

**PROPOSED MINIMUM STANDARDS OF ETHICAL BEHAVIOUR AND  
CLIENT CARE FOR AUTHORISED FINANCIAL ADVISERS**

**17 November 2009**

**Due date for submissions: 5pm Friday 18 December 2009**

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## 1. THIS CONSULTATION PAPER

This consultation paper includes:

- an introduction (Part 2); and
- an outline of the principles on which the *proposed* minimum standards of ethical behaviour and client care for Authorised Financial Advisers (AFAs) are based (Part 3); and
- an outline of the *proposed* minimum standards of ethical behaviour for AFAs (Part 4); and
- an outline of the *proposed* minimum standards of client care for AFAs (Part 5); and
- particular consultation questions relating to the *proposed* ethical behaviour and client care standards (Part 6); and
- how to provide submissions and feedback in relation to the proposed minimum standards with submissions due **5pm Friday 18 December 2009** (Part 7); and
- background information about –
  - the Code which is to be made providing minimum standards of professional conduct for AFAs (including in relation to ethical behaviour and client care) (Part 8); and
  - the Code Committee, the process it is undertaking in preparing a draft Code, and how to contact the Code Committee (Part 8).

### Context of this consultation paper

This consultation paper outlines the matters the Code Committee proposes the minimum standards of ethical behaviour and client care should include. These standards will be developed by the Code Committee:

- in the light of the submissions received; and
- through the process of preparing a draft Code that will be released for consultation early in 2010.

## Terms used

Act	the Financial Advisers Act 2008.
AFA	<p>an authorised financial adviser under the Act, being an individual who is:</p> <ul style="list-style-type: none"><li>• registered under the Financial Service Providers (Registration and Dispute Resolution) Act 2008; and</li><li>• authorised by the Securities Commission under the Financial Advisers Act 2008.</li></ul>
Category 1 product	<p>means:</p> <ul style="list-style-type: none"><li>• a security (other than a category 2 product); or</li><li>• any estate or interest in land; or</li><li>• a futures contract; or</li><li>• any other product specified by the regulations (see s 5 of the Act).</li></ul>
Category 2 product	<p>means:</p> <ul style="list-style-type: none"><li>• a call debt security; or</li><li>• a bank term deposit; or</li><li>• an insurance product excluding a life insurance policy issued after 31 December 2008 (as defined in the Securities Act 1978); or</li><li>• a consumer credit contract as defined in s 11 of the Credit Contracts and Consumer Finance Act 2003; or</li><li>• any other product specified by the regulations (see s 5 of the Act).</li></ul>
Code	the Code to be made under the Act providing minimum standards of professional conduct for AFAs.
Code Committee	the committee appointed under the Act to prepare a draft Code.
Financial advice	making a recommendation, or giving an opinion or guidance, in relation to acquiring or disposing of (including refraining from acquiring or disposing of) a financial product (s 11 of the Act).
Financial adviser service	giving financial advice, making an investment transaction, or providing a financial planning service (s 10 of the Act).
Financial planning service	means a service that analyses an individual's current financial situation, identifies his or her financial goals, and develops financial options for realising those goals (s 5 of the Act).
Investment transaction	means the receipt, handling, payment, or investment of money or other property by one person on behalf of another person in relation to acquiring or disposing of a financial product (s 5 of the Act).

## 2. INTRODUCTION

The purpose of the Financial Advisers Act 2008 is “to promote the sound and efficient delivery of financial advice, and to encourage public confidence in the professionalism and integrity of financial advisers”. One of the ways the Act will achieve this is by requiring, when it comes fully into force, that all AFAs comply with a Code providing minimum standards of professional conduct.

Under the Act, a financial adviser must be authorised if he or she provides one or more of the following services:

- (a) gives financial advice in relation to a category 1 product; or
- (b) makes investment transactions in relation to a category 1 product; or
- (c) provides a financial planning service.

Once the disciplinary committee is established, AFAs may be disciplined for breaches of the Code. Some of the disciplinary measures include cancellation of the AFA’s authorisation; debarring the AFA from applying for authorisation for a specified period or payment of a fine.

The Act requires that the Code must contain minimum standards of ethical behaviour and client care. This consultation paper seeks your views on the proposed minimum standards of ethical behaviour and client care.

This is the second in a series of consultation papers issued by the Code Committee. The first consultation paper was released on 23 October 2009 entitled “Proposed Minimum Standards of Competence, Knowledge and Skills for Authorised Financial Advisers”.

Your feedback and submissions on these consultation papers will inform the development of the draft Code. The release of the draft Code in early 2010 will then trigger a further round of consultation.

### **Who must comply with these standards?**

It is proposed that all AFAs must comply with these standards including those who only make investment transactions. However, as announced by the Minister of Commerce on 13 October 2009, the Ministry of Economic Development is conducting targeted consultation on the regulation of investment transactions. It is possible, therefore, that regulation of this activity may change in the future.

**What is the timeframe?**

The Securities Commission has indicated to the Committee that its provisional timing expectations are that:

- a draft Code is to be prepared by the Code Committee by early 2010; and
- following this, the Code is to be approved by the Commissioner for Financial Advisers and then by the responsible Minister.

Once this Code has been approved by the responsible Minister, the Commissioner for Financial Advisers will determine the date on which it is to come into force.

**Future standards**

It is likely that the Code Committee will review the standards from time to time and, in particular, after it has seen how the standards are working in practice. Under the Act, any proposed changes to the standards will require consultation.

### 3. OUTLINE OF PROPOSED PRINCIPLES ON WHICH THE PROPOSED ETHICAL BEHAVIOUR AND CLIENT CARE STANDARDS ARE TO BE BASED

The Code Committee has identified a set of principles on which the proposed minimum standards of ethical behaviour and client care (set out in Parts 4 and 5) have been based.

#### What are the proposed ethical behaviour principles?

The Code Committee proposes that the principles of ethical behaviour be based on:

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

#### *Ethical behaviour principles*

##### *Client first and integrity*

The over-arching ethical principle is that, in providing financial adviser services, AFAs must place the client’s interests first and must act with integrity.

##### *Independence, objectivity, and managing conflicts of interest*

This principle requires that an AFA provide financial adviser services that are independent and objective unless the AFA clearly communicates the lack of independence and/or objectivity to the client and puts in place any appropriate safeguards. Standards are also proposed dealing with the issue of conflicts of interest. The Code Committee also proposes standards that must be met in order for AFAs to state or imply their services are “independent” or “objective”.

##### *Good conduct*

The Code Committee proposes that the Code contains good conduct standards including a standard requiring that AFAs must not do anything that would be disreputable.

#### **Question:**

1. 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?

## What are the proposed client care principles?

The Code Committee proposes that client care will be the section of the Code that provides the practical and operational processes and standards for interacting with clients. These proposed processes and standards will seek to “promote the sound and efficient delivery of financial advice”.

### *Client care principles*

The Code Committee has identified seven client care principles that the Code Committee proposes should be incorporated in the proposed day-to-day processes of, and standards for, an AFA’s practice. These are:

- professionalism; and
- suitability; and
- capability and capacity; and
- effective communication; and
- effective dispute resolution; and
- compliance; and
- custody.

### *Professionalism*

The over-arching client care principle is professionalism. This requires an AFA to behave professionally in providing financial adviser services and, in particular, communicate clearly with the client, act in a courteous, open and honest manner, and provide services promptly.

### *Suitability*

The principle of suitability requires an AFA to take reasonable steps to ensure any financial adviser services the AFA provides are suited to the client’s needs, financial position and risk profile. This is subject to any express restrictions on the scope of services to be provided. Any restrictions must be clearly communicated to the client. This section also sets out the process for matching clients with suitable financial solutions (suitability analysis). A client may consent in writing to opt out of receiving a suitability analysis in particular circumstances.

### *Capability and capacity*

The principle of capability and capacity requires AFAs to identify, implement and review appropriate client care processes and controls. It also requires that AFAs ensure they have sufficient time and resources for the tasks they undertake.



### *Effective communication*

The principle of effective communication requires an AFA to provide prescribed information to a client:

- in writing, unless it is not practicable to do so; and
- in a form that the client is able to understand easily; and
- in an appropriately prominent fashion.

Under this principle the provision of advice to a client must be:

- in writing, unless it is not practicable to do so; and
- in a form that the client is able to understand easily.

### *Effective dispute resolution*

The principle of effective dispute resolution requires an AFA to have an appropriate internal dispute resolution process and to communicate that process to the client. For further information on external dispute resolution see the Ministry of Consumer Affairs discussion documents ([www.consumeraffairs.govt.nz](http://www.consumeraffairs.govt.nz)).

### *Compliance*

The principle of compliance requires AFAs to ensure that, in carrying out their financial adviser services, they comply with all legislative requirements.

### *Custody*

The principle of custody requires AFAs to safeguard a client's property and information in the AFA's possession or control.

#### **Question:**

2. Are the client care principles (professionalism; suitability; 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?

#### 4. OUTLINE OF PROPOSED MINIMUM STANDARDS OF ETHICAL BEHAVIOUR

##### **Proposed over-arching ethical standard: to act in the interests of the client and with integrity**

The Code Committee proposes that the overarching ethical standard provide for the following matters:

*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.

##### **Question:**

3. Do you think that the proposed over-arching ethical standard is appropriate? Should it apply to all AFAs?

##### **Proposed independence, objectivity and managing conflicts of interest standards**

The Code Committee proposes the following standards in relation to independence, objectivity and managing conflicts of interest:

*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 are 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.

**Questions:**

- 4. Should proposed standard 2 include a requirement that the client must expressly consent to a lack of independence and/or lack of objectivity?
- 5. Are the safeguards listed in proposed standard 2(2) appropriate? Are there other safeguards that should be included?

*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 obligation or arrangements, that make the financial adviser services not independent and/or objective; and
- (b) any safeguards the AFA will follow to ensure the client's interests are placed first.

*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.

**Questions:**

6. Is it sufficient that 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?
7. Do you agree with the proposed independence, objectivity and managing conflicts of interests standards (proposed standards 2-4)? Should the standards be modified or expanded in any way? Are there other independence, objectivity or conflict of interests standards which should be included in the Code?
8. 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?

*Proposed meanings of key terms used in standards 2, 3 and 4*

- (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.
- (2) It is proposed that financial adviser services provided by an AFA will not cease to be regarded as **independent or objective** only because-
- (a) the AFA has received financial benefits that the AFA has fully paid or credited to the client; or
  - (b) the AFA, or an AFA connection, may receive a benefit that is so remote or insignificant that it cannot be regarded as likely to influence him or her in providing those services; or
  - (c) the AFA's employer or business partner receives a benefit in relation to those services that the AFA is unaware of after having made all reasonable enquiries of the employer or business partner.
- (3) 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.
- (4) 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.

**Question:**

9. Do you consider that non financial benefits should be taken into account in determining whether an AFA is independent and objective?

**Questions:**

10. 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.)

11. Are the definitions of “connection of the AFA” and “member of the AFA’s family” appropriate? If not why not?

*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.

**Question:**

12. 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?

***Personal trusteeships***

The Code Committee is conscious of the inherent conflict of interest involved in AFAs taking on personal trusteeships and acting as directors or corporate trustees of family trusts.

**Question:**

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

**Proposed good conduct standards**

The Code Committee proposes the following standards in relation to good conduct:

*Proposed standard 7: AFAs must not bring the financial advisory profession into disrepute*

An AFA must not act, or conduct himself or herself, in a way which will, or is reasonably likely to, bring the financial advisory profession into disrepute.

*Proposed standard 8: AFAs must not misrepresent or exaggerate the effect of being an AFA*

An AFA must not misrepresent or exaggerate the meaning or implications of being an AFA or of belonging to a particular class of AFA.

**Questions:**

14. Are there any other good conduct standards that should be included in the Code?
15. In particular 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?
16. Should this section on good conduct (or any other section of the draft Code) include standards providing guidance on advertising and/or marketing of financial adviser services over and above the restrictions in the Financial Advisers Act? If so what should the standards require?



## 5. OUTLINE OF PROPOSED MINIMUM STANDARDS OF CLIENT CARE

### Proposed over-arching standard of client care: professionalism

The Code Committee proposes that the over-arching client care standard provide for the following matters:

*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.

**Question:**

17. Do you consider the proposed over-arching client care standard is appropriate?

### Proposed suitability standards

The Code Committee proposes the following standards in relation to suitability:

*Proposed standard 10: AFAs must clearly communicate the scope of services (including any express restrictions on services), fees and other payments*

- (1) Before providing any financial adviser services, an AFA must clearly communicate to the client:
  - (a) the scope of services that are to be provided (including any express restrictions on the scope of those services); and

- (b) any fees and other payments that are to be paid or made by the client, either directly or indirectly.
- (2) In particular, the AFA must explain whether he or she will:
- (a) appraise the client of material changes relevant to their investment or financial position in the future; and
  - (b) monitor the client's portfolio or financial position on an ongoing basis.
- (3) Where an AFA receives any form of trail commission or monitoring fee, the AFA must appraise the client of material changes relevant to their investment in a timely manner.

**Questions:**

- 18. Do you agree that a standard concerning scope of services should be included (proposed standard 10)?
- 19. Is it appropriate to require that where a trail commission or monitoring fee is charged, the AFA must provide ongoing proactive advice?
- 20. Should there be a standard requiring written terms of engagement with clients?

*Proposed standard 11: AFA 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 service 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.

**Question:**

21. Should AFAs be permitted not to undertake a suitability analysis? The Committee seeks your views on two 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 (as proposed above)?

*Proposed standard 12: AFAs must restrict financial advice where client has not provided full information for suitability analysis*

If an AFA concludes, having made reasonable enquiries as required by proposed standard 11, that the client has not provided all the information requested, the AFA must:

- (a) request the missing information; and
- (b) if the missing information is not provided, restrict any financial advice or financial planning service to those matters for which the AFA considers there is sufficient and relevant information available; and
- (c) ensure that, if restricted financial advice is given or financial planning service provided, that the statement of advice (as required by proposed standard 15) includes a written warning to the client that the advice or service is restricted, the nature of the restriction and the reasons for the restriction.

*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.

**Question:**

22. 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?

*Proposed standard 14: AFAs must undertake a reasonable investigation of financial products and services recommended to clients*

- (1) An AFA must undertake a reasonable investigation of any financial products and services to be recommended to a client.
- (2) An AFA may rely upon an investigation undertaken by a third party only if:

- (a) the AFA is reasonably satisfied that proper research has been undertaken by the third party; and
- (b) it is reasonable in all the circumstances for the AFA to rely upon the third party.

*Proposed standard 15: AFAs must provide the client with a statement of advice and take reasonable steps to explain the statement*

- (1) An AFA must provide to the client any financial advice or financial planning service, the basis for that advice or service, and the risks involved, in a written statement of advice.
- (2) The AFA must take reasonable steps to explain to the client the financial advice or financial adviser service, the basis for the advice or service, and the risks and benefits involved.

**Question:**

23. Do you agree that the proposed standards concerning suitability set out above should be included in the Code? Are there any other standards concerning suitability that should be included in the Code?

*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.

**Question:**

24. How long should AFAs be required to keep records? Should there be specific standards relating to electronic records?

## Proposed capability and capacity standards

The Code Committee proposes the following standards in relation to capability and capacity:

*Proposed standard 17: AFAs must consider whether sufficient time and resources are available*

When considering whether to provide any financial adviser services, an AFA must consider whether he or she:

- (a) is able to comply with the Code, including the relevant ethical requirements; and
- (b) has sufficient time and appropriate resources available to perform the financial adviser services to a professional standard.

*Proposed standard 18: AFAs must obtain outside expertise or decline to act if skills or resources are required which the AFA does not have*

- (1) If an aspect of a client engagement requires particular skills or resources which an AFA does not have, the AFA must either:
  - (a) obtain the services of a suitably qualified person to provide those skills or resources; or
  - (b) decline to provide the services and recommend that the client obtain alternative advice from an individual with appropriate skills or resources.
- (2) An AFA must not provide financial adviser services for which they do not have appropriate competence, knowledge and skills.

*Proposed standard 19: AFAs must ensure there are appropriate systems and procedures in place*

- (1) An AFA must take reasonable steps to ensure that appropriate systems and controls are in place in relation to the provision of his or her financial adviser services . The factors to be taken into account include:
  - (a) the nature, scale and complexity of the services; and
  - (b) the diversity of the services, including geographical diversity; and
  - (c) the volume and size of transactions; and
  - (d) the degree of risk associated with each area of the services provided.

- (2) An AFA must take reasonable steps to ensure that regular reviews are carried out of the systems and controls.

**Question:**

25. Are the proposed capability and capacity standards appropriate? Should the standards be modified or expanded in any way? Are there other capability and capacity standards which should be included in the Code?

### **Proposed effective communication standards**

The Code Committee proposes the following standards in relation to effective communication:

*Proposed standard 20: AFAs must provide information and advice in writing and in plain language*

- (1) Subject to disclosure requirements under the Act, where the Code requires an AFA to provide information to a client the information must be:
- (a) in writing, unless it is not practicable to do so; and
  - (b) in plain language so that the client is able to easily understand it; and
  - (c) appropriately prominent.
- (2) Where the AFA provides advice or plans to a client, the advice or plans must be:
- (a) in writing, unless it is not practicable to do so; and
  - (b) in plain language so that the client is able to easily understand it.

**Questions:**

26. Do you agree that information and/or advice should be or provided in writing unless that is not practicable?
27. 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?

## Proposed dispute resolution standards

The Code Committee proposes the following standards in relation to dispute resolution:

*Proposed standard 21: AFAs must have an internal dispute resolution process*

- (1) Under s 48 of the Financial Service Providers (Registration and Dispute Resolution) Act 2008, every financial service provider must be a member of either an approved dispute resolution scheme, or the reserve scheme, (an “external dispute resolution scheme”) in respect of a financial service provided to the public.
- (2) In addition to the requirements under the Financial Service Providers (Registration and Dispute Resolution) Act 2008, every AFA must have a dispute resolution process (an “internal dispute resolution process”) which seeks to resolve disputes before they are referred to the external dispute resolution scheme.
- (4) Prior to commencing providing financial adviser services for a new client, an AFA must provide the client with a statement on dispute resolution procedure. This statement must also be provided to clients at the time when the client wishes to make a complaint.
- (5) The statement must explain the dispute resolution procedure including:
  - (a) that the client must first provide a written statement to the AFA detailing the complaint; and
  - (b) the AFA’s internal dispute resolution process; and
  - (c) that if the client is not satisfied with the resolution of the dispute under the AFA’s internal dispute resolution process or if no response is given by the AFA within a reasonable time, the client may then escalate the complaint to the external dispute resolution scheme; and
  - (d) details on how to contact the external dispute resolution scheme.

**Question:**

28. 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?



*Proposed standard 22: AFA must actively attempt to resolve dispute*

Once a complaint has been made, an AFA must proactively process and attempt to resolve any complaint that the client wishes or may wish to make about the AFA or advice provided by the AFA.

*Proposed Standard 23: AFA must ensure all complaints are recorded in an internal dispute resolution register*

An AFA must take all reasonable steps to ensure all client complaints received by the AFA are recorded in an internal dispute resolution register at the AFA's place of business.

**Questions:**

29. Are the proposed internal dispute resolution standards appropriate?
30. How long should records of complaints be kept?

## **Proposed compliance standards**

The Code Committee proposes the following standards in relation to compliance:

*Proposed standard 24: AFAs must maintain adequate knowledge of and comply with all legislative obligations relevant to providing financial adviser services and comply with the Code*

An AFA must maintain an adequate level of knowledge of and comply with all legislative obligations relevant to the provision of financial adviser services, including but not limited to the obligations contained in this Code.

*Proposed standard 25: AFAs must take reasonable steps to ensure that employees comply with all relevant laws and the Code*

An AFA must take reasonable steps to ensure that any person he or she employs or appoints to conduct business for or with clients complies with all relevant laws and the Code when providing financial adviser services.

*Proposed standard 26: AFAs must report illegal activity of other AFAs in relation to financial adviser services and breaches of the Code*

An AFA who has reason to believe 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.

**Question:**

31. Are the proposed compliance standards appropriate? Should the standards be modified or expanded in any way? Are there any other compliance standards that should be included in the Code?

## **Proposed custody standards**

The Code Committee proposes the following standards in relation to custody:

*Proposed Standard 27: AFA must take reasonable steps to protect client information and property*

An AFA must take reasonable steps to protect the security of client information and client property to ensure that such information and property is protected from unauthorised disclosure and is not misused or lost. This includes information stored physically or electronically.

*Proposed standard 28: AFAs must only disclose client information if measures protecting against improper disclosure have been satisfied*

- (1) An AFA must not provide information concerning a client to a third party for any purpose unless the AFA first obtains the client's prior express written consent to disclose the information, unless the AFA believes on reasonable grounds that:
  - (a) the information is publicly available; or
  - (b) the AFA has evidence that the client is implicated in illegal conduct and the AFA is disclosing the information to an appropriate authority; or
  - (c) disclosure is necessary for the conduct of proceedings before any court or tribunal (being proceedings that have been commenced or are reasonably in contemplation); or
  - (d) the information is to be used in a form in which the client concerned is not identified; or

- (e) the disclosure is required by legislation or by a person acting under legislative authority to require it.
- (2) The client must actively consent to disclosure of the information. A client does not consent merely because they have or were given the ability to opt out of information being disclosed.

**Question:**

32. 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 (1)(a)-(e)) appropriate? Should they be modified or expanded in any way? Are there any other exceptions that should be added?

*Proposed standard 29: AFAs must return client's property on request or in accordance with the agreed terms of engagement*

A client's property must be returned to the client upon request and as soon as reasonably practicable, or in accordance with the agreed terms of engagement.

*Proposed standard 30: AFAs must keep records of clients' assets in the AFA's control or custody*

- (1) An AFA must keep records of client assets which are under the control or custody of an AFA including:
- (a) a description of the asset and identifying details; and
  - (b) the name of the person who transferred the asset to the AFA's custody or control; and
  - (c) the client on whose behalf the asset is to be held; and
  - (d) the purpose for which the asset was received; and
  - (e) the date on which the asset was transferred to the AFA's custody or control; and
  - (f) any maturity date; and
  - (g) information in relation to any security over the asset.

- (2) Details of all transactions undertaken in respect of client assets must be recorded as well as any errors in transactions and benefits received by the AFA.

*Proposed standard 31: AFAs must hold client money on trust and designate trust accounts containing client money as “trust accounts”*

- (1) Under s 39 of the Financial Advisers Act 2008, an AFA who receives money on behalf of a client receives the money on trust and must ensure that the money is paid promptly into a separate trust account.
- (2) Trust accounts containing client money must be designated as a “trust account”.
- (3) The following requirements must also be satisfied:
  - (a) the bank and any other known interested parties must be put on notice that the money in each trust account is trust money; and
  - (b) the bank must be put on notice of the matters described in s 43 of the Financial Advisers Act 2008.

*Proposed Standard 32: AFAs must credit all interest earned on client monies to the client unless client’s prior written authority obtained*

The AFA must obtain the client’s prior written authority before interest on client moneys may be applied for a purpose other than being credited to the client.

*Proposed Standard 33: AFAs must keep records of trust accounts*

- (1) Records must be kept of client monies which are received and placed on trust including:
  - (a) the name of the person from whom the money was received; and
  - (b) the amount of money; and
  - (c) the client for whom the money is to be held; and
  - (d) the purpose for which the money was received or other description of money; and
  - (e) the date on which the money was received; and

- (f) the form in which the money was received ie cheque or cash.
- (2) Details of all transactions undertaken in respect of designated trust accounts must be recorded as well as any errors in transactions and interest earned and application of that interest in accordance with standard 32.

*Proposed Standard 34: AFA must keep records of transactions with client money*

Records of transactions with client money must be kept including details of:

- (a) all client monies paid direct to the client, or to a third party on the client's instructions, the identity of that third person and a record of the client's instruction;
- (b) any errors in transactions undertaken with regard to client money; and
- (c) all interest earned on client monies and how interest has been applied in accordance with proposed standard 32.

**Question:**

33. How long should the records for trust accounts, client money and client assets be held?

*Proposed Standard 35: reconciliation and auditing*

- (1) Monthly reconciliation of the designated trust accounts must occur.
- (2) An independent chartered accountant must be appointed to audit the designated trust accounts on an annual basis.

**Questions:**

- 34. Is it appropriate to require trust accounts to be audited annually by a chartered accountant?
- 35. Are the proposed custody standards appropriate (standards 27-35)? Should the standards be modified or expanded in any way? Are there other custody standards which should be included in the Code?

## 6. PARTICULAR CONSULTATION QUESTIONS

The Code Committee welcomes submissions on all aspects of the proposed minimum standards of ethical behaviour and client care.

It would, however, be grateful if the submission could in addition respond to the following particular questions that have been asked throughout this paper. Please note questions 36-38 have not been set out earlier in the body of the paper as these are questions that relate to the consultation paper as a whole.

1. 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?

2. Are the proposed client care principles (professionalism; suitability; 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?

3. Do you think that the proposed over-arching ethical standard (proposed standard 1) is appropriate? Should it apply to all AFAs?

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

5. Are the safeguards listed in proposed standard 2(2) appropriate? Are there other safeguards that should be included?

6. It is sufficient that 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?

7. Do you agree with the proposed independence, objectivity and managing conflicts of interests standards (proposed standards 2-4)? Should the standards be modified or expanded in any way? Are there other independence, objectivity or conflict of interests standards which should be included in the Code?

8. 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?

9. Do you consider that non financial benefits should be taken into account in determining whether an AFA is independent and objective?

10. 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.)

11. Are the definitions of “connection of the AFA” and “member of the AFA’s family” appropriate? If not, why not?

12. 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?

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

14. Are there any other good conduct standards that should be included in the Code?

15. 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?

16. Should the proposed standards of good conduct (or any other section of the draft Code) include standards providing guidance on advertising and/or marketing of financial adviser services over and above the restrictions in the Financial Advisers Act? If so what should the standards require?
17. Do you consider the proposed over-arching client care standard is appropriate (proposed standard 9)?
18. Do you agree that a standard concerning scope of services should be included (proposed standard 10)?
19. Is it appropriate to require that where a trail commission or monitoring fee is charged, the AFA must provide ongoing proactive advice?
20. Should there be a standard requiring written terms of engagement with clients?
21. 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?
22. 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.)
23. 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?



24. How long should AFAs be required to keep records in relation to proposed standard 16? Should there be specific standards relating to electronic records?
25. 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 which should be included in the Code?
26. Do you agree that information and/or advice should be provided in writing unless that is not practicable?
27. 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?
28. 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?
29. Are the proposed internal dispute resolution standards (standards 21-23) appropriate?
30. How long should records of complaints be kept under proposed standard 23?
31. 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?
32. 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 standard 28(1)(a)-(e)) appropriate? Should they be modified or expanded in any way? Are there any other exceptions that should be added?
33. How long should records for trust accounts, client money and client assets be held under proposed standards 30, 33 and 34?
34. Is it appropriate to require trust accounts to be audited annually by a chartered accountant (see proposed standard 35)?

35. Are the proposed custody standards (set out in 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?

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

37. Is there anything else you would like to comment on in relation to the proposed minimum standards of ethical behaviour and client care?

38. 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?

## 7. HOW TO MAKE SUBMISSIONS AND GIVE FEEDBACK

### Submissions on proposed minimum standards

We encourage you to provide a submission on the proposed minimum standards of ethical behaviour and client care by:

- emailing us at [consultation@financialadvisercode.govt.nz](mailto:consultation@financialadvisercode.govt.nz); or
- writing to:  
Ethical Behaviour and Client Care Sub-Committee  
Code Committee  
c/o Securities Commission  
PO Box 1179  
Wellington 6011

**Your submission must include:** your name, address and contact phone number.

You must specify in writing if you require your submission, or part of it, to remain confidential to the Code Committee and the Secretariat, subject to any overriding statutory obligation.

**Your submission on this consultation paper must be made by: 5pm Friday 18 December 2009.**

The Code Committee's website is [www.financialadvisercode.govt.nz](http://www.financialadvisercode.govt.nz). All consultation papers and other documents released by the Code Committee can be downloaded from this website. This website includes a blog which will enable the public to give feedback on the proposed minimum standards, possibly with discussion chains emerging.

## Opportunities for feedback

The Code Committee is also proposing the following additional opportunities for feedback.

In particular:

- There will be three public meetings at the end of November/early December:
  - Christchurch 30 November 2009, The Christchurch Club, 154 Worcester Street.
    - 8.30am – attendees arrive.
    - 9.00am-11.30am – Presentation by Code Committee followed by question time.
  - Wellington 1 December 2009, Spectrum Theatre, BP House, Cnr Customhouse Quay & Johnston St (access off Johnston St)
    - 8.30am – attendees arrive.
    - 9.00am-11.30am - Presentation by Code Committee followed by question time.
  - Auckland 2 December 2009, Quality Inn Westend, 465 Great North Rd, Grey Lynn
    - 1.00pm – attendees arrive.
    - 1.30pm –4.00pm - Presentation by Code Committee followed by question time.

You can register for attendance at these public meetings by emailing [consultation@financialadvisercode.govt.nz](mailto:consultation@financialadvisercode.govt.nz).

These meetings are designed as a discussion forum. For feedback to be formally reviewed by the Committee, submissions need to be made in writing.

- Ross Butler (the Code Committee Chair), and members of the Code Committee are happy to consider invitations to speak with:
  - national and regional forums and meetings of advisers; and
  - consumer groups.

Please email the Code Committee's Secretariat at [secretariat@financialadvisercode.govt.nz](mailto:secretariat@financialadvisercode.govt.nz) if you would like to invite us to attend such a meeting. In most circumstances, we would expect the organisers to meet travel costs for Code Committee members.

- We will be seeking to meet with adviser associations and industry groups in the financial adviser sector and with consumer groups.
- We will also be continuing our useful dialogue with other Review/Taskforces/Inquiries engaging with the sector.
- The Code Committee will also be seeking to inform the media about its work, particularly those that focus on advisers and financial services.

## **8. BACKGROUND TO THE CODE AND CODE COMMITTEE**

### **Who must become authorised?**

When the relevant provisions of the Act come into force, the following financial advisers must be authorised by the Securities Commission:

- those giving financial advice in relation to a category 1 product; and
- those making investment transactions in relation to a category 1 product; and
- those providing a financial planning service.

### **AFAs must comply with the Code**

When the Act comes fully into force, AFAs must comply with certain obligations under the Act and its regulations, including an obligation to comply with the Code.

### **The Code**

The Code will set out minimum professional standards of:

- competence;
- knowledge and skills;
- ethical behaviour;
- client care; and
- continuing professional training.

### **Code Committee to prepare draft Code**

The Code Committee has been appointed to prepare a draft Code. The Code Committee must, in preparing the draft Code, consult with representatives of the financial adviser industry, and with interest groups within that industry. It must also allow an opportunity for anyone affected by the Code to make submissions.

## **The process for approving the draft Code**

### ***Approval by the Commissioner for Financial Advisers and the responsible Minister***

The Act sets out a detailed procedure for approval of the draft Code by the Commissioner for Financial Advisers and then by the responsible Minister.

Both the Commissioner and the responsible Minister may –

- refer the draft Code back to the Committee for further work before approving it; or
- in certain cases, make changes themselves.

### ***Coming into force***

After the Minister has approved the draft Code, the Commissioner must give not less than 28 days notice in the *Gazette* of when the Code will come into force.

## **Consultation in relation to proposed minimum standards**

### ***Nature of consultation***

The Code Committee considers that its consultation and engagement should be iterative in nature, rather than consulting only when a complete draft Code has been developed. The Committee prefers to give the sector a clear vision of its thinking in relation to the various aspects of the Code as they evolve.

This approach will enable the Committee to change or refine its thinking after considering feedback and submissions. It will also enable the industry to prepare for the new regulatory environment.

The Committee is approaching issues relating to the Code with an open mind, and is keen to get feedback on the proposed minimum standards.

### ***Further consultation papers***

The Code Committee anticipates that it will release a further consultation paper in the coming months on:

- continuing professional training.

### ***Draft Code***

The Code Committee aims to release a draft Code for discussion early next year. The release of the draft Code will be the trigger for a further round of consultation. Details will be advised at the time of release of the draft Code on our website [www.financialadvisercode.govt.nz](http://www.financialadvisercode.govt.nz).

***Analysis of submissions***

The Code Committee will analyse all submissions received including those marked “confidential”. A public report will be prepared in relation to all submissions received (except those submissions marked “confidential”) and will be made available on the Code Committee’s website.

**Contacting the Code Committee**

The Code Committee has its own website [www.financialadvisercode.govt.nz](http://www.financialadvisercode.govt.nz). The Committee will post all consultation papers and updates on this website. Submissions on consultation papers should be sent to:

- [consultation@financialadvisercode.govt.nz](mailto:consultation@financialadvisercode.govt.nz) or
- posted to:

Ethical Behaviour and Client Care Sub-Committee  
Code Committee  
c/o Securities Commission  
PO Box 1179  
Wellington 6011

The email contact details for enquiries directed to the Secretariat or the Chair are as follows:

Secretariat                    [secretariat@financialadvisercode.govt.nz](mailto:secretariat@financialadvisercode.govt.nz)

Chairman                      [chair@financialadvisercode.govt.nz](mailto:chair@financialadvisercode.govt.nz)

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Thanks for taking the time to read this consultation paper.

We are keen to hear your views on the proposed minimum standards of ethical behaviour and client care, and we value your input.

Sincerely,

Ross Butler

Chairman, on behalf of the Code Committee.

Wellington, 17 November 2009.