made the following comments with regard to “retail” customers:

- a suitability analysis should only be required when “retail” customers are receiving financial planning services.
- that an AFA providing a financial planning service to a “retail” customer should be expected to analyse the client’s current financial situation, identify his or her goals, and develop financial options for realising those goals.
- that the standard should read “before providing any financial planning services to a retail customer, an AFA must ascertain whether the service will be suitable for the client by (a) making reasonable enquiries to determine what the client’s financial needs and objectives are; and (b) making an informed assessment of the client’s risk tolerance, financial situation, investment portfolio and needs.”
- that clients should be able to consent in writing to not receiving a suitability analysis in relation to those financial planning services.

That submitter also made the following comments with regard to “wholesale” customers:

- a suitability analysis should not be required to be provided to any wholesale customer. That submitter stated that wholesale customers rarely seek financial planning services and do not want or expect an AFA to provide a full analysis of their current financial situation etc. They stated that “wholesale” customers are financially literate and are presumed to have access to financial and legal expert advice to determine whether the advice is suitable.
- that if such a standard is included in the Code, it is likely that each AFA advising these customers would write to each “wholesale” customer, seeking the customer’s written consent to not undertake such an analysis at any time for that customer. They stated that this would be inefficient and would undermine the regime.

One submitter suggested that requiring a suitability analysis was symptomatic of the proposal's attempts to make all financial advisers subject to requirements that are appropriate for certain financial planners in the retail market. They submitted that requiring a suitability analysis may be appropriate for certain full-service clients, but there will be many clients (e.g. wholesale clients) whose needs make such a step unwelcome and who should be able to opt out.

Certain groups that ought to be treated differently

One submitter stated that registered legal executives should not be required to carry out a suitability analysis. It was submitted that this is unnecessary as registered legal executives provide services that are limited to transactions that their employers consider to be a necessary incident of legal practice.

One submitter suggested that the standards should recognise that the need for risk assessment and research is less for debt reduction, mortgage and insurance products than for investment advice and that the Code should reflect this.

One submitter rejected mandatory suitability analyses for share broker AFAs, provided that the client has waived that requirement in the Client Agreement.

One submitter suggested that while the proposed requirements may be appropriate for financial planning and portfolio management services, they were far too prescriptive for many of the relationships conducted by NZX firms, who were already subject to "Know Your Client" requirements. That submitter suggested that share broker AFAs should be exempted from the requirement to conduct suitability analyses when the client has consented to opt out.

One submitter suggested that a suitability analysis should be required in the insurance context when advice (as opposed to just quotes) is given.

Practical difficulties and specific changes that are required

One submitter stated that the requirements in standard 11(2)-(3) are very difficult to quantify accurately in many financial products. That submitter queried: how does one assess the potential impact of a possible future income protection claim without knowing what the client's actual future income level is at claim time, without knowing what ACC benefits may or may not be offset or whether a claim will be partially upheld or not. It was suggested that it is simplistic to base standard 11 on the more certain and predictable sensitivity analysis that can be applied to investment business.

That submitter also stated that generally financial advice is a six step process and that the proposed suitability standards require the first five steps to be completed prior to engaging in the advice process. It was therefore submitted that an AFA must engage in providing quality advice before they are able to determine if they are able to provide quality advice.

That submitter also stated that the considerations in sub-paragraph 2 are too vague and require an AFA to consider what may or may not impact on the suitability of a product or piece of advice before determining whether or not they can give advice. It was submitted that the proposed standards which require professional client care and fiduciary responsibilities required by the FAA are adequate measures to ensure that advice is fit for purpose. It was also submitted that safeguards are also contained in the Consumer Guarantees Act, Securities Markets Act and Fair Trading Act. Therefore the submitter stated that proposed standard 11 should not be included in the Code and neither option set out in the question above should be chosen.

One submitter stated that option (b) should be permitted but that the client should not be required to consent in writing. It was submitted that file notes and initial sign up documents should suffice.

One submitter stated that the code should make reference to instances of non-disclosure by clients such as information that is critical in assessing suitability for particular financial products to give protection to the AFA.

One submitter stated that the recent Consumer “Mystery Shopper” methodology serves as a warning that best endeavours to help clients (often for minimal fees) is high risk. It was submitted that where there is an established relationship based on trust or a genuine referral then complimentary or low cost plans should be acceptable. However in other situations (person off the street) good practice would be to offer to do a full (not necessary comprehensive) plan at a specified rate. However it was stated that this will deter genuine prospects.

In relation to (b), one submitter suggested that if the matter is outside the scope of the adviser’s expertise, then they will by default be unable to carry out a suitability analysis and should disengage.

One submitter pointed out that continually re-evaluating suitability was problematic, and that investor sophistication was an issue: the initial contract should cover whether a suitability analysis will be needed on every occasion.

One submitter suggested that the suitability analysis (or the suitability of the advice itself) can be assessed, from a regulatory perspective, on the basis of information that the Code already requires to be collected – that is, the client data on the basis of which the advice will be given, which can be checked against the capabilities and capacity of the adviser as disclosed in the Adviser Business Statement and/or practice manuals. That submitter also suggested that where a personalised written suitability analysis is not practicable, a standardised version could be included in the scope of service (in a check box format).

That submitter suggested that in all cases:

- an adviser must not provide a service which they are not qualified or experienced to provide;
- an adviser can outsource any work within the scope of the engagement that is beyond their expertise; an insufficiently experienced adviser may proceed and learn “on the job” if under supervision from an appropriately qualified and experienced AFA;
- the client must be informed of the fact that particular advice or work is outside the adviser’s competence (including by way of a standardised text).

One submitter also indicated that a suitability analysis should not be required when providing generic advice, such as in a newsletter.

One submitter suggested that obtaining the suitability analysis itself should not be considered a financial planning service, so that advisers would have to become authorised in order to obtain the client’s consent not to do a suitability analysis.

One submitter questioned what the “trigger” for a suitability analysis would be.

One submitter believed that suitability analyses should be written, and the client and the adviser should agree as to how often they should be conducted.

Definitional issues and requests for clarification

One submitter agreed with the factors in standard 11 that need to be taken into account when making enquiries for a suitability analysis. However it was submitted that the “financial literacy of the client” could be difficult to ascertain without detailed questioning. That submitter queried how this can be achieved and how financial literacy is to be defined.

One submitter stated that it presumes standards 12 and 13 are subject to standard 11 ie if the client has acknowledged the limited service and waives a suitability analysis, standards 12 and 13 are inapplicable.

One submitter stated that if the AFA is only making an investment transaction on behalf of their client, then they agree that they should not be required to undertake a suitability analysis. They submitted that it is important that if the client is clear that the AFA is merely carrying out their instructions without providing anything further, there is no implication that the adviser endorses the transaction.

That submitter, however stated that when giving financial advice or providing a financial planning service, AFAs should use their best endeavours to obtain from the client all the information needed relevant to the scope of the service to be provided. Therefore it was suggested that standard 11 should distinguish between the different types of financial adviser services.

One submitter suggested that the standard should be drafted as follows:

“before providing any financial planning services to a “retail” client, an AFA must ascertain whether the service will be suitable for the client by, (a) making reasonable enquiries to determine what the client’s financial needs and objectives are; and (b) making an informed assessment of the client’s risk tolerance, financial situation, investment portfolio and needs... Clients should be able to consent in writing to not receiving a suitability analysis in relation to those financial planning services.”

That submitter referred to the requirement that the AFAs must ascertain whether the service is suitable for the client by “reasonably researching and considering any financial advice or plan to be given”. They submitted that it is not possible for an AFA to research the full plethora of products in the market. AFAs need to restrict their advice to the range of products they have available to them. That submitter stated that it would be detrimental if AFAs were advising on products they were not trained and familiar with.

One submitter stated that in relation to “financial advice” (as opposed from financial planning services), requiring a full suitability analysis is not practical given the current broad definition of financial advice. They submitted that AFAs will often provide incidental advice when answering simple questions such as whether insurance premiums should be paid annually or monthly. This level of financial advice does not require a suitability analysis. They stated that requiring clients to opt out of a suitability analysis will be impractical and may discourage people from taking the advice. That submitter stated that when AFAs give financial advice (but are not providing a financial planning service) the provisions of the FAA to exercise care, diligence and skill will require AFAs to perform a suitability analysis when the level of financial advice warrants this.

One submitter suggested that a formal, written suitability analysis before engagement was not necessary, but that it would be best practice.

Another submitter suggested that standard 11(1)(b) be expanded to “portfolio risk management and needs...”. They also suggested that a definition of what a suitability analysis consists of is required.

Other suggestions

One submitter also stated that competence requirements for AFAs should to a large degree resolve the question of whether AFAs provide services (such as suitability analysis) that are appropriate for the client's needs.

QUESTION TWENTY-TWO: Is it appropriate that where the suitability analysis shows that the financial adviser services offered by an AFA are unsuitable for the client, the AFA must not provide the financial adviser services or should the AFA be able to provide the services if the AFA informs the client that the services are not suitable but the client still wishes the AFA to provide the services? (see proposed standard 13)

Proposed standard 13: AFAs must inform client and not provide services if the financial adviser services offered by the AFA are unsuitable

Where the outcome of the suitability analysis shows that the financial adviser services offered by an AFA are unsuitable for the client's needs, the AFA must make this clear to the client and not provide the financial adviser services.

SUMMARY

Submitters were split in response to this question, with a significant majority in favour of permitting AFAs to provide services that they have deemed to be unsuitable. These submitters almost uniformly suggested that it was a matter for the client and the adviser to decide, provided that the client was fully informed of the reasons for which the service was potentially unsuitable and the potential consequences. A significant number of submitters suggested that the AFA should be required to obtain written consent from the client, while many implied that it would be sufficient if the client proceeded to seek a service after the adviser had explained why he or she deemed it unsuitable.

A number of submitters did, however, suggest that it would be inappropriate for the adviser to provide a service contrary to a suitability analysis. A proportion of these submitters suggested that doing so should be prohibited. In contrast, several submitters pointed to the risk that a client whose adviser refused to provide a service for this reason would then be free to seek that service from another adviser on a "transaction-only" basis.

INDIVIDUAL SUBMISSIONS

Adviser should be able to proceed

Eighteen submitters suggested that it should be up to the client and the AFA, provided the client has been fully informed in writing of the AFA's view as to suitability.

Two submitters suggested that a client's right to make their own decision should prevail, but that an adviser would be prudent to keep an adequate record of the client's informed decision.

One submitter suggested that an AFA should be required to document the unsuitability in understandable writing to the client, and the client must sign it.

Another submitter suggested that an AFA should be able to provide the service if the client insists, but that the client's express consent should be required.

One submitter suggested that the AFA could proceed if the client signed a waiver, but that it would be unwise to do so.

One submitter stated that AFAs should be able to provide financial adviser services if the AFA has informed the client that the services are not suitable and the client has expressly provided in writing that they wish the service to be provided.

One submitter stated that if an AFA feels strongly that they will not be able to provide suitable services then they should declare the unsuitability. It was suggested that in this case it would be best to ask the client to go to another provider. It was also stated that if, however, the client signs a document acknowledging that the AFA has told them the service is unsuitable, then the AFA should be permitted to accept this and provide the service.

One submitter stated that if the client wishes to buy a product or service that the AFA believes is unsuitable, the AFA should provide written advice with a clear explanation of why it is unsuitable. The client should be permitted to proceed if the client signs a waiver.

One submitter stated that the client should decide (provided they are in a sound mental state) and the AFA should get a signed disclaimer.

One submitter stated that the AFA should be able to provide the services if the AFA informs the client that the services are not suitable and the client expressly confirms in writing their wish that the AFA provide the service.

One submitter suggested that when a client wished to follow an unsuitable path, s/he should be allowed to do so if s/he indemnifies the adviser in writing.

One submitter stated that the AFA should be able to provide the services if the AFA informs the client that the services are not suitable but the client still wishes the AFA to provide the services. The agreement to proceed under these conditions must be recorded for the protection of the AFA.

That submitter also stated that AFAs are required to carry out a suitability analysis and provide advice that is suitable for the client. However rather than proposed standard 12 "AFAs must restrict financial advice where the client has not provided full information for suitability analysis", it was suggested that the AFA should be required to ensure that, if restricted financial advice is given or financial planning service provided, the statement of advice (as required by proposed standard 15) includes a written warning to the client that the advice or services are restricted and state the nature of the restriction and reasons for it.

One submitter suggested that an AFA should not be prevented from assisting a client with implementation after a client has chosen to reject part or all of the advice.

One submitter suggested that AFAs should be left to decide these matters themselves (e.g. by a client file note covering the risk warnings provided).

One submitter suggested that the interests of the client are paramount, and subject to the adviser's right to refuse to do something illegal, for example, they should effect instructions that are contrary to their advice after properly informing the client. That submitter suggested that the client's instructions should be recorded, at least in a file note if instructions were given by telephone.

One submitter stressed that the client's wishes had to take precedence, and if they wished to act contrary to a suitability analysis they should be allowed to do so.

One submitter responded in the negative and suggested that this was an attempt to impose particular management processes on advisers.

Nine submitters believed that this is the client's decision and that the Code should not assume that all investors require a full financial planning service.

One submitter suggested that the client's wishes should always be respected, and it should be the AFA, not the Code Committee, that determines whether to continue to offer the service. The submitter noted that clients value the ability to retain control. That submitter suggested that it will be good practice for AFAs to clearly outline their concerns to clients and document that they have done so (though the submitter was ambivalent about whether this should be a requirement).

Six submitters stated that if a client wants to proceed it should be at the discretion of the AFA whether to offer the services. They submitted that it would be prudent for the AFA to outline his or her concerns to the client and to document this. But the six submitters were ambivalent about whether advice and a warning should be required under the Code.

One submitter suggested that, from an investor's perspective, the decision should be left to the customer. They stated that the adviser is retained to provide advice, but the investor must make the decision.

One submitter suggested that, with the client's money at risk, it should be the client who decides whether to proceed with a particular course of action.

One submitter suggested that the adviser must be able to provide the service regardless.

One submitter stated that the suitability analysis is a flawed concept and should not be included in the Code. However it was submitted that AFAs should be permitted to make a transaction or provide a product that is unsuitable. It was submitted that the Code should not limit the consumer's right to buy something they do not need or to make a poor decision. It was also submitted that the professional should be required to give a warning of the lack of suitability but the consumer, once informed of this, should be allowed to continue with the unsuitable path.

One submitter stated that this is a decision between the client and the AFA, if the client agrees then their choice should be respected. They suggested that the adviser should make a clear file note or obtain the client's sign-off that they are aware that the services they are choosing are not the most appropriate for them based on the suitability analysis.

One submitter stated that the standards pertaining to suitability analyses should only apply to financial planning services and that if a consumer wants to make an investment transaction, they should be permitted to do so. It was suggested that prohibiting consumers from doing so (by not allowing AFAs to act for them) unjustifiably infringes on consumers' personal freedoms. Similarly, consumers may seek simple, quick advice on products they are already intent on purchasing (eg "what are the advantages of your company's third party car insurance?"). If the Code requires such advice to be preceded by a suitability analysis, the effect will be that such clients do not receive advice at all.

One submitter stated that an adviser should be free to provide services if a client still wishes to undertake that transaction despite an adviser's advice to the contrary. They also submitted that it should be made clear that an adviser is not obliged to provide the service, and should retain some prerogative to decline to act for the client.

That submitter also said that it is difficult to require an adviser to override the wishes of a client, particularly in a situation where the client is otherwise fully informed and wishes to proceed. They submitted that absent illegality, or improper motive on a client's behalf (insider trading, market manipulation) client instructions should always be afforded the highest priority. But it was noted that if a client is mentally incapacitated or under duress or undue influence the adviser should be prevented from acting on instructions.

One submitter stated that the AFA should be free to provide the services if the client wants the service.

One submitter preferred more flexibility so that the AFA is able to provide the services if the AFA informs the client that the services are not suitable but the client still wishes to proceed.

One submitter stated that it should be the client's decision.

One submitter stated that this is a matter for the adviser to raise with the client at the time of giving advice and then the decision is left to the client.

One submitter stated that if the client wishes to proceed after appropriate advice from the AFA, then it should be a matter for the client to decide.

One submitter suggested that it should be up to the client and adviser whether to continue in these circumstances. That submitter was "ambivalent" about whether full disclosure should be mandatory.

One submitter stated that they disagree with AFAs not providing services even if the AFA believes the services are not suitable for the client. They submitted that advice is just an opinion and it should not be binding on the customer or limit their choices if they disagree with the advice. Clients should have the freedom to act on the services provided by the AFA however they wish. They agreed that in these circumstances the client should give informed consent in writing. The submitter stated that this is similar to other professions ie clients can instruct their lawyer to act in a way that is contrary to the advice given.

One submitter stated that standard 13 is unnecessary and/or is addressed under standard 1. They also stated that standard 13 conflicts with standard 11. They also observed that it would be prudent for an AFA providing financial and product advice in this circumstance to communicate in a transparent fashion the situation and options available.

Adviser should not proceed or should be prohibited from proceeding

One submitter suggested that an adviser should not sell a product which is not suitable for their client's requirements.

One submitter suggested that it would be unprofessional for an AFA to provide a financial advisory service that was, in the adviser's opinion, unsuitable for the client.

Another submitter suggested that an adviser should never continue to provide a service when a suitability analysis shows that it is not in the client's best interests.

One submitter suggested that it would be "wise" for the AFA not to provide the service in these circumstances.

One submitter suggested that AFA should not provide unsuitable services.

One submitter questioned the necessity of regulation of this matter when common sense would dictate that the adviser should not provide the service.

One submitter stated that common sense and best practice suggests that the AFA should not provide the service.

One submitter stated that where the services offered are unsuitable, the AFA should not provide the services and that to do otherwise would be to go against the ethical behaviour principle of placing the client's interests first and acting with integrity.

One submitter agreed with proposed standard 13 that services should not be provided and said that to do otherwise would compromise the AFA's integrity and would be against the client's best interests.

One submitter stated that the AFA should not be able to provide services if they are unsuitable.

One submitter stated that AFAs should never be permitted to provide financial plans that, based on the information they have available, AFAs know to be unsuitable, because the very purpose of a financial planning service is to develop the best means for clients to realise their goals. In response to standard 12, they submitted that AFAs should be allowed to provide financial planning services on the basis of limited information, provided they take the steps outlined in the standard.

Problems with regulating this matter

One submitter noted that this would not prevent a determined client from turning to another adviser and asking for that service to be performed on an "execution only" basis.

One submitter suggested that many problems in the industry have not been caused by investors rejecting sound advice, but by investors failing to take advice at all and just responding to an advertisement.

Nine submitters questioned whether, if one AFA determined that it was inappropriate to provide a given service, the client would then have to disclose this to another adviser. They stated that the client may not wish to even disclose the existence of the relationship with the other adviser.

One submitter stated that the most important aspect is to ensure that the client has been properly advised and then it is up to the client to make an informed decision regarding how to proceed. They submitted that an AFA should be able to provide the services in the situation contemplated by question 22. It was argued that if they could not, a situation could arise where a client goes to an AFA who carries out a suitability analysis (which should determine if the service is not in the best interests of the client) and is then prohibited from providing the service notwithstanding that the client may still want it. The client would then need to go to a different AFA, consent to not having a suitability analysis in order to receive the service that the first AFA was not permitted to provide because he or she carried out the suitability analysis.

One submitter suggested that this was too hypothetical.

One submitter stated that the difficulty with requiring an AFA not to carry out an unsuitable transaction despite the client's insistence is that it places the adviser in a difficult situation. They

submitted that it was possible that the adviser will taint their analysis, even unconsciously, if they know they will lose work as a result. It was submitted that it is better for the adviser to provide an objective analysis so that the client is properly informed.

One submitter expressed concern that the proposed standards could place an AFA in the role of decision-maker or gate keeper rather than adviser. In particular they stated that proposed standard 13 would prohibit an AFA from providing financial adviser services that he or she believes are unsuitable for the client's needs. One submitter stated that this misstates the role of the AFA and negates the clients' right to choose. It also was submitted that this ignores the reality that advice is opinion-based and different AFAs may make different recommendations.

That submitter also stated that this could encourage clients to shop around for an AFA prepared to give effect to their instructions and this would not be in the best interests of the consumer or consistent with the aim to promote sound and efficient delivery of financial advice. They submitted that the AFA should be able to provide financial adviser services if he or she informs the client that the services are not suitable but the client still wishes the AFA to provide the services.

One submitter agreed that if the suitability analysis is undertaken and the solution is unsuitable, then the services should not be provided by the AFA. However it was noted that if full disclosure has occurred and documentation and records are kept, undertaking investment transactions for a client may be appropriate. They stated that the client has a right to proceed once there has been adequate disclosure and once appropriate waivers/disclaimers are signed. It was submitted that an overarching standard like this is inappropriate as this issue should be dealt with on a case by case basis. They stated that if it is decided that AFAs can provide the services provided full disclosure and waivers have been exchanged, the Code should provide guidance regarding when it is appropriate to provide the services.

One submitter did not agree that either of the proposals should apply to financial advice or investment transactions because neither of those types of financial adviser service should require suitability analyses. They stated that the duty to exercise reasonable care, diligence and skill will protect the quality of those services. They stated that if clients are intent on purchasing particular financial products, but AFAs withhold advice and/or refuse to perform execution-only investment transactions, this will significantly curtail consumer freedom.

One submitter recommended that standard 13 be reworded to be more like IFA's rule 25 and the AFA should not be permitted to allow a client to opt out.

Other matters

One submitter suggested that standards 12 and 13 were inappropriate and impractical for the share broking industry, especially when a client just wishes an AFA to complete a transaction. They stated that if the client wishes a transaction to be carried out contrary to a suitability analysis, the Code should not prevent them.

One submitter suggested that standards 12 and 13 were too prescriptive for many situations when an investor just requires an NZX AFA to facilitate a transaction. The submitter recommended removing standards 12 and 13.

QUESTION TWENTY-THREE: Do you agree that the proposed standards concerning suitability (proposed standards 10-16) should be included in the Code? Are there any other standards concerning suitability that should be included in the Code?

SUMMARY

A number of submitters replied that the proposed suitability standards were appropriate and that no more standards were required.

Consistent with responses to Questions 21 and 22, a number of submitters stressed that it was necessary to recognise that many clients do not want a full financial planning service, and suggested that the suitability standards should be flexible to reflect this. The importance of distinguishing between retail and wholesale customers was also highlighted.

In relation to standards 11, 12 and 13, guidance was sought on how these standards would be implemented, and it was suggested that the exemption would be so universally utilised that the standards could prove meaningless.

Some submitters were concerned about what a “reasonable” investigation in the context of standard 14 would constitute, while others suggested that the standard should be adjusted to suit the characteristics of the insurance market where it was feasible to investigate all products on the market.

A number of submitters suggested that standard 15 ought to be narrowed to take account of clients who did not require a full service, such as share broking clients, while one submitter suggested a carve-out proviso reading: “unless it is not practical to do so.”

INDIVIDUAL SUBMISSIONS

General endorsements

Nine submitters endorsed the standards and did not think any others were needed.

One submitter suggested that suitability is important, and that compliance with these standards will override any potential conflicts and any perceived lack of objectivity.

One submitter agreed that the suitability standards should be included. They also suggested that some thought should be given to estate planning ie where investments are via a trust, the suitability of the advice to the beneficiaries of the trust should be considered. However this was difficult where the beneficiaries have not come into being yet and therefore consideration of the class of client is required.

One submitter agreed that it is appropriate to include suitability standards in the Code. However it was stated that consideration should be given to the different types of financial adviser services and whether the same standard is required for all three types.

One submitter stated that the proposed standards are appropriate. It submitted that the suitability analysis should always be assessed against the scope of the services being contracted ie a suitability analysis for a financial planning appointment will be very different to a suitability analysis for a stockbroker.

One submitter stated that the suitability standards should be included in the competence, knowledge and skills section.

General rejection

One submitter suggested that, because they conflicted with the primacy of consumer choice, standards 11, 12, 13 and 14 should not be included.

One submitter stated that suitability requirements were outside the scope of what the Code should regulate, and should be left to the good business practices of advisers.

Another submitter suggested that these requirements were impractical and ignored section 3(a) of the FAA. The submitter suggested that the client should decide.

One submitter stated that the suitability standards should not be included in the Code.

Different types of services

One submitter stated that not everyone requires a full financial planning service so it is unnecessary and would add to all clients' costs through extra compliance.

One submitter was concerned that the focus in the proposals on suitability could have a tendency to lead customers towards costly "full-service" financial planning services that would not be suitable in all circumstances.

Eleven submitters suggested that the Code should be more flexible to take account of clients who do not require a full financial planning service to avoid unnecessary compliance costs.

One submitter stated that the proposed minimum suitability standards are not practical or necessary for two of the three types of financial adviser services: financial advice and investment transactions. They submitted that the proposed standards would require AFAs to conduct suitability analyses when financial advice is given as an incidental part of the financial services provided by the AFA's respective employers. It was submitted that this will include:

- answering common, over-the-counter questions such as "what is the best term deposit rate today?" or "which account is better for school children?" and
- performing investment transactions without client contact.

One submitter argued that the Code should recognise those services below full financial planning to avoid imposing unnecessary compliance costs.

Another submitter criticised the assumption that all advisers are providing comprehensive financial planning advice, and questioned whether the Act intended the Code to be so prescriptive.

One submitter suggested that the Code should be flexible to take account of sophisticated clients who do not require a full financial planning service.

Nine submitters suggested that it will not always be appropriate to disclose full details of his assets to his adviser. The submitters believed that it was within the client's rights to seek limited advice and provide limited information in order to receive it.

One submitter was opposed to the proposition that he would be obliged to reveal all his personal information to an AFA, who would then conduct a suitability analysis and tell him what advice he was allowed to receive. That submitter suggested that it should be for the investor to decide how much

information to disclose, and for the investor to decide what advice to receive. It was stated that if the client wants it a comprehensive financial planning service they can ask for it.

Two submitters pointed out that these standards do not appear to take account of the provision of a “discretionary investment management service”.

One submitter stated that not all clients require the protection of the suitability standards and that some simply want a particular transaction done and should be able to do that without too much paperwork.

One submitter expressed concern that requiring AFAs to perform a suitability analysis for all types of financial adviser services (rather than only financial planning services) may be impractical and unrealistic in many situations, and that it may impose considerable cost barriers to obtaining financial advice.

One submitter stated that the Code should provide flexibility so that the AFA can execute the client’s instructions and not receive full information on the client’s particular circumstance if that is the wish of the client.

One submitter stated that the standards need to allow for different consumers’ needs otherwise all clients will be subject to unnecessary compliance costs.

One submitter stated that there is no recognition of sophisticated investors or those who wish to operate on a transaction or execution basis. He suggested that the Code must address this and provide a low regulation/low cost solution (status quo) to enable this sector to operate efficiently.

Two submitters stated that the code fails to provide for clients who do not want a full financial planning service. They submitted that more flexibility needs to be allowed for recognition of the client’s sophistication to prevent unnecessary compliance costs.

One submitter agreed with the suitability standards in principle but that it needs to accommodate or address specialist providers that are only providing general or product advice without reference to the overall portfolio of a particular client.

One submitter stated that the principle of suitability (and proposed standards 10-14) should not apply to institutional investors as they do not require and do not want the protection. It was suggested that such a service will be of no benefit to institutional clients and such clients are unlikely to provide AFAs with the financial information to undertake the analysis and the outcome (that in the absence of such information, an AFA must restrict their advice) is not commercial. In many cases an AFA only provides execution services to an institutional client.

Retail and wholesale customers

One submitter made the following comments with regard to “retail” customers and proposed standard 15:

- A statement of advice should only be required to be provided and explained when providing financial planning services. However the customer should be verbally advised that they can request any advice in writing. If financial advice is merely being provided, a record should be kept but it should not need to be documented before being given to the customer.
- If the Code does require advice to be provided in writing, guidance should be provided on what is “not practicable”.

- It was submitted that if the Code requires a record of financial advice be kept, it should not necessarily need to be provided to the customer.

That submitter also made the following comment with regard to “wholesale” customers and proposed standard 15:

- A statement of advice should not be required to be provided and explained to wholesale customers.
- That wholesale customers have access to their own internal and external financial and legal resources as well as their own expertise. They stated that wholesale customers do not need or want the same level of protection as retail customers.

That submitter stated that proposed standard 16 should only apply to “retail” customers receiving financial planning services.

Standards 11, 12 and 13

Two submitters questioned whether the Code Committee has examined the practicalities of retaining standards 12 and 13, and in particular how they are going to be efficiently and fairly judged and enforced from one AFA to another.

One submitter stated that proposed standards 11 and 13 appear to conflict: standard 11 suggests that the client can expressly consent to proceed irrespective of the suitability analysis, however standard 13 precludes the AFA from proceeding to offer services where the service is unsuitable. That submitter stated that this requirement could also annoy customers.

One submitter referred to proposed standard 12 and agreed that where the client has not provided the full information the AFA should go through all steps (a)-(c).

One submitter had concerns regarding the legal liability when AFAs endeavour to meet standard 12 and 13. It was stated that an unintended consequence of meeting this standard could be the threat of legal action over conflicts that could arise.

One submitter anticipated that the exemption will be universally utilised rendering the principle redundant. They preferred a procedure that clearly puts the client on notice that the advice may not be suitable for their particular needs if a suitability analysis has not been conducted. It was also suggested that the notice be a prescribed notification rather than a duty of care on the adviser.

In relation to standard 13, three submitters stated that if one AFA states that the service is inappropriate then all other AFAs presented with the same request and information will decline to provide the service. The submitters stated that this would restrict the client’s ability to choose an investment and that the decision to decline to provide the service should take into consideration the investor’s experience and knowledge of financial services and investments.

Reasonable investigation

One submitter suggested that at the beginning of standard 14 the following words should be added “consistent with the scope of engagement” because the client may have deliberately limited that scope.

Another submitter questioned what “reasonable” and “reasonably” in standard 14 meant, or how they would be judged.

One submitter suggested the insertion of the following words in standard 14(2)(c): “AFAs should have reason to accept the accuracy of the contents of registered prospectuses and registered investment statements.”

One submitter suggested that practical examples of what constituted a “reasonable” investigation and “proper research” were required – for example, was the report on Bridgecorp just before its failure “reasonable”?

One submitter agreed with proposed standard 14 relating to investigation of financial products and services. However, it was stated that the word “reasonable” poses problems, both here and in proposed standards 15, 16 and 25, as it is open to interpretation. They stated that proposed standard 14 would be strengthened if it was made clear that professionalism, as defined under the client care principles, includes the obligation to be well-informed about a wide range of products and services. That submitter also stated that where investigation is undertaken by a third party, “proper research” should be defined as that which meets high professional and ethical standards.

One submitter stated that the insurance product replacement standard should be added. With regard to standard 14(2)(b) they recommended that the word “all” be removed as it is too broad.

Statements of advice (standard 15)

One submitter suggested that a written statement of advice should be provided unless the client has expressly consented to a no-advice service.

One submitter suggested that NZX firms should be excluded from standard 15.

One submitter suggested that standard 15 is too prescriptive for some business, and that “transaction-style” services be excluded.

One submitter suggested that standard 15(1) is totally impracticable in many situations such as share trading.

One submitter suggested that proposed standard 15 should be subject to a “unless it is not practicable to do so” carve-out (as is the case with proposed standard 20). They stated that written advice will not always be practicable (for example, a client may telephone an AFA asking for advice as to whether the client should buy or sell shares at a particular time).

One submitter stated in response to proposed standard 15, that due to the wide definition of financial advice, it may not always be practical, nor may clients always desire, advice to be provided in writing.

One submitter stated that proposed standard 15 is not practical as advice is often given verbally. They stated that the aim of the rule appears to be – to reduce misunderstandings by clients of advice. However the submitter stated that the decision of whether advice should be in writing should be discussed and agreed between the adviser and the client.

One submitter stated that a written statement of advice or recommendation should always be provided but if the client chooses a “no advice” process then this document need not be provided. It was noted that recording advice enables an AFA to prove their position regarding any future claim or dispute.

One submitter queried whether a client should have the ability to waive receiving a written statement of advice. It was suggested that some clients will not want written advice on all occasions.

One submitter stated that the statement of advice should only be required where personal advice is being provided – not product advice or general advice.

One submitter stated that under proposed standard 15 AFAs are required to provide clients with a written statement of advice and take steps to explain the advice and basis for it. It was suggested that while this will provide desirable protection for retail investors, if codified, it will require a major departure from current practice in the wholesale market. It was also pointed out that given the wide definition of “financial advice” under the Act, requiring every matter which may be caught under that definition to be communicated in such a manner is unrealistic and commercially unworkable.

One submitter stressed that often for NZX Advisors it was not practicable for advice to be given in writing, and suggested that NZX Advisors enjoy an express exclusion from this requirement.

QUESTION TWENTY-FOUR: How long should AFAs be required to keep records in relation to proposed standard 16? Should there be specific standards relating to electronic records?

Proposed standard 16: AFAs must take reasonable steps to ensure that records of information obtained for suitability analysis are kept

An AFA must take reasonable steps to ensure that records are kept of:

- (a) the information obtained from the client in carrying out a suitability analysis; and
- (b) the reasoning and research regarding the suitability of the plan or advice for the client; and
- (c) the statement of advice.

SUMMARY

Most submitters endorsed a requirement to maintain records, although a significant minority suggested that existing legislative requirements are sufficient. Others suggested that if the Code did include a standard on this matter it should impose obligations that were consistent with those existing legislative requirements.

Of those who recommended that the Code regulate this matter, a range of record keeping periods were suggested. The most frequent suggestion was that advisers be required to keep records for seven years, particularly because this would be consistent with many other legislative requirements (such as for tax records). Also frequently suggested was that the adviser be required to keep the records for the duration of the relationship and, according to most of these submitters, for a stipulated period afterwards (generally between three and seven years). A range of other suggestions were made by a few submitters, up to ten years and “permanently”.

As with other standards, some submitters suggested that the standard should provide that record-keeping by an AFA’s FSP employer should be sufficient, and that this standard should only apply in respect of retail clients.

INDIVIDUAL SUBMISSIONS

General observations

One submitter agreed that written statements of suitability should be recorded. That submitter suggested that there be a requirement to keep file notes pertaining to relevant matters that are not recorded elsewhere.

One submitter stated that keeping records on each client is of the utmost importance: particularly the suitability analysis, the primary instruction and the service and recommendations provided.

One submitter suggested that rules about record-keeping were impractical.

One submitter suggested that minimum standards for the integrity of client records would be useful.

One submitter stated that this varies with the type of service and product. They stated that this should not be covered by the Code. They also submitted that risk advisers need to keep life-long records for clients. They suggested that there should be a requirement to keep thorough and extensive written records, electronic or otherwise.

One submitter stated that because business is verbal, there is not always a record of conversations. It was submitted that compliance should not be too prescriptive and records are not always necessary. They also submitted that records are unlikely to reduce errors as effective communication is not improved by an adviser writing down an incorrect instruction, or a client making errors in written communications.

One submitter suggested that obsolete and inactive files could be archived, instead of destroyed, but that the basic authority contract and information relating to active investments should be kept accessible.

Electronic storage

One submitter stated that as IT capabilities change so rapidly it is appropriate for the requirements around retention of records to be generic and principles-based. Otherwise specific requirements would out-date quickly.

One submitter suggested that advisers should be required to maintain backups of electronic records.

One submitter suggested that offsite backup of electronic records should be required.

One submitter stated that electronic and hard copy records should be kept in conditions which ensure their safety and confidentiality.

One submitter stated that in terms of electronic records, it is important that appropriate back-up systems are utilised to ensure that such records are securely maintained.

One submitter did not see the necessity for different rules for electronic and physical records.

One submitter noted that standards relating to electronic records are desirable but queried whether these are covered by other legislation.

Another submitter suggested that the FAA had no role to play in regulating electronic record-keeping.

Another submitter stated that additional standards should not be required for electronic records.

Relationship with other legislation / do not need to regulate this

One submitter suggested that the Code should avoid being too prescriptive here.

Six submitters suggested that other legislation adequately regulated this matter.

One submitter suggested that given the legislative obligations, including the new Anti-Money Laundering and Countering the Financing of Terrorism Act 2009, it should not be necessary to impose additional requirements.

One submitter stated that there are legislative requirements to maintain client records ie Anti-Money Laundering and countering the Financing of Terrorism Act and that the new standards should therefore align.

Five submitters stated that given the other legislative requirements to retain client records ie Anti-money Laundering and Countering the Financing of Terrorism Act, they considered that it is unnecessary to introduce standards regarding this. It was submitted that the proposed disciplinary and dispute resolution bodies also impose a natural incentive to retain records, as the absence of records will make it difficult for the AFA to defend themselves. They submitted that if any standard is appropriate, it is that all relevant records that exist at the time that a disciplinary or disputes resolution process commence must be retained until such process is concluded in full.

One submitter stated that there is a natural tendency to retain records, but she was unsure how any standardisation could improve on the requirements with respect to anti-money laundering.

One submitter stated that additional standards regarding record keeping are not necessary for NZX Advisors as NZX Firms are required to keep all records and documents for 7 years (NZX Rule 3.27).

Two submitters suggested that the period should be consistent with the Limitations Act 1950.

One submitter stated that the requirements should be aligned with the legislative requirements of the Privacy Act 1993.

Timeframes

Seven years

Twelve submitters preferred that any record-keeping requirements replicate those of other professionals, such as solicitors and accountants, and therefore be set at seven years generally (which they stated is one year more than the limitation period for civil claims).

One submitter stated that each area of specialty advice will have records and detail that provide key information and this information should be kept for an industry-specific period. It was suggested that the detail regarding the client's financial position, the analysis and recommendations made at the time are critical and that documents should be kept for 7 years.

Another submitter stated that records should be kept long enough for the AFA to demonstrate that the service was provided in accordance with the Code of Conduct, if challenged. They stated that it would be reasonable to expect this to be at least 7 years, in line with tax records.

Duration of relationship

Five submitters suggested that information should be retained for the duration of the relationship with the client plus seven years.

One submitter stated that disputes often arise many years later, and that clients are often poor at keeping records themselves and therefore advisers should keep records for as long as the relationship continues. Three others agreed with this length of time, with one other stating that files should be kept indefinitely.

One submitter stated that records should be maintained for the duration of the account and for at least a further five years. It was stated that these records will be used to satisfy the anti-money

laundering requirements and monitoring obligations and source of funds (anti-money laundering requirements require records to be kept for five years).

One submitter proposed that records be kept for as long as the retainer and continual service is provided and for three years after the last service transaction in order to comply with the Fair Trading Act 1986 and the Consumer Guarantees Act 1993 e.g. regarding recommendations and service quality. It was also submitted that it is necessary to keep financial transactional records for tax purposes.

One submitter stated that they do not destroy records of existing clients – some files go back 17 years and in other cases it has been agreed that files could be destroyed after all the investments had been liquidated. It was stated that records should be kept for three years after the adviser/client relationship ceases. He also stated that client records are valuable when an estate is being wound up. He also submitted that electronic records are part of the client's total records and that it is good practice to back up electronic records with off-site storage.

Other lengths of time

One submitter responded that records should be kept “permanently”.

One submitter suggested that guidance could be obtained from the Chartered Secretaries of New Zealand's publication “The Disposal and Retention of Documents” available at www.csnz.org.

One submitter suggested that advisers should only be required to keep records for as long as necessary, and that clients should protect their own records.

One submitter suggested that records should be kept until their relevance is expended – for life insurance, for example, this will probably be when the insured dies.

Three submitters stated that records should be kept for ten years. They stated that although IRD guidelines indicate most records should be kept for seven years, many law firms keep all records for ten years, in line with Land Information New Zealand requirements for land transfer documents.

One submitter stated that AFAs should keep records until after the death and settlement of the estate of the client.

One submitter stated that records should be kept for 7-10 years and that electronic systems should be required to have back-up systems in place.

One submitter stated that the standard should align with the Financial Transactions Reporting Act, which is five years, and ten years for tax-related advice.

One submitter stated that there should be no time limit.

Other observations/exceptions

One submitter stated that standard 16 should state that where an AFA is an employee or agent of a FSP records can be kept by the FSP on the AFA's behalf.

One submitter stated that allowing FSPs to keep records of the actions performed by their employed AFAs will often be more practical than requiring each AFA to keep individual records, because many different AFAs within each FSP may be involved in advising the same client. They stated that clients expect the FSP to keep the records and therefore standards 16, 30, 33 and 34 should state that AFAs

do not need to keep records if their employers do. That submitter stated that standard 16 should make provision for AFAs to, in the case of employed AFAs, give records to their employers for safe keeping.

That submitter also submitted that this standard should only apply to financial planning services to “retail” customers.

QUESTION TWENTY-FIVE: Are the proposed capability and capacity standards appropriate (standards 17-19)? Should the standards be modified or expanded in any way? Are there other capability and capacity standards that should be included in the Code?

SUMMARY

Submitters were generally supportive of these standards. Standards 17 and 18 were particularly endorsed, while standard 19 attracted some criticism. Some submitters queried how the standards would be monitored, or questioned whether they would be practical in application.

Standard 17 received little criticism. It was suggested that standard 1 rendered it redundant, while one submitter suggested that advisers should be required to go beyond “considering” whether they have resources and should actually determine whether they have resources and act accordingly.

Comments on standard 18 were generally positive with some comments on how the standard would work in practice.

The criticism directed towards Standard 19 was generally concerned with the position of FSPs and QFEs. The major submission was that this obligation either should be owed by the organisation, and the institutional advisers themselves, or that the obligation should be removed entirely for institutional advisers in favour of the protection afforded by QFE processes.

INDIVIDUAL SUBMISSIONS

General endorsement

Fifteen submitters expressed agreement with the standards.

One submitter stated that they would add capital adequacy as a minimum requirement, whether by capital, guarantee or insurance.

Three submitters stated that they support proposed standards 17 and 18.

One submitter stated that the proposed capability and capacity standards are appropriate. It was submitted that the educational competency and technical product knowledge and knowledge of the code would be an over-arching requirement in meeting these standards.

One submitter stated that the standards are appropriate and the standards should be high and measured to ensure compliance.

One submitter supported standards 17-19 but noted that no mention is made of training, despite the fact that reference is made to continuing professional training.

One submitter suggested that firms should be accountable to an industry body.

One submitter stated that these standards are appropriate but they must be practical in their application and not place undue cost or disincentivise the AFA or clients.

Standard 17 (sufficient time and resources)

One submitter stated that proposed standard 17 is suitable.

One submitter suggested that Standards 17 and 18 are adequately covered by Standard 1 and are therefore redundant.

Another submitter suggested that proposed standard 17 needs to go beyond an AFA having to “consider” that he or she has sufficient time and resources available. They stated that it should require that the AFA must ensure that, when agreeing to provide financial adviser services, that he or she does in fact have sufficient time and resources available.

Standard 18 (need for outside expertise)

Eight submitters endorsed the requirement to outsource work when appropriate, as part of the adviser’s duty to only perform work that they are suitably skilled and resourced to perform.

One submitter stated that proposed standard 18 is suitable and consistent with the aims of the FAA. However it was suggested that the word “obtain” should be changed to “suggest” – i.e. “AFAs must suggest outside expertise or decline to act”. They stated that it may be above and beyond what a client expects for an AFA to be required to obtain the outside expertise. It was suggested that the obligation to obtain outside expertise may put the client and AFA in conflict and present unnecessary business barriers or create liabilities for the AFA on behalf of the client.

One submitter queried whether under standard 18, the AFA must recommend a particular AFA. It was submitted that provided the name of another AFA may not be appropriate.

One submitter stated that proposed standard 18(1)(a) and (b) should include a qualification that the AFA has reasonable grounds to believe that the other adviser is “a suitable qualified person” or has the “appropriate skills or resources”, as the case may be. In other words, they stated that the AFA should not become responsible for the advice given by the other adviser if the AFA had reasonable grounds for thinking that such other adviser was appropriately qualified.

One submitter suggested that Standard 18(2) should be given greater prominence. It recommended that Standard 18 start with the requirement that an AFA provide advice only within their competence, with standard 18(1) prescribing the action to be taken when the adviser does not have competence.

One submitter expressed concern regarding the ability to outsource services as the AFA must ensure the person being referred to has the specific skills to assist the client. It was noted that an appropriate recommendation to the consumer is more valuable than simply declining to assist.

One submitter stated that no one has expertise in all areas covered by comprehensive financial planning and that AFAs should be free to give “advice” to see an expert (ie share broker, accountant, lawyer, mortgage broker, bank etc) without being responsible for the advice that the expert gives.

Standard 19 – appropriate systems and procedures

One submitter did not support the standard 19 because it is unclear how AFAs will be able to comply with it. They stated that AFAs employed by FSPs will not normally have control over the systems and controls that relate to that FSP’s provision of advice and therefore standard 19, may put them in conflict with the practices of their employer. They stated that systems and controls are not something normally associated with self-employed individuals and therefore standard 19 may not apply to non-employed AFAs either.

One submitter stated that proposed standard 19 should be removed. It was submitted that there is no indication of how standard 19 applies to AFAs employed by FSPs. They stated that in large FSPs, it is likely that AFAs will not have control over the systems and processes that relate to the provision of financial adviser services by that FSP. This is especially the case for FSPs that are QFEs. It was pointed out that s 66 of the FAA provides that applicants for QFE status must have the capacity to ensure that its employees and agents who are financial advisers comply with all of their financial adviser obligations (including the Code).

One submitter stated that the standard should recognise the differences between an AFA employed by a QFE, and one which is not. They stated that each employee should not be required to review the QFE's systems and controls and that responsibility should be assumed by the QFE with monitoring by the Securities Commission.

Two submitters noted that this standard is problematic when an AFA is an employee of a QFE but does not have direct control over procedures, and they stated that the standard does not address the AFA's liability in those circumstances. The submitter suggested that primary liability should rest with the QFE, subject to liability for the AFA when he or she knew, or ought to have known, that systems and processes were inadequate or inappropriate but continued to use them regardless.

Two other submitters supported the content of standard 19, but noted that the NZX Rules already cover this material and therefore NZX firms should be exempted from it.

One submitter agreed in general but stated that "diligence" has a much wider acceptance than capability. They stated that in standard 19 the "geographical" consideration is not understood – they queried whether it means that an AFA must make arrangements for dealing with out of town clients?

One submitter stated that standard 19 appears difficult to grasp. It was suggested that it is not clear what an appropriate system and procedure might be that takes into account the geographical diversity. It was suggested that paragraph (1) should be removed from proposed standard 19.

One submitter stated that standard 19(1)(c) could be expanded - "volume and size of transactions" to include "asset allocation or exposure" rather than just size.

One submitter queried how the systems and controls will be reviewed and deemed appropriate. They queried whether an external or regulator review is required or whether the systems and controls will only come under scrutiny if they fail.

One submitter referred to standard 19(2) and asked what is "regular" and who should conduct the reviews? The submitter queried: Should this be an internal or external reviews and should it be independent from the AFA or can the AFA conduct the review? They also queried whether this would be a QFE compliance function.

QUESTION TWENTY-SIX: Do you agree that information and/or advice should be provided in writing unless that is not practicable?

SUMMARY

A large number of submitters endorsed the requirement for advice to be in writing, but a number of submitters also rejected it. Many of these submitters suggested that it should be a matter for the client and the adviser to agree on, and that there should not be a presumption in favour of written advice. Some submitters, while supporting the requirement for advice to be in writing, pointed out that it was not a panacea.

Other submitters stressed that it would be appropriate for some types of advice to be in writing but not all, but these submitters did not tend to engage with the scope of the “unless it is not practicable” exception. Submitters in the share broking context were particularly concerned about the proposal to require advice to be in writing.

Particular refinements to the standards were suggested, particularly regarding the retail/wholesale distinction, and a number of submitters wished to clarify that email constituted “writing”. Several submitters endorsed the importance of requiring clear communication.

INDIVIDUAL SUBMISSIONS

General endorsement

Fourteen submitters endorsed this requirement.

One submitter stated that information and advice should always be provided to clients in writing.

One submitter did not support “out” clauses.

One submitter suggested that all advice, except ad hoc minor advice, should be in writing, and the exempted advice should still be recorded in a file note.

One submitter agreed that information/advice should be provided in writing unless not practical. It was submitted that it is easy to write and send confirmation of agreed phone advice and that file notes by the adviser need to be the minimum standard, if written advice is not practicable.

One submitted that information should be provided as soon as practicable following the first contact with the client.

Disagree

One submitter stated that information/advice should not be required to be in writing. It was submitted that this is unnecessarily prescriptive and of uncertain benefit and may impose unnecessary costs which would be borne by the client. It was also submitted that in many instances it will be impractical.

One submitter stated that information and advice should not always be required to be in writing.

One submitter stated that written information should not be mandatory as although it reduces risks, it is not appropriate in every circumstance and would ultimately increase costs for all clients.

One submitter said no and that efficient and personal advice can occur via the phone and face to face. He stated that communication in writing will increase costs, cause delays leading potentially to financial loss and inefficiency to the detriment of the public. It was submitted that the focus should be on ensuring clear documentation of the advice process at the time the client signs up and accurate up to date file notes.

One submitter said no and it was submitted that in many interactions the advice requested is likely to be a yes/no with a short explanation. They stated that to force all comments to be made in writing would increase the costs of doing business.

One submitter stated that it is not possible for the industry to have all its communication with clients in writing and that most clients verbally place orders and the adviser's notes detail the transaction. It was stated that the industry "would simply grind to a halt within a matter of days" if writing was required.

One submitter stated that written information and advice tends to mitigate risks but prescribing that services be delivered in writing may add to client costs in some circumstances. They stated that this is not a matter for the Code or at least should be stated as a matter of principle not prescription.

Let the client and adviser agree

One submitter suggested that the extent to which advice should be required to be in writing should be agreed between the adviser and the client, not stipulated by the Code. They stated that this would allow them to agree, for example, for follow-up buy recommendations on the secondary market to be made over the phone.

One submitter suggested that there should be scope for clients and advisers to agree on appropriate and sufficient means of communication.

One submitter suggested that, because written advice costs more, it should be a decision for the consumer.

One submitter disagreed with this requirement, stating that individual clients should be free to choose how to receive advice, but agreed that disclosure should be in writing.

Another submitter suggested that advice sometimes had to be given verbally, and that this was a choice for the client.

One submitter stated that standard 15 stated that the requirement to put all advice in writing is not practical as advice is often given verbally. They stated that they understood that the aim of the rule is to reduce misunderstandings by clients of advice. However they submitted that the decision of whether advice should be in writing should be agreed to between the adviser and the client.

One submitter suggested that both client and adviser should sign any instruction document and review report, but that it is not practical for the Code to require everything to be in writing.

One submitter stated that clients should be able to choose how they receive financial advice. It was stated that if a client prefers to receive advice over the telephone, or face-to-face, then this should be allowed, even if it is practicable to do so in writing. Therefore that submitter stated that proposed standard 20 should be re-drafted as follows: "AFAs must provide information, advice or plans to a client:

- (a) in plain language so that the client can easily understand it; and
- (b) if the client requests, in writing.”

That submitter stated that the FAA defines financial advice very broadly. It was submitted that in some cases the client may not desire advice to be in writing. For example, when a client visits an AFA face to face or rings the AFA, they will expect the AFA to provide some kind of advice during that interaction and discussion. They submitted that this expectation is not misplaced because many other advisory professions, such as lawyers and accountants provide advice verbally.

One submitter stated that all financial plans should be in writing and that the provision of written financial advice is best practice. However the submitter expressed concern that standards 15 and 20 will require all financial advice to be provided in writing even when a client requests otherwise or clearly desires verbal advice ie calling an AFA or meeting with an AFA. They submitted that accountants and lawyers provide verbal advice and AFAs should also be permitted to do the same.

That submitter also stated that standard 20 should be re-drafted so that AFAs can provide advice either in writing or verbally, but that written advice should be recognised as best practice and AFAs must provide written advice if the client so requests.

Some advice in writing

One submitter suggested that while some advice – e.g. an investment proposal and subsequent quarterly reports – ought to be in writing, not all advice needed to be. They submitted that verbal advice following up on earlier written advice might be appropriate.

One submitter suggested that initial contact should be in writing, but subsequent advice need not be.

One submitter suggested that all advice as to risk and investments should be in writing, unless the advice purely concerns the selection of a product provider relating to a specific need.

Another submitter stated that there is a difference between information and advice. It was submitted that it would be too onerous to require that information be in writing.

Impracticality of application in certain circumstances and proposed exemptions

One submitter expressed concern that requiring written advice might be impractical and unnecessary in some circumstances, such as when a client calls an adviser and advice is given over the phone (and the call is recorded).

Twenty-three submitters suggested that in some circumstances written advice may not be necessary (e.g. if a “buy recommendation” followed earlier written advice).

Six submitters stated that while it is acknowledged that written information and advice can reduce risk for all parties involved, prescribing that all services are required to be delivered in writing increases the costs for consumers. Therefore they stated that the decision of whether information and/or advice should be provided in writing should be a decision for the one paying for it not the Committee. Further to this comment they stated that not all advice requires the support of a prescribed written format – ie the client may have received a research note from a specific company with a “buy” recommendation. They stated that this same recommendation could have been “flagged” in an earlier client review and the same recommendation would be consistent with the client’s investment objectives. In this case they submitted, it would be reasonable to rely on the previous correspondence as opposed to adding another costly layer of compliance.

One submitter stated that providing advice in writing was often impractical for sharebrokers, and that NZX firms should be exempted from both standards 26 and 27.

One submitter suggested that it was simply not practicable for writing to be given in many cases, and suggested that it was essential that NZX firms be excluded from this requirement for transaction-style business. They stated that this would otherwise place advisers in an invidious position.

One submitter stated that it is not practical for NZX Advisors to provide that all information/advice in writing, and any requirements to do so would restrict the ability of NZX Advisors to deliver service in a timely manner. They stated that in certain situations the requirement could be appropriate but is not suitable as an over-arching standard.

Suggested refinements to standards

Two submitters suggested that all advice should be provided in writing within five days of giving it.

One submitter suggested that standard 20(1)(b) and (2)(b) be expanded to read “...that the client could *reasonably be expected to understand*” to remove the subjectivity.

One submitter suggested that standard 20(1) be amended to read “...requires an AFA to provide *additional* information to a client...”.

One submitter did not agree that all advice should have to be in writing, and suggested that guidance was required on what “not practicable” constituted.

One submitter made the following comments with regard to “retail” customers and proposed standard 20:

- A statement of advice should only be required to be provided and explained when providing financial planning services to “retail” customers. However the customer should be verbally advised that they can request any advice in writing. If financial advice is merely being provided, a record should be kept but it should not need to be documented before being given to the customer.
- That if the Code does require advice to be provided in writing, the submitter seeks guidance on what is “not practicable”.
- It was submitted that if the Code requires a record of financial advice be kept, it should not necessarily need to be provided to the customer.

That submitter made the following comments with regard to “wholesale” customers and proposed standard 20:

- A statement of advice should not be required to be provided and explained to wholesale customers.
- That wholesale customers have access to their own internal and external financial and legal resources as well as their own expertise. That wholesale customers do not need or want the same level of protection as retail customers.

One submitter agreed with this standard in general terms, provided the manner of documentation is not overly prescriptive. They submitted that if it is overly prescriptive then it will result in bulky meaningless documentation.

One submitter suggested that where it is not practicable to provide advice in writing the adviser should keep a record of the information/advice even if it is not sent to the investor.

Other observations

One submitter recognised that written advice can prevent confusion and disputes, but can still be subject to argument.

One submitter stressed that many complaints dealt with by it could be traced to a dispute about what the consumer was told at the time of entering into the contract. The submitter stated that when these disputes arise many years later, and the Ombudsman is unable to resolve conflicts of oral evidence, it is crucial that there be as much written record as possible.

Two submitters suggested that “full disclosure” must be in writing to comply with s 3(a) of the FAA.

One submitter stated that for trusts, where the highest standards of a professional and prudent person of business are expected, advice in writing should be the norm.

One submitter stated that advising and interaction is often completed verbally. It was submitted that no amount of written work can replace the verbal interview and verbal understanding of the client’s needs.

One submitter stated that advice in writing would be the preferred approach. However they stated that they are aware that in certain parts of the industry, it is common and well accepted for certain advice to be given verbally. In this situation they submitted that it is nevertheless important that some record is kept of the advice given to avoid disputes regarding exactly what is said.

Effective communication standards

One submitter strongly supported the proposed effective communication standards and the emphasis on ensuring that advice and disclosure is in plain language.

One submitter stated that care needs to be taken to ensure that verbal communication with clients is not discouraged.

One submitter stated that the principle of effective communication should only apply to a financial planning service.

One submitter responded “yes,” but suggested that there should also be a requirement for the AFA to endeavour to ensure that the client understands the advice provided.

One submitter endorsed the Code requiring a certain standard of communication of advisers.

One submitter emphasised the importance of plain language without compromising accuracy and clarity:

- it should not be assumed that clients are familiar with jargon, or with terms such as “trust” and “product” which have particular meanings in this context;
- expressions such as “equivalent of a bank deposit” should not be used to describe a product;
- no acronyms should be used unless they are clearly explained; and
- font size is important and a minimum of 12 point is recommended.

One submitter also stated that information relating to finance and investment should be offered in such a way as to encourage people to ask questions.

Electronic records / email

One submitter suggested that “writing” should include email. Another submitter stated that the Code should specify that “in writing” includes email where the client has agreed to receive communications by email.

One submitter stated that advice should be in writing and the use of email should be considered to be “in writing”. They stated that it would be simple to provide advice and then provide a follow-up email to ensure the advice is recorded. They expressed concern regarding the words “unless impracticable” as this unrecorded information requires interpretation which can cause confusion.

Another submitter suggested that “in writing” should include by email and on a website, and that there should not be a requirement that the writing be individually addressed.

QUESTION TWENTY-SEVEN: Should the client be able to waive this requirement by agreeing in writing that subsequent disclosure of specified information or advice is not required to be in writing?

SUMMARY

Submissions were generally in favour of permitting clients and advisers to agree that future advice be provided verbally. A significant majority suggested that this was too risky, because it would put naïve customers at risk and create problems of proof in the event of a dispute. Other submitters suggested that the requirement will be useless, because firms will obtain waivers as a matter of course, while others suggested that the proposal be reversed so that clients can *request* that advice be provided in writing.

A number of submitters suggested that advice should not be required to be in writing in the first place, and therefore the client and adviser should not be required to sign a waiver.

Several submitters suggested that it would still be prudent for the adviser to record his or her dealings with the client in writing, at least for the purpose of risk management. Some submitters queried how the proposal would work: they wondered whether “subsequent” meant subsequent to the waiver or subsequent to the primary advice, and suggested that the former interpretation could mean that the primary advice itself could be provided in writing, which would be undesirable.

INDIVIDUAL SUBMISSIONS

General support

Eleven submitters endorsed the suggestion that clients should be permitted to waive the requirement to give advice in writing.

One submitter said “yes,” where the subsequent activity is in the nature of implementation or repeat transactions.

One submitter noted, however, that for certain advice ie whether to acquire a given product, it will not always be practicable to give the advice in writing – e.g. for an urgent telephone purchase.

One submitter agreed that this is appropriate but this should not prevent an AFA from providing further disclosure as considered appropriate.

One submitter stated that the client should be able to waive this requirement. It is submitted that in a market or leveraged trading relationship ie derivatives trading, it is not possible for instructions and advice to be recorded in writing. They stated that provided those terms and conditions are set out in the contract and explained to the client, the adviser should be able to proceed.

One submitter stated that “retail” customers receiving financial planning services should be able to waive this requirement by agreeing in writing that subsequent disclosure of information or advice is not required.

One submitter stated that it is vital for wholesale clients to be permitted to waive this requirement.

Disagree

One submitter suggested that only “cowboys” would want to follow this course.

Six submitters responded “no,” because a naïve or trusting client could be misled.

One submitter questioned the utility of such a requirement when the necessity of being able to provide advice verbally means that many firms will obtain waivers as a matter of course.

Two submitters stated that this proposal is not workable. It was submitted that proposed standard 20 should be redrafted so that the starting point is reversed ie AFAs should be able to provide financial advice verbally unless the client requests the advice is provided in writing.

One submitter stated that they struggle to understand the implications of this question. They submitted that after a prospective client has read and digested the written advice, a comprehensive discussion ensues in which many matters are covered. They stated that it is impractical for those issues to be conveyed in writing. It was submitted that the need for such advice in writing could be avoided by requiring that the client complete written instructions to the adviser prior to implementation of any advice or recommendations.

One submitter suggested that subsequent ad hoc advice – such as whether to fix or float a mortgage – should be permitted to be given orally as long as a needs analysis was on file. However it was noted that it would still be prudent to record this by email.

Advice/information should not be required to be in writing therefore waiver not required

Eight submitters suggested that advice should not always be required to be in writing and so written waivers should not be required.

Five submitters stated that it is not necessary or appropriate to permit waivers for written advice and it should not be made mandatory.

One submitter stated that written advice should not be required. It was submitted that written proposals are normal but often with well-known clients advice is verbal. It was also stated that this is the preferred way to interact for both parties.

Other comments

One submitter suggested that a client should be able to waive this requirement, but that the adviser should still be required to retain a record of the advice.

One submitter noted that even if a client agreed not to receive advice in writing, it would probably be in the adviser’s best interests to provide it in writing to forestall any disputes later on. That submitter suggested that with certain communications, such as disclaimers as to disclosure, agreements to provide limited scope of advice, etc, it will almost always be “necessary” to provide the information in writing.

One submitter stated that the client should be permitted to waive their right to written advice but as a protection for the adviser, written records need to be kept. They stated that even simple advice may lead to conflicts in the future.

One submitter suggested that where a client had chosen not to receive advice in writing, the adviser should make a written note of all circumstances and discussions with the client.

One submitter agreed that the client should be able to waive this requirement but the AFA should not be permitted to recommend that the client waive the requirement.

One submitter stated that they are uncertain as to what is meant by “subsequent disclosure”. They stated that assuming it is subsequent to the written waiver, rather than subsequent to the advice or plan, it could therefore mean that the substantive advice or plan may be given verbally. They stated that this does not seem appropriate.

Another submitter stated that clients should have that option but asked whether this applies only to the subsequent advice or whether it also extends to the initial advice. They proposed that a record of any verbal advice should be made.

QUESTION TWENTY-EIGHT: Proposed standard 21 requires AFAs to have an internal dispute resolution process. Is this practical? How should an individual AFA who does not practise with other AFAs be required to deal with complaints?

SUMMARY

In general submitters endorsed the requirement for an internal dispute resolution system, and many suggested that sole practitioners be required to at least consider complaints or maintain a complaints register. The difficulties for sole practitioners were also recognised, however, and it was suggested that the extent to which they can maintain an internal dispute resolution system is limited. A number of submitters suggested using an external person or a professional organisation to provide a reciprocal or peer “internal” process before a dispute was elevated to a proper external dispute resolution service.

A number of submitters did, however, suggest that because dispute resolution was being considered by the Ministry of Consumer Affairs then the Code should not deal with it. Others were concerned at professional indemnity insurance implications, and others suggested that an exception should be provided for employed AFAs.

Several submitters highlighted the importance of disclosure and a number of “procedural” suggestions were made.

INDIVIDUAL SUBMISSIONS

Endorsements

General endorsements of an internal dispute resolution system

Seven submitters endorsed the requirement to have an internal disputes resolution process so that advisers can demonstrate how they deal with complaints.

One submitter agreed that advisers should have internal dispute resolution systems, and noted that neither the Insurance and Savings Ombudsman nor the Banking Ombudsman would accept complaints before they had gone through an internal process.

One submitter suggested that an internal dispute resolution process was appropriate in addition to membership of an Approved Dispute Resolution scheme.

One submitter stated that this is practical. They stated that the external dispute resolution regime means that it should not be mandatory for an adviser to obtain an independent assessment as part of the initial complaint process.

One submitter stated that advisers should have an internal dispute resolution procedure and that this should be in their office operations manual. However in standard 21(4), they recommended that “prior” be replaced with “on engagement” if this requirement is more extensive than that provided in the disclosure statement.

Complaints register

One submitter endorsed the requirement for an internal dispute resolution service, noting that it does not have to be particularly complicated but should involve a disputes register.

One submitter noted that AFAs should be required to at least have a complaints register, and noted that without an effective internal disputes resolution procedure AFAs lose: the benefits of direct feedback, the opportunity to prevent the escalation of a complaint, and the potential to make immediate improvements to their services.

Other observations

One submitter stated that the internal dispute resolution is practical. They stated that they assume that it is a pre-condition of approved dispute resolution schemes agreeing to consider a complaint that the dispute has first been through the adviser's internal process. It was submitted that an AFA who does not practise with other AFAs should still comply with these requirements. One submitter stated that it would not be desirable for individual AFAs to use the default dispute resolution scheme in place of an internal complaints process.

One submitter recognised that AFAs who operate individually will need to tailor their internal dispute resolution processes to their particular circumstances, this can be done through each AFA's business statements. They stated that at a minimum those individual processes should incorporate the requirements of standards 22 and 23.

One submitter suggested that an internal process should use a representative (within an organisation with the necessary infrastructure) or an industry body (for individuals.)

Alternative "internal" options and role of professional organisations

Two submitters suggested that membership of a professional organisation would assist sole practitioners in dealing with complaints by establishing an "internal" dispute resolution service.

One submitter suggested that dealer groups be permitted to operate their own internal dispute resolution process to which sole practitioner members can refer disputes.

One submitter suggested that an internal dispute resolution system should not involve consideration of a dispute by the person against whom it is made. The submitter acknowledged that this may be difficult in some situations, and so suggested options including: using the internal dispute resolution process of the provider of the product; using the process of the AFA's employer (if they are employed); using the process of a professional body of whom the AFA is a member; or instituting reciprocal "internal" procedures. It was suggested that guidance could be taken from the Australian Securities & Investment Commission Regulatory Guide 165 Licensing: Internal and External Dispute Resolution.

One submitter stated that in addition to belonging to an external dispute resolution scheme, AFAs would belong to a professional organisation and that this would provide peer support, shared knowledge, and on-going training. They suggested that within such an organisation, either AFAs or the governing body could nominate other AFAs to provide a reciprocal "internal" dispute resolution process.

One submitter stated that internal disputes processes are an important initial step and they suggested that AFAs should be permitted to enlist the help of industry associations to assist with mediations. It was suggested that this allows consumers to access appropriate outcomes without a drawn-out cumbersome process.

The Code should not regulate this

Twelve submitters rejected the inclusion of dispute resolution requirements in the Code, and suggested that this are being dealt with by the Ministry of Consumer Affairs.

One submitter questioned the need for this standard, as they stated that it largely repeats the obligations owed under the legislation.

Another submitter suggested that requiring NZX firms to comply with this standard would create unnecessary duplication.

Two submitters suggested that procedures required at common law and under legislation are sufficient.

One submitter pointed out that registered legal executives are subject to a complaints process under the Lawyers and Conveyancers Act 2006.

One submitter said “no” as the Financial Service Provider (Registration and Dispute Resolution) Act 2008 will cover this. They stated that while an internal procedure would be of some value, it is unnecessary and unrealistic. They also stated that advisers who run small to medium sized businesses and provide financial services to clients do not have the resources to do this and therefore this standard should be deleted.

Concerns

One submitter suggested that it is not reasonable to expect an AFA to have an internal dispute resolution process. It was submitted that dispute resolution requires an independent third party to arbitrate, mediate or facilitate acceptable solutions. They suggested that as an AFA is required to belong to an external dispute resolution scheme, an internal dispute resolution scheme does not add anything and will impose unnecessary costs on AFAs. It was accepted, however, that an AFA should have an internal complaints handling process which would include at some point referring the matter to a dispute resolution scheme. It was also suggested that a complaints handling process that is equitable and transparent can be run by a single AFA as well as any institutional arrangements.

One submitter suggested that requiring an internal dispute resolution process in all cases might not be practical, and that there would not necessarily be any harm in having disputes referred directly to an independent dispute resolution scheme.

Comments regarding sole practitioners

One submitter felt that an internal dispute resolution system would be difficult to establish for sole practitioners and a third party would need to be involved.

One submitter noted that sole practitioners may experience difficulties in administering internal dispute resolution services.

Another submitter endorsed the requirement to have an internal dispute resolution process, but noted that this might be limited with a sole practitioner and referral to an external service would often be necessary.

One submitter suggested that external consideration of complaints about the services of sole practitioners would make sense.

One submitter suggested that internal dispute resolution procedures would be impractical for small firms, and that external procedures should be available as a first resort in such situations.

One submitter suggested that it was impractical to require sole practitioners to have an internal dispute resolution system.

One submitter suggested that proposed standard 21 is practical. It was suggested that those who practise on their own will have to alter their business model.

One submitter agreed that an internal dispute resolution process was laudable, and that a sole practitioner could have an independent party to act as an “internal” arbitrator.

One submitter stated that individuals should not be required to maintain their own dispute resolution process. That submitter argued that this is counterproductive and should be dealt with outside the Code. It was submitted that complying with this standard would not guarantee any improved perception of advisers. They stated that proposed standards 22 and 23 are sufficient in relation to dispute resolution.

One submitter stated that for small 1-2 person businesses this is probably not practical. They suggested that there is a business opportunity for the establishment of dispute resolution consultants for small practices.

One submitter suggested a “peer review” system rather than an internal system for sole practitioners or closely-held practices.

One submitter stated that individual AFAs should have a nominated third party to provide the “internal” process.

One submitter stated that a sole practitioner AFA could refer the complaint to another AFA who has an internal dispute resolution facility. It was submitted that this is similar to professions such as lawyers and accountants which deal with complaints that are handled by parallel service providers.

One submitter suggested that disputes involving products or outcomes could be solved by introducing the product provider.

One submitter stated that AFAs who operate by themselves should have a process for dealing with complaints.

One submitter suggested that individual AFAs should be able to enlist the help of a professional organisation for “internal” dispute resolution or an external agency.

At least consider the complaint

One submitter suggested that a “sole practitioner” should be able to demonstrate that s/he has fairly considered a client complaint and that the client has been advised of his/her opportunity to take the dispute to an external dispute resolution scheme.

One submitter stated that where an AFA does not practise with other AFAs, the AFA should first deal with the complaint himself/herself and failing satisfaction of the complainant, the complaint should be referred to the external disputes resolution scheme.

Another submitter suggested that an individual AFA or an adviser business can undertake an honest appraisal of the merits of the client’s complaint, but that reference to an external scheme may be necessary.

Insurance implications

One submitter suggested that the implications of professional indemnity cover needed to be taken into account, because generally the adviser cannot contact the client after a claim has been lodged.

One submitter noted that the ability of some advisers to deal with complaints internally may be constrained by the terms of their professional indemnity policies.

One submitter stated that proposed standard 21 is practical for organisations but would be difficult for AFAs in sole practice. It was submitted that any mechanism suggested for sole practitioners needs to work properly with each AFA's insurer.

Employees

One submitter stated that it has an internal disputes resolution process and does not object to this standard. However it was submitted that this standard should not be required for those AFAs employed by a FSP as AFAs employed by FSPs are subject to their employer's processes.

One submitter stated that AFAs who are employees of FSPs should be excused from the requirement to have an internal dispute resolution procedure if they participate in the FSP's complaint resolution procedure.

One submitter stated that FSPs who employ AFAs should have internal processes for resolving complaints and that it will not be practical, or indeed meaningful to require individual AFAs to have their own "internal dispute resolution processes". They explained that this is because, as AFAs will all be individuals, the extent of any "internal dispute resolution process" for those people would be limited to:

- addressing complaints in a timely, fair and even handed manner (standard 22); and
- ensuring complaints are adequately recorded (standard 23).

That submitter stated that to require anything further would necessarily involve a third party, which will be the role of each AFA's external dispute resolution scheme. They noted that the Code cannot impose internal dispute resolution obligations on FSPs who employ AFAs because the Code will only apply to AFAs themselves.

That submitter stated that proposed standard 21 should be removed and AFAs should only be required to address complaints fairly and proactively (standard 22) and record complaints on an internal dispute resolution register (standard 23).

Procedure / general observations

One submitter suggested that AFAs have a choice when a dispute cannot be settled internally, of either going to an external dispute resolution person nominated in their disclosure documents, and then to the alternative dispute resolution scheme if necessary, or going directly to the alternative dispute resolution scheme.

One submitter suggested that advisers should use best endeavours to resolve complaints, but that there should be some screening of vexatious complaints.

One submitter stated that it was in the interests of AFAs (and the AFA's employer) to deal with and record complaints otherwise the customer will lodge the complaint with the relevant dispute resolution scheme.

One submitter stated that the onus is on AFAs to generate simple systems for clients to lodge a complaint with ease. They observed that while many clients may wish to submit this in writing, a complaint could also take a verbal form, such as a telephone conversation. They stated that in such cases, the onus would be on the financial adviser to write to the client acknowledging receipt of the verbal complaint, summarising their understanding of the complaint, and outlining the steps they propose to take to resolve the complaint.

That submitter expressed support for the requirement for an approved dispute resolution procedure. However, if the client has a complaint, proposed standard 21(5)(a) requires the client to provide a written statement to the AFA detailing the complaint. They referred to the recent Ministry of Consumer Affairs consultation document which noted the definition of complaint in the Australian Standard on Complaints Handling. That submitter suggested that the definition be expanded to read “any expression of dissatisfaction or concern about a service or a product provided by a member company for which the complainant implicitly or explicitly expects redress (remedial action or compensation) and has not received satisfactory resolution”.

That submitter stated that guidance should be given to AFAs on when a complaint has reached an impasse in internal dispute resolution, and can be deemed as having reaching deadlock. In addition to an unsatisfactory response, proposed standard 21(5)(c) refers alternatively to no response being received within a “reasonable time”. It was suggested that further guidance should be given on what may be “reasonable” ie “two months from receipt of complaint”.

One submitter stated that the relevant standard should be focused on the behaviour of AFAs when dealing with complaints rather than actual process. For example, AFAs should be required to deal with complaints in a timely manner, give due consideration to complaints and use reasonable efforts to resolve them. It was also submitted that an AFA should not be permitted to use an internal disputes process as a way of delaying the referral of the complaint to an external dispute resolution scheme.

That submitter stated that if standards regarding dispute resolution processes are to be included in the Code, further guidance is required on dispute resolution processes. They stated that this is particularly relevant for individual AFAs. For instance is a timetable by which time an AFA must respond to a complaint sufficient? They submitted that if more than this is required, one option for individual AFAs may be to refer the complaint to an independent AFA for consideration.

One submitter suggested that it was already a requirement of the Adviser Disclosure Statement that the adviser inform the client of the dispute resolution body they belong to.

One submitter was in support of the internal dispute resolution process and options to refer to external dispute resolution schemes be communicated to the client prior to commencing financial adviser services. They suggested that the disclosure document would contain information on the process to be followed in laying a complaint with the Securities Commission.

QUESTION TWENTY-NINE: Are the proposed internal dispute resolution standards (standards 21-23) appropriate?

SUMMARY

Most submitters endorsed these requirements, although it was suggested that NZX firms and employed advisers should be exempted. A number of modifications were suggested, listed in the Individual Submissions. The most frequently suggested modification was that only written complaints should be required to be recorded in the complaints register.

INDIVIDUAL SUBMISSIONS

General endorsement

Fifteen submitters endorsed the standards.

One submitter stated that while the nature of the internal dispute resolution process will vary according to the size of the firm or practice within which the adviser operates, it is reasonable for the adviser to have an established means of dealing with disputes/complaints from clients.

Two submitters supported the requirement in standard 21(4) that AFAs provide their clients with a statement on the dispute resolution procedure.

One submitter stated that the standards are appropriate in part but a key issue is the process agreed with an AFA's insurer for dealing with complaints and/or claims as a result of the nature and manner of the insurance in place.

One submitter stated that sub-paragraph (5) of proposed standard 21, which requires the client to provide a written statement to the AFA and for the AFA to make a formal response, is reasonable. They stated that for a sole practitioner this would be all that is practically possible.

One submitter agreed with standard 22.

Two submitters suggested that the onus be on the AFA to create a straightforward system for the lodging of complaints, that complaints be able to be made verbally, and that the AFA have an obligation to confirm the receipt of the complaint and its content.

Rejection or proposed exceptions

One submitter stated that the standards are not appropriate as it would increase costs for no benefit. They stated that it is appropriate to have an internal complaints process but dispute resolution should be conducted by an independent third party, not an internal process.

One submitter suggested that the provisions of the FAA are sufficient, and that membership of an approved external dispute resolution scheme should be enough.

Another submitter stated that most advisers will have had little experience with disputes. He referred to the IFA's complaints procedure service and submitted that often a considered response satisfies a client.

One submitter stated that all NZX firms and NZX Advisors already operate under NZX's approved framework and are required to manage their complaints in a prescribed manner (NZX rule 11.6). It was submitted that care should be taken not to impose unnecessary requirements.

One submitter suggested that requiring NZX firms to comply with this standard would create unnecessary duplication.

One submitter referred to standards 21-23 and said that their interpretation is that these standards will not extend to apply to AFAs who do not give advice to the public (as it drives off the requirement for an external dispute resolution service under the Financial Service Providers (Registration and Dispute Resolution) Act 2008 and they submitted that this should be made clear.

One submitter stated in relation to proposed standard 23 that they record all complaints and they do not object to the standard. However they stated that this standard should not apply to employees of FSPs as they are subject to their employer's internal dispute resolution process.

Proposed modifications

One submitter agreed with the proposed standards, but suggested that standard 21(4) should be consistent with s 22 of the FAA (so that the statement about the dispute resolution system should be provided before or as soon as practicable after the provision of the service).

One submitter suggested that the reference to "internal" procedures suggested that they were internal to the AFA, rather than their organisation, and so the wording could be improved.

Two submitters noted that, in submissions to the Ministry of Consumer Affairs on the reserve dispute resolution scheme under the Financial Service Providers Act 2008, they recommended the definition of a "complaint" be broadened to match Australia's: "Any expression of dissatisfaction or concern about a service or a product provided by a member company for which the complainant implicitly or explicitly expects redress (remedial action or compensation) and has not received satisfactory resolution." Those two submitters sought guidance on what a "reasonable time" in the context of standard 21(5)(c) would constitute (e.g. 2 months from receipt of complaint.)

One submitter suggested that the standards should provide guidance as to the elements that should form part of an internal disputes resolution process, including: specifying the type of information that must be collected and stored; specifying the requirement to develop a statement setting out the issue in dispute; ensuring the dispute resolution process is visible and readily accessible; ensuring the process is transparent and conforms with the principles of natural justice; and ensuring that the responsibilities of both parties are made clear.

One submitter suggested that the onus should be on the AFA to proactively move the complaint through the internal dispute resolution process and beyond, and that there should be more rigorous obligations on AFAs. Another submitter suggested that there should be a provision for the monitoring of internal dispute resolution registers.

One submitter suggested that it should be expressly required that independent dispute resolution services be free to the consumer.

One submitter agreed that there should be a requirement to hold all correspondence and keep a complaints register.

One submitter stated that they would like further clarity on what should be included in each AFA's dispute resolution statement.

One submitter stated that in terms of the disputes resolution register, clear guidance on what type of complaint should be recorded would be helpful as one AFA's manner of record keeping may differ from another's. They stated that it may lead to a skewed impression as to the number of complaints made by clients of an AFA.

One submitter stated that the NZX format for this standard should be used to add more detail to dispute resolution standards.

Written vs non-written complaints

One submitter suggested that verbal complaints should be handled in-house, but that written complaints should be dealt with by a compliance department (in the case of a firm) or by an external body (in the case of a sole practitioner).

One submitter suggested that complaints should be in writing so as to be seen as material.

Twelve submitters suggested that only written complaints should be required to be recorded in a complaints register.

QUESTION THIRTY: How long should records of complaints be kept under proposed standard 23?**SUMMARY**

A range of periods were suggested. A large number of submitters suggested that records be kept for seven years, to be consistent with other reporting requirements, while other submitters just noted that this standard should be consistent with other legislation and the other record-keeping standards in the Code.

Other submitters, meanwhile, suggested that records should be kept until the complaint is resolved, or for a period thereafter. Some submitters suggested that this period should be at the adviser's discretion, while others suggested up to seven years. Still more submitters suggested that the period should be calculated from the end of the relationship with the client. A number of submitters suggested a certain period from the time the records came into existence (from three years to indefinitely).

INDIVIDUAL SUBMISSIONS**7 years**

Nine submitters suggested that the same period required of other professionals should be used (i.e. 7 years).

One submitter stated that NZX Firms are required to keep records and documents for 7 years (rule 3.27). That submitter suggested that this is sufficient and no extra compliance burden should be placed on NZX Advisors or NZX Firms.

One submitter stated that they should be kept for 7 years but AFAs should be allowed to keep records electronically and/or give records to their employers.

Consistency with other legislation or other standards

One submitter pointed to the need to consider other legislative requirements for record-keeping.

Another submitter suggested that the limitation period included in the finalised "Operating Rules" be consistent with the Limitation Act provisions in force, which may be different (with the replacement of a "reasonable discoverability" period with a three-year "late knowledge" period) if the Limitation Bill 2009 is passed into law.

One submitter noted that in the consideration of a dispute, the dispute resolution service may generate its "own" information which may be subject to the Public Records Act 2005, but the "contributing" information remains the property of the parties.

One submitter stated that requirements should be aligned with the legislative requirements of the Privacy Act 1993.

Two submitters stated that records should be kept for the applicable periods in the Limitations Act 1950 and other legislation.

One submitter stated that the Code should align with the Financial Transactions Reporting Act, which is five years and then ten years for tax-related advice. They stated that additional standards should not be required for electronic records.

One submitter stated that consistency in record keeping is essential and that client records and complaints should be kept for the same length of time.

One submitter stated that the records should be kept for the same period as prescribed in Question 24.

One submitter stated that the record-keeping requirements should be the same for service providers and the dispute resolution provider.

Until resolution or for a set period thereafter

One submitter stated that records should be kept until the complaint has been resolved to the satisfaction of the client.

One submitter suggested that once a dispute has been resolved, and any appeal period has expired, all that was necessary was to note the complaint on a register. They submitted that only written complaints need to be recorded.

Thirteen submitters suggested that records should be kept until the complaint is resolved to the client's satisfaction, or longer at the AFA's discretion.

One submitter suggested that records should be kept for at least two years after the dispute has been resolved.

One submitter suggested that complaints should be recorded in an internal complaints register and all negotiations and resolutions should be kept on the client file for three years after resolution.

One submitter suggested that records should be kept for at least five years after a complaint is settled, to tie in with the approved dispute resolution scheme review period and to enable monitoring of trends.

One submitter suggested seven years after a dispute is concluded.

Duration of relationship or for a set period thereafter

One submitter suggested that records should be kept for seven years after the relationship with the client ends.

Another submitter stated that records should be kept as long as the complainant is a client and for a few years after the end of the client relationship. However she noted that these days it should be possible to keep or archive records forever.

One submitter stated that records should be kept for as long as the client remains a client but in practical terms any complaint records should be kept for as long as the AFA is in business.

Other periods

One submitter suggested three years, while two others suggested five years and one other submitter suggested ten years.

One submitter believed that AFAs should keep records until after the death and settlement of the estate of the client.

One submitter stated that records of complaints should be kept indefinitely.

Other observations

One submitter suggested that standard 23 should state that any complaint about an AFA who is an employee or agent of a FSP can remain on the FSP's internal dispute resolution register when the AFA leaves the FSP (and does not need to be held at the AFA's new place of business).

QUESTION THIRTY-ONE: Are the proposed compliance standards (standards 24-26) appropriate? Should the standards be modified or expanded in any way? Are there any other compliance standards that should be included in the Code?

SUMMARY

Although these standards received widespread support, a number of particular points were made about them. Firstly it was questioned whether standard 25 was necessary, while other submitters sought clarification as to its scope and application, particularly in relation to employees.

Some submitters rejected standard 26. Some suggested that a peer review system be introduced, while others suggested that the standard needed to be refined so that unfounded complaints are not made and so that minor breaches need not be reported. Concern was also expressed about whether adequate “whistle-blowing” protection was provided. Finally, it was suggested that more consideration ought to be given to enforcement, including specifying who would receive complaints and ensuring that that entity has sufficient capacity.

INDIVIDUAL SUBMISSIONS

General endorsement

Twenty-five submitters endorsed these standards. Three submitters endorsed standards 24 and 25.

One submitter supported the standard of compliance but stated that they thought some of these aspects may be covered by existing law.

Standard 24

One submitter stated that proposed standard 24 is too narrow and should be expanded to include all laws and not just legislative obligations. It was submitted that fiduciary obligations should be addressed in this context.

One submitter stated that these are appropriate but in relation to proposed standard 24, they questioned how long this adequate knowledge must be maintained. They stated that some requirement along the lines of CPD points would enhance the ongoing competence requirements of an AFA.

Standard 25

One submitter suggested that standard 25 was unnecessary as compliance was already obligatory.

Two submitters suggested that the standard relating to employees should only apply to the extent that the employee in question is under the direct responsibility of the AFA.

One submitter noted that if the employees are providing financial adviser services (as specified in standard 25) the employees would need to be authorised. However they suggested that if the employees are providing secretarial and administrative assistance to the AFA then the AFA should be liable to ensure that any work produced complies with the Code and relevant laws.

One submitter states that further clarification is required in respect of the scope of proposed standard 25. For example if an AFA employs or appoints another AFA, will the first AFA be in breach of proposed standard 25 if the “employee AFA” breaches the Code?

One submitter stated that there is an anomaly between standards 24 and 25. They stated that under standard 24, AFAs must have regard to legislative obligations relevant to financial adviser services and the Code and that under standard 25 employees have to comply with all relevant laws which is wider.

One submitter suggested that standard 25 did not recognise that an AFA is an individual but their employer is likely to be a separate legal entity.

One submitter supported standard 25 but submitted that the word “appoints” should be replaced with the word “engages” so that it is clear that standard 25 only applies to employees or agents of an AFA rather than non-related persons to which a client has been referred by an AFA.

Standard 26 – Reporting of illegal behaviour

One submitter stated that AFAs should not be under any legal obligation to report other AFAs’ illegal activity or breaches of the Code, which is what proposed standard 26 would impose. They considered that proposed standard 7 will be sufficient to ensure that AFAs who turn a blind eye to the illegal conduct of AFAs will themselves be in breach of the code. They submitted that if an AFA knows that another AFA is acting in breach of the Code, but elects not to notify this to the appropriate authority, the AFA will have conducted themselves in a manner which is likely to bring the advisory profession into disrepute and will be a breach of standard 7.

One submitter suggested that standard 26 could lead to breaches of an employer/employee contract, and questioned whether there were similar laws for the legal, accounting or medical professions.

One submitter expressed concerns regarding the legal liability when AFAs endeavour to meet standard 26. It was stated that an unintended consequence of meeting this standard could be the threat of legal action over conflicts that could arise.

One submitter suggested that it was overly onerous to *require* advisers to bring suspected illegal conduct to the attention of authorities, and that the onus of doing so must rest on the client and the appropriate regulatory authorities.

One submitter stated that a system of peer review should be established within the profession. They stated that commercial sensitivity may preclude other firms examining an adviser’s data, so dealer groups can conduct such reviews. That submitter suggested that those undertaking peer reviews should be obliged to report illegal activity subject to defined protections (e.g. for privileged information).

Two submitters suggested that, in relation to reporting breaches, there should be certain exemptions for immaterial and minor breaches or where it is known or believed that the breach has already been reported.

One submitter stated that there should be exemptions for immaterial and minor administrative breaches and where it is known or believed that the breach has been reported by another party.

One submitter suggested that standard 26 created scope for abuse, and suggested that AFAs should be required to have “proof” of illegal activity before reporting it to the authorities.

One submitter stated that an AFA should be required to have “reasonable grounds” for his or her belief before informing the relevant authorities under proposed standard 26.

One submitter suggested that standard 26 include a requirement that reports not be vexatious.

One submitter stated that AFAs should not be permitted to publicly criticise other AFAs. They stated that there should be an ethical obligation in the Code for AFAs that are aware of any unacceptable practices to report (only) factual information to the Disciplinary Committee. They stated that this should only occur where there are reasonable grounds to suspect another AFA to misconduct or unsatisfactory conduct.

One submitter stated that the wording for proposed standard 26 is open to interpretation regarding the evidentiary basis required and therefore should be drafted as follows: “An AFA who has reasonable grounds to suspect that another AFA has, when providing financial adviser services, engaged in illegal conduct or conduct in breach of the Code must promptly inform the appropriate authority”.

One submitter stated that the words “actual or suspected” should be inserted between “report” and “illegal” in proposed standard 26.

One submitter stated that the Committee or Securities Commission needs to provide guidance on what is a material breach, particularly in absence of guidelines on what “advice” constitutes so that the system is not “clogged up” with immaterial breaches.

Whistle-blowing issues

One submitter pointed to the need for statutory protection for whistle-blowers.

One submitter noted that there did not appear to be statutory protection for whistle-blowers.

One submitter was concerned to know whether “whistle blower” legislation would protect AFAs, or only employees.

One submitter suggested that it was necessary to include whistle-blowing protection to accompany standard 26, which might require an amendment to the FAA. They also suggested that whistle-blowing protection should extend to the illegal activity of non-authorised advisers as well as authorised advisers.

One submitter suggested that there is a small problem regarding proposed standard 26 as there is the prospect of an employee-AFA being required to engage in whistle-blowing of their own corporate colleagues possibly without any particular protection.

Another submitter queried what protection can reasonably be provided to AFAs when they report illegal activity.

Refinements/modifications

One submitter stressed that, to maintain public confidence, QFEs must be subject to the same obligations as all AFAs, and must be under an obligation to report their own AFAs.

One submitter urged the Code to recognise the difference between investment advisers and insurance advisers.

One submitter suggested that the Code make specific reference to the Consumer Guarantees Act 1993 and the Fair Trading Act 1986, both of which financial advisers are obliged to comply with. It pointed particularly to the need to regulate *omissions* as well as outright misrepresentations.

One submitter suggested that the Code should expressly prohibit advisers from misleading customers.

One submitter supported the standard of compliance but suspect that some of these aspects may be covered by existing law.

One submitter recommended that prescribed industry standards like those documented by ISI are also included as well as legislative ones.

Enforcement

One submitter suggested that rigorous enforcement of compliance was the key to ensuring that clients were protected, because most problems were due to “crooked” advisers. The submitter suggested that an enforcement body under the auspices of the Securities Commission would be useful.

Another submitter suggested that, in relation to standard 26, it might be preferable to include a reference to “the appropriate authority” rather than just requiring the AFA to report the illegal activity.

Two submitters questioned whether the Committee had fully taken account of the enforcement implications of a Code of this size and complexity, and whether the Securities Commission’s input had been obtained in this regard.

QUESTION THIRTY-TWO: The general rule in proposed standard 28 is that an AFA must not disclose information without the client’s prior express written consent. Are the exceptions to this general rule (set out at standards 28(1)(a)-(e)) appropriate? Should they be modified or expanded in any way? Are there any other exceptions that should be added?

SUMMARY

While a number of submitters endorsed this standard, many stressed that its relationship with other legislation (particularly the Privacy Act) needed to be taken into account. Some suggested that the Privacy Act alone was sufficient, while others suggested that it should be ensured that the content of standard 28 be consistent with the Act.

A number of exceptions were suggested, including for NZX firms, for peer review and to other professionals such as lawyers and accountants.

A number of refinements were also suggested, particularly regarding clients’ consent. Lastly, a number of submitters were concerned with how the standard would apply to organisations, and in particular wished to clarify that an AFA’s employer would not constitute a “third party”.

INDIVIDUAL SUBMISSIONS

General endorsement

Nine submitters endorsed the general rule.

One submitter noted the importance of external dispute resolution services having access to all the necessary information, and endorsed the Standard as drafted.

Other legislation is sufficient

Seven submitters suggested that standard 28 might unnecessarily duplicate provisions of the Privacy Act, and one other submitter suggested that the Privacy Act is sufficient.

Two submitters suggested that the Privacy Act and the NZX Rules provide sufficient protection.

One submitter pointed out that the Lawyers and Conveyancers Act (Lawyers: Conduct and Client Care) Rules set out the duties and responsibilities in this regard.

Standard should be consistent with other legislation

One submitter suggested that the Code’s requirements should mirror, and not go beyond, those of the Privacy Act 1993 and the common law.

Two submitters suggested that the Code should mirror the Privacy Act, and permit the release of information when it was required by the Code (e.g. access for an auditor or reviewer).

One submitter suggested that disclosure should only be required where the client has consented or where required by law.

One submitter stated that the principles should be consistent with the Privacy Act.

One submitter stated that any requirements should be aligned with the Privacy Act 1993 with expansion to property in terms of proposed standard 28. They submitted that it would not be prudent to go outside the principles in that Act or the exceptions in the Act.

One submitter stated that the Code should cross-reference the Privacy Act 1993 to avoid any conflict of interpretation. That submitter agreed with the standard provided that it only applied to AFAs who are not employees of an FSP or a QFE as they stated that the employer of the AFA should be accountable.

That submitter recommended inclusion of principle 11(a) of the Privacy Act – “that the disclosure of the information is one of the purposes in connection with which the information was obtained or is directly related to the purposes in connection with which the information was obtained”. They stated that inclusion of this principle will enable disclosure of information to third parties provided the disclosure was directly related to the provision of the financial adviser services. They submitted that this is particularly relevant for a financial institution providing investment services which involve nominee companies, custodians and affiliates.

That submitter noted that there is no equivalent to proposed standard 28(1)(b) in the Act and that requiring the AFA to have evidence is an onerous test. They submitted that the test should instead be that the AFA “believes on reasonable grounds that the client is implicated in illegal conduct.”

One submitter stated that, as much as possible, standards relating to client information should be based on the Privacy Act 1993 principles. It should not, for example, be permissible to reveal client information simply because that information is already publicly available (as all names and addresses and already publicly available on the electoral role). Instead, the obligation to keep client information confidential should apply even if that information is publicly available.

One submitter stated that express provision should be made for the Unsolicited Electronic Messages Act 2007 although this may conflict with proposed standard 28(2).

One submitter stated that the principle of custody is covered by the Privacy Act. They stated that it is unclear what is meant by “implicated” under proposed standard 28(1)(b).

Exceptions

One submitter suggested that requiring NZX firms to comply with standards 27 and 28 would create unnecessary duplication.

One submitter suggested, in relation to standard 28(1)(a)-(e) that there must be an opportunity for peer review (best practice review) without the need for prior written consent from the client. They stated that the client should be informed of the practice. It was suggested that organisations conducting such reviews should be subject to the same requirements to protect client information as AFAs.

One submitter suggested the standard should allow an AFA to release information to an accountant for proper purposes when the adviser has reasonable grounds for supposing that the client would not object.

Another submitter agreed that there should be an exception for sharing information with the client's other professional advisers (such as a lawyer or accountant) when the AFA believes on reasonable grounds that the client wishes the information to be shared.

One submitter stated that there should be a specific exception for disclosure in the course of business ie stock broking firm disclosing client details to its trading participant or the registry.

Refinements

One submitter suggested that a general consent to obtain and disclose information should be sufficient (rather than requiring individual consents).

One submitter stated that it is important that the consumer actively consents to disclosure of any information except in the areas noted.

One submitter stated that client information should not be disclosed without the client's authority unless there is a legal or professional right or duty to disclose the information. It was submitted that the professional right or duty to disclose is not included in the proposed standard. The submitter stated that in the case of AFAs who are members of NZICA, the professional right or duty to disclose could arise with regard to NZICA's practice review process or where a member faces disciplinary action. Therefore they submitted that the Committee should consider an exception for this kind of circumstance.

One submitter stated that some guidance on what is acceptable (and/or not acceptable) for the purposes of obtaining prior written consent might be useful. It was submitted that there should be exceptions allowing disclosure in the following circumstances:

- the disclosure of the information is one of the purposes in connection with which the information was obtained or it is directly related to the purposes in connection with which the information was obtained; and
- where required under the Code (ie to an auditor for the purposes of proposed standard 35).

One submitter suggested that standard 28(2) might be inconsistent with standard 28(1)(b) and (e).

One submitter agreed that the exceptions are appropriate apart from (a) which suggests that any client information can be provided to third parties if it is already publicly available. They stated that this would allow an AFA to disclose clients' contact details provided the client was listed in the telephone directory. Accordingly they submitted that it should be deleted.

One submitter pointed to the fact that the standard assumes that the adviser owns the database, which will often not be the case.

Issues with employers and organisations

Ten submitters endorsed the requirements generally, but questioned whether an AFA's employer might be considered a third party.

One submitter sought clarification that an adviser's employer did not constitute a "third party" to whom the adviser could not disclose information.

One submitter stated that standard 28 is appropriate if applied to individuals that are not employees of an FSP or a QFE. If the AFA is an employee of an FSP or QFE it was submitted that the employer should be accountable.

One submitter suggested that “reasonable grounds” should include passing personal information to FSPs that the client has agreed the adviser can deal with on the client’s behalf.

QUESTION THIRTY-THREE: How long should records for trust accounts, client money and client assets be held under proposed standards 30, 33 and 34?

SUMMARY

A number of submitters suggested that records ought to be kept for seven years (although some submitters suggested up to ten years). A number of submitters stressed that the requirements should be consistent with existing legislation, while some suggested that the existence at general law of obligations to retain documents meant that it was unnecessary for the Code to regulate this matter.

Particular submissions were made on how the requirements would apply to FSPs and QFEs.

INDIVIDUAL SUBMISSIONS

Seven years

Thirteen submitters suggested that the same period required of other professionals should be used (they suggested 7 years).

One submitter stated that NZX Firms already have a record keeping system that is monitored by NZX through a combination of on-site and desk based inspections. It was stated that NZX Firms must keep all records and documents for 7 years (rule 3.27) and that submitter stated that no further requirement is necessary.

One submitter stated that all records should be kept for 7 years, but AFAs should be allowed to keep records electronically and/or give records to their employers to keep.

For the duration of the relationship and for a specified period thereafter

One submitter suggested that records should be kept for seven years after the end of the relationship with the client.

One submitter suggested five years from the closure of the account or relationship (consistent with the anti-money laundering requirements).

One submitter proposed that records be kept for as long as the retainer and continual service is provided and for three years after the last service transaction to the client in order to comply with the Fair Trading Act 1986 and the Consumer Guarantees Act 1993 e.g. regarding recommendations and service quality.

Other periods

One submitter suggested that financial records for trust accounts, client money and client assets be kept for 6 years after the conclusion of the transaction.

Another submitter suggested 7-10 years.

One submitter stated that records for trust accounts, client money and client assets should be held for ten years.

One submitter stated that records should be kept for ten years.

One submitter stated that records should be retained until after the death and settlement of the estate of the client.

Another submitter suggested that it was necessary to keep financial transactional records for six years after the transaction for tax purposes.

Should be consistent with other legislation

One submitter stated that other legislation covers retention timeframes and that these should be mirrored.

Two submitters suggested that the requirements should be consistent with the Limitations Act 1950.

One submitter stated that the requirements should be aligned with the Privacy Act 1993, Financial Transaction Reporting Act 1996, Anti-money Laundering and Countering Financing of Terrorism Act 2009 and relevant tax legislation.

One submitter stated that any standard for trust accounts should align with the Financial Transactions Reporting Act, which is five years, and ten years for tax-related advice. They stated that additional standards should not be included for electronic records.

Not necessary because of existing legislation

Nine submitters stated that taking account of other legislative requirements including the Anti-Money Laundering and Countering the Financing of Terrorism Act, it is unnecessary to introduce standards to cover retention of client records. Further they stated that the AFA's employer may determine this issue and it may be outside the direct control of the AFA.

Two submitters suggested that requiring NZX firms to comply with standards 29 to 35 would create unnecessary duplication.

Two submitters suggested that existing record-keeping requirements imposed by law were sufficient.

Other observations and suggested exemptions

One submitter suggested that a definition of "control and custody" was required.

One submitter suggested that FSPs should be able to keep records of their AFAs' trust accounts.

One submitter also suggested that retention of records could be outside the control of the AFA (e.g. in the control of their employer).

One submitter also stated that this does not apply to life and health insurers as they do not use trust accounts and do not hold client money or assets.

In relation to proposed standard 30, one submitter stated that it is appropriate if applied to individual AFAs. If an AFA is an employee of an FSP or QFE, then the provider (ie the bank) should be held accountable for keeping records. They stated that if shares and bonds are held in a nominee name, the submitter would seek the client's consent in writing that the adviser is not liable provided they take "reasonable steps".

In relation to proposed standard 31, that same submitter agreed that the standard is appropriate if applied to individuals that are not employees of a FSP. They submitted that if the adviser is

employed, the FSP or QFE should be responsible. They submitted that it is common with the likes of WRAP platforms that individual accounts are held for each client and income is deposited in these accounts and fees deducted and the client receives a statement showing the cash account. They stated that there should be no obligation to designate such accounts as "Trust Accounts" or to have such accounts audited.

That submitter referred to standard 32 and stated that this standard is appropriate if applied to individuals that are not employees of FSP or QFEs.

That submitter also stated that standard 33 is appropriate if applied to individuals that are not employees of FSP or QFEs. It was submitted that the QFE should be able to keep these records where the AFA is either employed by, or is an agent of, a QFE.

That submitter stated that standard 34 is appropriate if applied to individuals that are not employees of FSP or QFEs. It was submitted that the QFE should be able to keep these records where the AFA is either employed by or is an agent of a QFE.

That submitter agreed with proposed standard 35 and said that monthly reconciliation of the designated trust accounts should occur, and an independent chartered accountant should be appointed to audit the designated trust accounts on an annual basis.

QUESTION THIRTY-FOUR: Is it appropriate to require trust accounts to be audited annually by a chartered accountant (see proposed standard 35)?

SUMMARY

This standard was generally endorsed as a useful safeguard. However some submitted that this imposed disproportionate costs on AFAs and that an internal audit would be sufficient.

It was also submitted that lawyers and registered legal executives are subject to the Lawyers and Conveyancers Act (Trust Account) Regulations 2008 and that any such standard should not apply to lawyers and registered legal executives.

NZX Advisors also stated that this aspect is adequately covered by the NZX Participant Rules. It was also submitted that such a standard should not apply to statutory trustee corporations as defined in the Trustee Act as they are already subject to internal audit, compliance programmes and supervision by the High Court.

INDIVIDUAL SUBMISSIONS

Appropriate

Twenty-three submitters agreed that this standard is appropriate.

One submitter agreed that the standards are appropriate if applied to individual AFAs.

One submitter stated that this is reasonable and is consistent with external requirements.

Another submitter suggested that this requirement was appropriate, and protected AFAs against employee fraud as well as protecting clients.

One submitter responded “yes”, but noted that the account may not be under the direct control of the AFA.

Inappropriate

One submitter disagreed and stated that the requirement to audit should not be limited to utilising an independent chartered accountant. They argued that internal audit units can just as effectively provide this type of audit. They stated that depending on the type and number of clients, the annual requirements may prove a costly and time-consuming exercise, give the comprehensive nature of the content of the standards in terms of transactional records.

One submitter said the requirement was inappropriate.

One submitter suggested that firm trust accounts were already subject to scrutiny.

One submitter stated that it is not necessary to have trust accounts audited by a Chartered Accountant. It was submitted that inspection by the Securities Commission or other nominated agency could be carried out periodically under the FAA.

One submitter stated that it does not require an annual audit of a member’s activity in respect of client monies. It was noted that NZICA and the Law Society have come to the same conclusion. It was suggested that a more cost-effective alternative would be for the inspection process to include a review of trust account records. It was noted that NZICA’s standards only require audit of members’ activity in respect of money held on behalf of clients if NZICA requests it or where the member has lent or invested in an associated finance entity.

That submitter also stated that clarity is needed regarding what is meant by an audit of “trust accounts”. It is the adviser’s activity in respect of client monies that should be subject to audit. They submitted that it also should be made clear what the audit would entail. For example NZICA’s standard states that the auditor must express an opinion as to whether the client monies have been properly maintained, recorded and accounted for by the member or firm in compliance with the standard.

One submitter stated that this does not apply to life and health insurers as they do not use trust accounts and do not hold client money or assets.

Registered Legal Executives

One submitter pointed out that registered legal executives must be aware of and comply with the Lawyers and Conveyancers Act (Trust Account) Regulations 2008.

NZX Firms

One submitter suggested that this Standard was appropriately covered by NZX rules and so NZX firms should be exempted from its application.

Another submitter stated that this requirement is unnecessary. The submitter referred to the NZX Rules which require NZX Firms to provide NZX with any Bank Audit confirmations requested by their auditors on an annual basis. Therefore they submitted that no new standards are necessary.

Statutory trustee corporations

One submitter agreed, but suggested that the requirement should not apply to trust accounts and funds where one of the statutory trustee corporations (as defined in the Trustee Act) is a trustee, as they are already subject to internal audit and compliance programmes and supervision by the High Court.

General comments

One submitter suggested that adviser associations could be authorised to do this work.

QUESTION THIRTY-FIVE: Are the proposed custody standards (standards 27-35) appropriate? Should the standards be modified or expanded in any way? Are there other custody standards which should be included in the Code?

SUMMARY

One major issue raised in relation to this question was that employed AFAs do not have control of the custody systems and procedures. It was pointed out that for clients of QFEs and FSPs there are often a number of AFAs that advise them and the client would expect the FSP or QFE to maintain records.

In relation to the record keeping required by standards 30, 33 and 34, it was stated that these standards should make it clear that employers of AFAs can keep records on behalf of AFAs.

Regarding standard 30, it was submitted that item (d) requiring the AFA to record the “purpose for which the asset was received” was not clear.

Several submitters referred, in relation to standard 31, to difficulties they had experienced with banks in trying to get client fund accounts designated as trust accounts.

Some submitters stated that in the share broking market standard 32 would be unworkable as NZX firms did not usually pay credit interest on trust settlements to clients. They submitted that disclosure should be sufficient.

Exemptions were supported by some submitters for particular groups:

- Lawyers - have ethical rules and trust accounting regulations that must be followed; and
- NZX Advisors - are required to follow the NZX Rules.

INDIVIDUAL SUBMISSIONS

Appropriate

Nine submitters were in support of the standards.

One submitter stated that the custody standards are comprehensive and thorough.

Inappropriate

Application of standards to those employed by FSPs or QFEs

Four submitters stated that the matters covered in these standards may not be under the direct control of the AFA who is employed or is part of a QFE and therefore an exemption is required.

One submitter agreed that these standards are generally appropriate but stated that they do not understand how these will apply in a corporate environment (particularly to a broking firm). It was submitted that these are not obligations that can be maintained by individual advisers as the client relationship is held by the firm and the client may have any number of different advisers. It was submitted that if these are adviser obligations it will require arrangements to be made for sharing and access to that file or multiple files. They stated that provision should be made for an AFA to rely on other parties to maintain records.

One submitter stated that standards 27-33 are appropriate if applied to individual AFAs. However they stated that if an AFA is an employee of an FSP or QFE, then the provider, (ie the bank) should be held accountable for the custody standards. If shares and bonds are held in a nominee name, they stated that they would seek the client’s consent in writing that their advisers are not liable as long as reasonable steps are taken.

One submitter noted, however, that the standards will apply only to AFAs and not to employers of AFAs (s 36 and 86 of the FAA). They stated that this may lead to confusion and therefore the Code should make this issue clear.

One submitter argued that employees of QFEs should be excluded from these requirements.

One submitter endorsed the custody standards, but suggested that careful consideration would be needed to be given to QFEs, and the extent to which QFEs on the organisation-wide level are capable of complying with the requirements.

One submitter suggested that these standards failed to recognise the complexities of an AFA-employer relationship, and suggested that these standards should only apply where the AFA is directly responsible and accountable for the delivery of the services in question (i.e. not where a QFE is responsible).

One submitter stated that the requirements to keep records (standards 30, 33 and 34) should be modified to allow employers of AFAs to keep records relating to activities performed in the course of their business by their employees and agents who are AFAs. They stated that this is more practical as many different AFAs within each FSP may be involved in advising the same client. It was submitted that for FSPs who are QFEs, record keeping will also be consistent with their regulatory role.

That submitter stated that clients who obtain services from AFAs acting on behalf of a FSP will expect the FSP to keep the AFA's records. They stated that this was especially the case where the client is a client of the FSP rather than of the individual AFA, with the effect that if the AFA left the FSP, the client would continue to obtain services from the FSP. They stated that the proviso for standards 30, 33 and 34 could read as follows:

Records must be kept unless those records relate to activities undertaken, in the course of a financial service provider's business, by an AFA who is an employee or agent of the financial service provider, and the financial service provider holds the records in accordance with this standard.

That submitter stated that this proviso would operate to excuse the AFA of its obligation provided records are still being kept, but would not place obligations on the FSP. They submitted that as the Code only applies to AFAs this is appropriate.

Standard 30

One submitter suggested that, to avoid duplication, standard 30 should allow for the record keeping to be undertaken by a third party where the AFA is satisfied that adequate records are being maintained.

One submitter suggested that standard 30(1)(d) was confusing and that a better approach to the standard would be to require the AFA to record all information concerning assets under their control that is necessary to perform their role.

Standard 31

One submitter suggested that the Code Committee consult NZX on the difficulties NZX firms have had getting banks to agree to "client funds accounts" being accorded trust account status.

One submitter stated that standard 31 is inappropriate and will be difficult to enforce. They referred to the NZX rules which state that client funds are to be held in account with "client fund account" in its name (NZX rule 14.7.1(a)) and they stated that amendments to the NZX rules will be required if standard 31 comes into force. They also stated that there has been some difficulty in attempting to have banks agree to the trust status of such accounts.

One submitter stated that under standard 31, the reference to the FAA should be expanded to any applicable legislation or regulation (ie client funds regulations).

Three submitters noted that the trust account may not be under the direct control of the AFA.

Standard 32

One submitter queried whether under this standard it is intended that the client's prior written authority should be obtained for the deduction of resident withholding tax and a bank's/deposit-holder's commission?

Two submitters suggested that standard 32 as drafted could be unworkable, and that disclosure should be sufficient.

One submitter stated that standard 32 is inappropriate as NZX Firms do not usually pay credit interest on trust settlement accounts to clients. It was submitted that disclosure of this standard practice should be sufficient.

Standard 35

Two submitters proposed, in relation to Standard 35, that the cash component of trust accounts should be reconciled daily.

Other professions

One submitter stated that NZICA has a separate standard that applies to member or firms who receive and hold client monies (Professional Standard 2- client monies). They stated that this contains the minimum standards that must be met when having custody of any money (in whatever form) coming into a member or firm's control which is the client's property.

One submitter noted that standards 31 and 32 could be inconsistent with the common practice of pooling both retail and wholesale clients' funds into call accounts, the interest on which is used for account charges to avoid costly individual transactions.

One submitter said yes but that lawyers complying with their own ethical and trust account obligations should not be subject to the ethical standards.

One submitter suggested that these standards were appropriately covered by NZX rules and so NZX firms should be exempted from their application.

General comments

One submitter stated that these standards will need to be reconciled with or be made subject to the Client Funds Regulations as there are some conflicts.

One submitter agreed that the standards are appropriate but stated that it is unclear what client property means. They suggested that this should be defined.

One submitter stated that this does not apply to life and health insurers as they do not use trust accounts and do not hold client money or assets.

One submitter stated that he has never operated or needed to operate a trust account. He stated that he does not know any financial planner who uses one. It was submitted that strict criteria should apply to trust accounts (he suggested that the Code Committee should look at the lawyer's rules for guidance) and there should be a central register of trust accounts which should be audited annually.

One submitter stated that with increasing regulation, information may need to be made available to external parties for compliance purposes. They suggested that strong safeguards are needed to protect consumers in this area.

One submitter stated that apart from standard 28, the proposed custody standards are appropriate.

One submitter suggested that the standards appeared overly prescriptive, particularly standard 33, and that a more principle-based approach would be preferable.

One submitter suggested that certain exemptions be included for immaterial and minor administrative breaches.

One submitter suggested that this was adequately policed by existing statutes.

One submitter noted that although proposed standards 29-35 set out various money handling obligations that will apply to AFAs, those standards will not, and cannot, apply to employers of AFAs (because the Code itself applies only to AFAs and not their employers). For this reason, they stated that the proposed standards will not be relevant to AFAs whose employers handle payments by clients such as banks. However it was noted that many clients of employed AFAs may misread the proposed standards, and think they do apply. They suggested that to avoid this confusion, the Code should make it clear that these standards only apply to AFAs and that other, different obligations apply to employers of AFAs.

One submitter stated that no other custody standards are required.

One submitter suggested that there should be prohibitions on paying premiums on clients' insurance policies or recording their address without a written request to a client.

MISCELLANEOUS QUESTIONS

QUESTION THIRTY-SIX: Noting the Ministry of Economic Development’s targeted consultation on regulation of investment transactions, are there any standards that you think should not apply to those who only make investment transactions (as defined in section 5 of the Act) and who do not provide other financial adviser services?

SUMMARY

Most submitters felt that AFAs who only make investment transactions should be treated differently under the Code. Several stated that the suitability standards should not apply to these AFAs. Others stated that only the custody standards should apply.

A number of submitters referred to changes to the FAA that they are seeking ie the removal of investment transactions from the definition of “financial adviser services”. (These comments have not been recorded as changes to the FAA are not within the Code Committee’s ambit.)

INDIVIDUAL SUBMISSIONS

Standards for those who only make investment transactions should be the same

Two submitters stated that those who only make investment transactions should be required to comply with the same standards as other AFAs.

Standards should not be the same for investment transactions

One submitter stated that there are standards that should not apply to those who only make investment transactions. It was pointed out that the MED has said that one option may be to create authorised investment transaction entities.

One submitter suggested that many of the proposed standards were not appropriate for transaction-style business.

One submitter suggested that the Code be relaxed for those providing transaction-only services or other restricted services, provided that full disclosure is made.

Suitability standards should not apply

One submitter stated that most of their comments have been made in the context of a member of NZICA who would be subject to their financial advisory engagement standard. It was submitted that members who only make investment transactions would not be subject to this standard and therefore it is likely that many of the standards in the Code should not apply to such AFAs as they are merely carrying out the client’s instructions without providing any explicit advice. They stated that the only caveat is that the client needs to be made aware that agreeing to make the requested transaction in no way implies that the AFA considers the transaction is appropriate for, or in the best interests of the client.

One submitter suggested that many of the standards should not apply to those who just undertake investment transactions, such as the requirement to conduct a suitability analysis. The submitter preferred, however, to wait until the targeted consultation is completed before commenting further.

One submitter suggested that the Code needs to take account of investors that want a limited service.

One submitter also suggested that the client-first and independence requirements should be replaced with a “do no harm” rule, and that suitability standards should not apply.

Only custody standards

One submitter stated that it is necessary to understand the outcome of consultation before a definitive response can be given. However, they submitted that it is likely that only those standards relating to custody will be relevant.

Two submitters suggested that, other than the custody standards, the above standards were not appropriate for those only undertaking investment transactions.

Only client care and dispute resolution standards

One submitter stated that investment transactions should not require an adviser to become authorised. However they submitted that if investment transactions do require authorisation, only the principles and standards relating to client care and dispute resolution should be applied. They stated that principles and standards relating to advisory services should not be required.

General comments

One submitter stated they prefer to wait until the results of the targeted consultation have been released.

One submitter stated that there is confusion around the definition of investment transactions and how the Code will apply to AFAs who perform investment transactions.

One submitter suggested that the Code Committee should exercise “extreme caution” before tampering with, or over-riding, NZX regulation.

One submitter suggested that standards relating to investment transactions, such as custody, do not apply directly to QFEs but will be imposed via the terms and conditions of QFE status.

Another submitter also noted that the Code may apply to personnel who are only involved in investment transactions for instance call centre operators who may be subject to the proposed standard which requires them to give other parties’ interests priority over their employer’s.

QUESTION THIRTY-SEVEN: Is there anything else you would like to comment on in relation to the proposed minimum standards of ethical behaviour and client care?

SUMMARY

Classes

A large number of submitters stated that there should be different standards for different classes of AFAs and that a “one size fits all” approach is inappropriate given the width of the application of the FAA.

Some of the different classes of AFA suggested were:

- those who provide services only to wholesale FSPs or habitual clients. It was suggested that these AFAs should not be required to comply with the:
 - scope of services standard (standard 10).
 - suitability analysis standards (standards 11-16); and
 - advice in writing standard (standard 20).
- AFAs employed by FSPs (and QFEs). It was suggested that these AFAs should not be required to comply with the:
 - advice in writing standard (standard 20);
 - standard requiring written terms of engagement;
 - dispute resolution standards (standards 21-23); and
 - standards requiring the AFA to keep individual client files (standards 27-34).

The rationale for these exceptions is that employed AFAs should be able to rely on the employer to be responsible for client communications, dispute resolution processes and custody systems.

It was also suggested that a distinction between the provision of general advice and the provision of personal advice should be recognised.

Mortgage brokers and insurance brokers expressed concern that the standards focused on investment advisers and therefore were not tailored to insurance and mortgage sectors.

It was also submitted that the ethical behaviour and client care standards should not apply to lawyers as lawyers are already required to comply with the Lawyers and Conveyancers Act (Lawyers: Conduct and Client Care) Rules 2008 and the Lawyers and Conveyancers Act (Trust Account) Regulations 2008. It was stated that although s 12(d) of the FAA will mean that the majority of lawyers’ work will fall within the exemption “in the course of professional practice if the advice is a necessary incident of legal practice”, it should be made clear that where this exemption does not apply, lawyers do not need to comply with the Code. It was submitted that lawyers also have a robust complaints system and complaints review system via the Legal Complaints Review Officer and also have fiduciary duties towards their clients.

In relation to lawyers’ employees it was submitted that they should not be required to comply with the Code as lawyers are entirely responsible for their employees’ work.

NZX Advisors also submitted that the NZX Rules cover the matters in the Code and therefore the Code should not apply to them.

Principle-based approach vs prescriptive approach

A number of submitters stated that the Code was too prescriptive and should provide more flexibility by providing a principle-based approach.

A number of other issues were discussed in this section which are recorded below.

INDIVIDUAL SUBMISSIONS

Who should the ethical behaviour and client care standards apply to?

Classes not “one size fits all”

One submitter stated that there needs to be more classes of AFA with varying obligations. It was stated that a “one size fits all” approach is inappropriate given the wide range of adviser services and investment products. They also proposed incorporating the “general vs personal advice” model used in Australia as a partial solution.

One submitter stated that the development of classes may be useful given the sector currently touches on such a range of individuals and entities and as a result the proposed standards are not necessarily an easy fit.

Another submitter was generally supportive of the standards but stated that a one size fits all approach may not be appropriate for all clients.

One submitter stated that there appears to be a one-sized fits all approach without understanding that specialised advice can be and should be given on different products.

One submitter stated that a one-size-fits-all approach is not appropriate and different classes should be treated differently.

One submitter stated that the proposed Code was focused on the position of financial planners and yet is intended to cover a much wider range of individuals and is therefore potentially not fit for purpose.

One submitter suggested that a wide range of services will be captured by the Code, from transaction-only services to comprehensive financial planning, and that this needed to be taken account of.

One submitter also suggested that a three tiered structure be adopted to differentiate between different kinds of advisers: companies selling insurance and insurance products; companies selling various investments trusts/funds; and companies selling a comprehensive range of investment products, including debt, equities, investments trusts and hybrid/derivative products. That submitter envisaged that the standards should be raised as the sophistication of the services being offered increases.

One submitter stressed that it is unfair to impose the compliance costs of comprehensive financial planning advice on investors who seek a more limited service or who are more financially literate.

AFAs who provide services solely to wholesale FSPs

One submitter stated that it may not be appropriate for all the proposed ethical behaviour and client care standards to apply to those who only provide services to wholesale FSPs (ie suitability analysis, advice to be in writing, scope of services).

One submitter expressed concern regarding the application of the Code to wholesale service providers. It was submitted that the Securities Act 1978 and Securities Markets Act 1988 generally made a distinction between those investors who require the protection of legislation and those who do not (those whose principal business is the investment of money or who, in the course of and for

the purposes of their business, habitually invest money, persons who are required to pay a minimum subscription price, or who are wealthy or otherwise eligible persons as defined in the Securities Act 1978). They also submitted that this distinction be extended to the proposed standards.

That submitter stated that the application of “retail regulation” to wholesale markets will create issues of increased administration, time and cost and will restrict the quick and efficient access to financial products and services for wholesale clients. It was submitted that these protections will not be seen as desirable for institutional investors. Therefore they stated that the proposed standards should not apply where a financial adviser service is provided to an institutional client.

One submitter stated that wholesale FSPs may need to be assessed differently in certain circumstances.

One submitter stated that the standards of AFA competence, disclosure and client care should be in two parts: the first applying to AFAs and the second applying to those AFAs who provide financial adviser services solely to wholesale or sophisticated customers. They submitted that the ethical standards should apply to all AFAs.

One submitter stated that it would be preferable if an AFA could “categorise” each client according to factors such as his or her level of financial literacy and/or net worth and apply certain standards accordingly. They observed that this would mean that retail clients would be fully protected by the Code but wholesale clients and habitual investors could benefit from a “light touch” that would promote the efficient delivery of financial services to sophisticated investors. For example, wholesale clients may not welcome the administration involved in opting out of a suitability analysis each time it requires a financial adviser service (proposed standard 11) and will not always want a written statement of advice or for that statement to be explained to them (proposed standard 15).

One submitter stated that some of the minimum standards should depend on customer type. It is stated that the competence, knowledge and skills and client care should match the customer’s situation including their reliance on their adviser, level of sophistication and understanding of financial products and risk. They stated that the levels of protection and information should be proportionate and targeted to operate in the least intrusive and most practical manner. They submitted that the customer’s situation including reliance on the adviser, level of sophistication and understanding of financial products and risks, should be taken into account.

That submitter also suggested that the code should distinguish between “wholesale” customers (those who are professional, wholesale, sophisticated or eligible) who do not need the same level and type of service and non-wholesale customers that are not “wholesale” customers ie retail customers (although by using the word “retail” they stated that does not include sophisticated investors).

That submitter stated that if the regime does not exclude “wholesale” customers, the Code should be in three parts:

- Part 1 – standards applying to AFAs generally (ie ethical standards);
- Part 2 – standards applying when a customer is a retail customer; and
- Part 3 – standards applying when a customer is a “wholesale” customer.

One submitter suggested that the bulk of the proposed standards should not apply to AFAs who provide financial adviser services exclusively to “wholesale financial adviser providers”.

One submitter also suggested that the Code make a distinction between advice provided to individuals and to corporate entities, suggesting that it is the former category of advice with which the FAA and the Code are most concerned.

One submitter sought clarification as to how the Code will apply to “wholesale” AFAs.

One submitter suggested that the Code did not take into consideration wholesale financial advisers.

One submitter suggested that a weakness of the FAA was its failure to treat wholesale or business-to-business advisers differently.

AFAs employed by FSPs

One submitter also stated that the proposed standards make no allowance for FSPs to comply on behalf of the AFAs that they employ. They stated that AFAs who work for large FSPs and may only ever have brief one-off contact with particular customers (ie answering over-the-counter questions) will need to provide written terms of engagement, dispute resolution information, have individual customer files and give them advice in writing. It was suggested that the standards as proposed would result in a significant proportion of financial adviser services currently provided being prohibited because employed AFAs would be required to comply with standards when they cannot practically do so. It was suggested that the emphasis should be shifted to disclosure and transparency around independence (rather than achieving independence which would only ever apply to a small percentage of AFAs). They stated that it should allow AFAs to rely on their employer to undertake the communication, dispute resolution and custody obligations.

That submitter supported the introduction of a Code of Conduct for AFAs but submitted that the proposed standards do not recognise that most AFAs will be employees of registered FSPs and therefore will be providing advice on behalf of their employer. Therefore it was submitted that the proposed standards are not relevant or applicable to the actual circumstances in which financial adviser services are routinely provided. They expected that many of its AFAs will provide financial advice both on category 2 financial products (such as call debt securities, term deposits and general insurance) and category 1 products which that submitter issues. This means that the submitter's employees will often provide financial adviser services for which their AFA status is not required. They also stated that this means that the proposed minimum standards will apply to everyday, over the counter interactions that bank staff will have with clients.

One submitter generally agreed with the proposed standards but was concerned that the standards may not be applicable or practical for AFAs who are employed by FSPs because the standards:

- require all AFAs who are employed or engaged by FSPs to state to their clients that they are “not independent or objective”;
- impose a client first standard that may prohibit AFAs from advising on products approved or sold by a particular range of FSPs; and
- require employed AFAs to perform duties that are more appropriately performed by the AFA's employer eg record keeping and providing terms of engagement.

General vs personal advice (research)

One submitter suggested that clients should be given the right to choose their own products and to elect *not* to receive advice on which products to choose. They pointed to the breadth of the terms “opinion, guidance or recommendation”, which may capture research or summaries not directed at particular clients. They endorsed the Australian distinction between “personal advice” – which is tailored to the particular requirements of a client and is akin to a “financial planning service” – and “general advice”, which is not.

Mortgage and insurance

One submitter expressed concern that the Code is attempting to create a “one-size fits all” approach for mortgage broking, insurance, and financial planning. It was submitted that this may cause a dramatic shift in the sustainability of mortgage broking and insurance. They stated that it will also inhibit and destroy the substantial benefits the two sectors provide to the New Zealand consumer.

One submitter suggested that differentiation ought to be made between investment advisers and insurance/mortgage brokers.

Lawyers

One submitter stated that once the FAA is in force, section 12(d) will provide lawyers with a limited exemption which will cover the majority of lawyers' work.

However that submitter stated that lawyers should not be subject to the ethical behaviour and client care standards for AFAs as lawyers are strongly regulated and subject to their own ethical requirements contained in the Lawyers and Conveyancers Act (Lawyers: Conduct and Client Care) Rules 2008 (LCCC Rules). The following comments are made:

- The legal profession has numerous public protection safeguards which taken together are not replicated in any other professional or occupation group. The LCCC Rules are backed by a complaints system which are considered by the Society's Standards Committees and complainants have the opportunity to have decisions reviewed by the Legal Complaints Review Officer who is entirely independent and appointed by the government.
- Lawyers have fiduciary duties to their clients and conflicts of interest of any kind are not permitted. Lawyers are not allowed to accept any reward for personal services or advice beyond proper professional fees calculated in accordance with the LCCC Rules.
- There is precedent for a parallel regime for lawyers – namely, solicitors nominee company and contributory mortgage regime operates separately from but in harmony with the contributory mortgage brokers regime regulated by the Securities Commission. The submitter stated that it would be highly unsatisfactory for lawyers to be subject to differing regimes with separate regulators and believes there is a compelling case for lawyers to be exempted from the ethical standards.

That submitter also stated that to the extent that lawyers' employees are subject to the FAA, lawyers' employees work for and through lawyers. They stated that lawyers, as employers are entirely responsible for the work done by their employees and therefore the ethical standards should not apply to employees of lawyers who are subject to their own ethical requirements.

Another submitter also stated that registered legal executives should not be subject to the minimum competence standards. It was submitted that registered legal executives work under the supervision of lawyers who, under s 12 of the FAA are deemed not to be providing a financial adviser service "if the advice or transaction is a necessary incident of legal practice". It was pointed out that registered legal executives are subject to the disciplinary and complaints framework in the Lawyers and Conveyancers Act 2006 s 120(2)(a)(iii) and are bound by the Lawyers and Conveyancers Act (Lawyers: Conduct and Client Care) Rules 2008. They submitted that legal executives are sufficiently regulated by this regime. It was submitted that if it is determined that registered legal executives are subject to the proposed competence standards, there will need to be close scrutiny to ensure that there are no inconsistencies between the Lawyers and Conveyancers Act (Lawyers: Conduct and Client Care) Rules and the Code.

NZX Advisors

One submitter stated that the proposed standards are already addressed in the NZX rules and provide sufficient protection. It was submitted that NZX Advisors should be exempted from the standards where those provisions are already addressed in the NZX Rules.

One submitter stated that NZX firms must meet certain standards within the industry including full disclosure. She submitted that NZX accreditation is very important and she submitted that

insufficient weight has been given to it in the consultation paper. She submitted that this accreditation should be recognised as offering investors protection.

One submitter also agreed with the ethical behaviour and client care principles generally but he expressed concern regarding how these apply to NZX Advisors.

Principles vs prescription

Code should be principle-based

One submitter stated that the Code is excessively prescriptive and should offer more flexibility by being more principle-based.

One submitter stated that the Committee is proposing a prescriptive model that dictates behaviours rather than principles and that a principle-based model is preferable as it will encourage ethical behaviour. It was acknowledged that a principle-based approach requires more professional judgement than a rule-based approach but that a principle-based approach has the advantage of flexibility so that the principles can be practical for a variety of circumstances.

Two submitters supported a principle-based approach however they say that more detail is required ie guidance notes that would enable the objectives of the principles to be clearly measured. They referred to the guidance notes provided within the NZX Participant rules.

One submitter suggested that the Code should be rewritten as a series of broad principles, rather than prescribing rules applicable to the provision of financial advice to financially illiterate people.

One submitter stated that the Code should be principle-based as this would allow more flexibility and would allow for variations in business models. They submitted that the Professional Advisers Association's Code of Ethics exemplifies the sort of approach the Code Committee should take. It was submitted that s 86 of the FAA provides flexibility in terms of how the minimum standards are to be written and their practical application. It was also stated that if a principle-based approach is not chosen, minor breaches of the Code could occur readily eroding public confidence in the advice process which is the opposite of the FAA's aim. That submitter stated that most consumers do not want detailed or complex rules when they seek advice and the complexity may cause clients to buy direct from product providers or QFEs without any advice. That submitter assumed that employees of QFEs will not be subject to the Code and they submitted that regulation should be "certain, stable and simple".

One submitter stated that some of the requirements may be overly prescriptive even though they are appropriate conceptually (ie the requirement to be courteous which perhaps should not of itself lead to disciplinary action against an AFA if this is not complied with).

One submitter stated that the standards are too prescriptive and a principle-based approach would be more appropriate. It was submitted that a prescriptive approach may:

- increase costs for NZX Firms and advisers with no added benefit;
- be inappropriate as many standards apply to an AFA where for many NZX Advisors, the NZX firm is responsible for the particular action (ie standard 21);
- be too inflexible and impractical when considering the varied range of financial services provided, roles undertaken by AFAs and different types of clients. It was submitted that some standards are only practical for independent advisers engaged in financial plans for individuals rather than an NZX Advisor providing specialist advice on securities or a futures contract to his or her client.

One submitter stated that the Code is meant to be a principle-based document but in his opinion it is too prescriptive.

One submitter expressed concern that setting a complicated set of standards will move the financial advisory profession to be more process driven, increase costs, de-humanise the giving of advice and cause the client/adviser relationship to deteriorate.

One submitter suggested that excessively prescriptive rules would frustrate good advisers, but it will not force bad or unethical advisers to change their ways.

One submitter stressed that the Code should focus on principles, not prescriptive rules.

Seventeen submitters endorsed the use of “guidance notes” to assist advisers in implementing the Code.

Four submitters supported the principle-based approach but stated that guidance notes would be useful. They submitted that having guidance notes alongside regulation works well with the NZX Participant Rules.

One submitter endorsed the inclusion of general principles, because prescriptive rules merely encourage participants to try to circumvent them.

One submitter recommended a principle-based approach, rather than a prescriptive approach, to better accommodate the diverse businesses that will be caught by the Code. The submitter pointed to the INFENZ Code of Ethics and Standards of Professional Conduct as an example.

Code should be prescriptive rather than principle-based

One submitter endorsed the need for a strong code of minimum standards of ethical behaviour and client care. That submitter expressed concerns about the principle-based approach taken in the proposed standards. It was recognised that this creates flexibility for AFAs but there is concern that it will be easy for unscrupulous AFAs to bend the rules as the rules are inherently unclear. They submitted that their experience with the Credit Contracts and Consumer Finance Act has demonstrated the difficulties with a principle-based approach as there is less clarity for consumers regarding their rights and the obligations. It was noted that one of the objectives of the FAA is to encourage public confidence. It was also submitted that more prescriptive rules accompanying the principles would be more likely to encourage this.

Protection for elderly consumers

One submitter believed that all possible efforts should be made to ensure maximum protection for consumers of financial services. It was submitted that:

- Many retired people depend on extra income derived from their savings and investments to supplement New Zealand Superannuation. Even though the dollar amounts may be small, this may make the difference between a comfortable standard of living and one which is very basic. Therefore this extra income must be protected to the fullest extent.
- People who have retired from the paid labour force are not able to recoup income and capital lost as a result of bad financial decisions, possibly made based on poor advice. Their investment “nest eggs” are the result of a lifetime of work and careful savings.
- Through no fault of their own, older people may not be as well informed about financial matters as younger people and may know less about how to find information. This may be because of fewer educational opportunities in earlier decades, or through social stereotyping (for example, the belief that women should be less concerned with a family’s financial affairs).
- Older people need trustworthy advice on financial matters in an increasingly complex environment. In the past older people would have trusted their lawyer or bank manager. Now lawyers’ fees are prohibitive and most people no longer have a personal relationship

with their bank. Advisers in trading banks are often inexperienced, have performance targets to achieve, and may be in receipt of incentives that cause them to lose sight of the difference between marketing a product and providing advice.

- Some older people suffer from physical and mental disabilities which may impair their ability to handle their financial affairs. Some older people are vulnerable to abuse and neglect, especially financial abuse.
- Older people have been hit hard by the recent failure of many finance and investment companies. Many have lost some or all of their life savings. The money they invested in good faith has gone and with it some of their plans for a comfortable retirement.
- Therefore they stated that very high standards of ethical behaviour and client care should be set.

General Comments

One submitter stated that it is generally supportive of the proposed principles.

One submitter stated that there are two different types of advice that are provided to the consumer. The first is the advice given to ensure that the client's needs are met prior to advice that is given regarding individual product or supply. The initial advice is provided to the consumer currently at no cost. It assists the consumer to obtain the necessary information to ensure that the future selected financial products meet their needs. It was submitted that this initial advice is generic to product selection and is provided with the over-arching principle to provide the client with quality advice that can be relied on.

One submitter suggested that public trustees in New Zealand are largely useless.

One submitter suggested that the power to remove an adviser's authorisation was the most powerful tool available.

Another submitter noted that the losses resulting from finance company collapses were often suffered by investors who had not sought advice at all.

One submitter suggested that some of the proposed standards (such as knowledge of legislation, custody of records, borrowing/lending from/to clients, joint investments and trusteeships) were really subsets of the over-arching duty to be objective and manage conflicts of interest, so should be reformulated as guidelines, rather than standards.

One submitter suggested that the Code needed to take account of the fact that there are disagreements between well-informed advisers (e.g. as to the usefulness of quarterly monitoring of long-term portfolios, the value of proactive advice, the relative merits of actively managed funds and indexed funds, and the place for alternative assets in a portfolio). That submitter stated that the adviser should make it clear what his or her investment philosophy is at the start of the relationship.

One submitter stated that client remedies will be reduced under the new regime as instead of claims against companies, clients will have recourse only to individual advisers. That submitter also made a number of other comments:

- contractual relationships will be more complicated. For larger advisory firms, separate contractual relationships will need to be established between each individual adviser and each client. They stated that most clients deal with more than one adviser when dealing with larger stock broking firms.
- Insurance will need to be maintained at an individual level rather than corporate level which will increase costs

- It is contrary to the Australian model which allows corporates to provide financial advice via individual advisers acting on behalf of the corporate.
- Restricting authorisation to individuals makes it difficult to establish any capital adequacy thresholds as they can easily avoid liability by declaring bankruptcy. They stated that with a corporate structure it is easier to establish minimum capital requirements.
- Given the fiduciary obligations of advisers in equity, Parliament is imposing personal liability far beyond the statutory penalties.
- There is reference to “members” of an exchange. It was submitted that this is archaic language and has no recognition under Securities legislation or in the NZX rules and that it should be “Exchange Participants”. However they stated that this presents an issue as it includes advising firms and individual advisers.
- The Code and the FAA and FSPA seem to contemplate, if not require, that the QFE or corporate is providing financial advice.
- In the investment entities issues paper, reference is made to recommendations distributed under corporate letterhead being signed by an accredited adviser. It was submitted that this is not permitted by the wording of s 14 of the Act as that must be considered to be the company giving the advice.

They submitted that they prefer the Australian model of advisers providing either general advice or personal advice, with an additional statement of advice being required when giving personal advice. It was submitted that this would address many of their concerns, particularly if different obligations are imposed on personal advisers.

One submitter suggested that it was important to avoid unnecessary disruption to the industry, and particularly to smaller operations that are closer to their clients than corporates are and who the submitter suggested act more ethically. That submitter stressed that the Committee had to be aware of the “clout of the corporate”.

One submitter stated that the Code Committee must ensure that the proposed standards result in better advice to consumers and that the standards do not scare clients further. They submitted that there is a need to ensure that clients do not take investment decisions into their own hands.

One submitter stated that the Code is seeking to create a no fault outcome for consumers and that this is unrealistic.

One submitter stated that the Code Committee is doing some excellent work. She submitted that the default KiwiSaver providers should be abolished and all should compete on an even playing field.

One submitter stated that the fiduciary nature of adviser obligations should be set out in the Code and should possibly replace the codified obligations imposed by the Committee. They submitted that if this is not done, legislation should be passed to make it clear that fiduciary obligations do not apply to financial advisers. It was stated that advisers and clients need to understand when fiduciary obligations apply.

One submitter stated that they do not understand the rationale for prohibiting corporate advisers from carrying on business. It was submitted that stock brokers and advisory firms should be permitted to carry on business through individual accredited advisers.

One submitter suggested that there be a requirement for fees to be reasonable, as for lawyers and accountants.

One submitter suggested that the Committee should attempt to align developments in New Zealand with those in Australia as much as possible.

One submitter questioned whether the Code's requirements would impact on the delivery of overseas investment services that are to be delivered in New Zealand.

One submitter expressed concern that clients could be overwhelmed by the number of documents with which they are faced, including: adviser disclosure statement; terms of engagement; suitability of advice; and statement of advice.

QUESTION THIRTY-EIGHT: Do you consider there are areas other than competence; knowledge and skills; ethical behaviour; client care; and continuing professional training that should be covered in the Code?

SUMMARY

Only a small number of submitters answered this question but most felt that there were no other areas that ought to be covered. However some did comment that as the regime matures other areas that should be covered may emerge.

Four submitters suggested further topics that the Code could cover: conduct when giving advice to replace any existing life insurance product; capital adequacy; clarification of remedies for clients; sanctions for breach of standards; and standards requiring appropriate product knowledge.

INDIVIDUAL SUBMISSIONS

Further areas

One submitter stated that the difference in client remedies for breach of contract and breach of fiduciary duties needs to be highlighted for both advisers and clients. It was submitted that if an adviser breaches a fiduciary duty, the consequences can be quite severe and far exceed the loss or damage in a contractual setting ie an aggrieved investor could recover all loss in value of an investment for failure to disclose commission, even though that failure did not contribute to the loss.

That submitter also stated that capital adequacy should be addressed and that advisers should be obliged to carry adequate capital or financial resources to meet client obligations. That submitter stated that this may consist of a combination of capital, third party guarantee and insurance.

One submitter suggested that the Code should also consider appropriate product knowledge and product accreditation on products that an adviser purports to be able to advise on (but notes that this may be covered in the upcoming "Continued Professional Training" document).

One submitter said "yes" but stated that one significant client care standard has been overlooked – conduct when giving advice to replace any existing life insurance product eg life, disability health etc. It was submitted that the consequences for poor advice are enormous and must be controlled for the public good. It was also submitted that insurers have a duty of care to monitor replacement business, the reasons why an AFA has recommended the policy be replaced and particularly what has been discussed regarding what is not covered by the new policy eg suicide in the first 13 months. It was also submitted that insurers typically overlook the thoroughness of industry's advice of replacement business and they stated that it is negligent to only confront such errors of judgement at claim time.

No further areas

Seven submitters stated that there were no other areas that ought to be covered in the Code.

One submitter said that if anything they would like to see the Code restricted to these areas only.

More areas in the future

One submitter stated that the proposed areas are appropriate but it was suggested that new areas may be covered in the future if issues are identified.

MISCELLANEOUS COMMENTS

SUMMARY

There were a number of submissions on topics outside the power of the Code Committee. These submissions were summarised and considered by the Committee but have not been included in this document. Topics covered included:

- QFEs;
- Changes to the FAA and submissions seeking clarification regarding the application of the Act;
- Consumer education;
- Regulatory requirements for registered advisers (Category 2 product advisers).

Aspects that relate to ethical behaviour and client care and that are within the ambit of the Code Committee's powers are summarised in this document and include submissions on the "wholesale" definition.

INDIVIDUAL SUBMISSIONS

Wholesale customers

One submitter stated that the regime should exclude customers considered "professional, wholesale, sophisticated or eligible" and stated that this will align New Zealand with the Australian regime and ensure that protection for customers who truly need protection. One submitter stated that alignment is important as otherwise New Zealand financial markets will be viewed as inefficient and will be less appealing to investors generally. It was submitted that the tests used in Australia and the United Kingdom for classifying customers should be used as a guide but thresholds should be adapted to fit the New Zealand market.

That submitter referred to the Ripoll report and stated that this report suggests that Australia will continue to distinguish between "wholesale" and other customers. They stated that the report suggests raising competence standards for independent financial planners and increasing transparency surrounding the affiliations of financial advisers.

That submitter stated that "wholesale" customers are significant contributors to New Zealand's economy and they should not be hindered in participating in the market. They suggested that FSPs should be able to classify customers as "wholesale" based on objective quantitative and qualitative tests. For example, if the FSP is satisfied that the customer has previous experience and expertise in using financial services and investing in financial products then it should be able to classify that customer as "wholesale". They stated that thresholds should be set at a level appropriate for New Zealand. They stated that "retail" customers should be given the right to request re-classification as is provided for in the United Kingdom and Australia.

That submitter recommended that the Committee seek feedback from the following organisations on appropriate protections for wholesale customers: state owned enterprises; the fund managers of the ACC Fund; the NZ Superannuation Fund; the Government Superannuation Fund; the National Provident Fund; and other fund managers such as AMP and Tower Asset Management; companies listed on the NZX; and industry groups such as the Capital Markets Development Taskforce, the New Zealand Chamber of Commerce, Business New Zealand, and the New Zealand Business Roundtable.

One submitter stated that the FAA should not apply to the provision of financial adviser services to other FSPs and/or to people who are not protected as members of the public under the Securities

Act 1978. Therefore they stated that advisers who provide wholesale advice only will not need to become AFAs.

That submitter noted that the Capital Markets Development Taskforce proposes a similar exemption for wholesale advice because it considers that:

- the regulation of financial advice outside the retail market is not justified as non-retail investors are able to obtain information from their advisers, judge the competence of advisers and verify the practices of their advisers without inflexible, mandated disclosure, codes of practice and competence standards; and
- regulating wholesale advice is inconsistent with the approach of the Securities Act which imposes minimal obligations on those issuing to certain classes of investors.

That submitter stated that the cost of requiring wholesale advice to comply with the proposed standards outlined in the consultation paper will far outweigh any benefit to be gained by those in the non-retail market.

Costs

One submitter expressed concern about the cost and “red-tape” that may be caused by the new Code.

One submitter stated that the standards will increase compliance costs and as a result increase costs for consumers and that this could lead to less advice being sought and further under-insurance.

Disclosure

One submitter stated that complying with the code should not involve a telephone book level of suitability analyses, disclaimers, disclosures, qualified advice, advice on commission. It was submitted that the United Kingdom regulations have been “over-the-top” and generally not very helpful to clients. He submitted that in the United Kingdom potential clients they would have helped in the past, are avoided because transactions are too small and the effort, time and paperwork required to comply with the regulations, make it difficult to proceed. He stated that the system should not be prohibitively expensive for poorer people.

Consultation

One submitter suggested that the questions regarding commissions suggests a predisposition by the Code Committee to a particular outcome.

One submitter stated that the Code Committee lacks sufficient adviser and client input. He stated that his over-riding concern is that the legal framework is such that New Zealanders are encouraged to seek financial advice.

One submitter stated that the consultation paper is confusing in its layout and extremely difficult to follow. They stated that this lack of clarity may compromise the consultation process and could, at worst, be seen as a deliberate attempt to subvert that process.

Other Codes of Ethics referred to by submitters

The Code Committee’s attention was drawn to the Chartered Financial Analyst Institute’s Code of Ethics, the Code promulgated by the Financial Planning Standards Board and the Million Dollar Round Table Code of Ethics.

General comments

One submitter expressed concern that there are no life or health insurance advisers on the Code Committee.

One submitter stated that some clients are impaired or have limited mental capacity, some are blind and some are uninterested. He stated that it was his approach to prepare a “normal” plan and encourage a party associated with the client (trusted family member, solicitor) to endorse the recommendations.

One submitter referred to the Secret Commissions Act and suggested that reference to this should be made in the Code and it should be referenced as a mechanism for prohibiting hidden fees or requiring disclosure, particularly in developing industry practices.

One submitter suggested that clients had to bear a degree of responsibility for protecting their own affairs. That submitter pointed out that an aim of the FAA regime was to ensure the efficient (i.e. cheap) delivery of advice, and that excessive restrictions on advisers would only inhibit this, leading to more customers choosing to rely on their own research or journalists’ opinions rather than obtaining quality advice.

One submitter stated that the question of advisers trading as principals should be addressed. Independent advisers should not be permitted to trade as principals. They submitted that principal trading should be permitted by institutions free of any fiduciary obligations. It was suggested that separate rules should be developed specifying how FSPs can operate when acting as principals ie different disclosure and notification rules will be required and some restrictions on providing personal advice or creating Chinese walls within larger institutions.