

Ref: 622-020 / #124821

17 August 2010

Chairman
Code Committee for Financial Advisers
WELLINGTON

Attention: Mr Ross Butler

Dear Ross,

DRAFT CODE OF PROFESSIONAL CONDUCT FOR AUTHORISED FINANCIAL ADVISERS

I refer to the draft Code of Professional Conduct (the “draft Code”) submitted to me on 30 July 2010. I would like to thank the Code Committee for its hard work on the draft Code to date.

I have undertaken a review of the draft Code as required by section 88 of the Financial Advisers Act 2008 (the “Act”).’

I am required under the Act to approve the draft Code if I am satisfied that-

- the draft Code has been approved by a majority of the Code Committee; and
- the Code Committee has complied with the obligations set out in section 87(2) of the Act; and
- the draft Code is consistent with the Act.

Following my review of the draft Code I am not satisfied that the draft Code is consistent with the Act in three respects, two of which affect operative provisions of the Code. Accordingly I must, under section 89 of the Act, direct the Code Committee to revise the draft Code.

I am satisfied that the Code Committee has complied with its obligations under section 87(2) of the Act. While it is a matter for the Committee as to how it complies with this direction, I am not directing you to undertake further consultation or receive submissions.

In accordance with section 89(2) of the Act I set out below the concerns I have regarding the consistency of the draft Code with the Act. I have approached the question of consistency by considering the requirements for the content of the Code in section 86 of the Act, the purpose of the legislation set out in section 3, and also consistency with the obligations imposed on financial advisers in Part 2 of the Act.

Background to the Code

This section, although not an operative part of the Code, provides an overview of the scope and aims of the Code. It includes a description of the financial advisers who are required to

be authorised under the Act. It is my opinion that this description needs to be revised in order to accord with changes to the Act that came into force on 1 July 2010.

I should record that I am satisfied from my review that the operative provisions of the Code have been updated to take account of the recent changes to the law and the Code Committee's subsequent final consultation.

Code Standard 5

This standard in the draft Code provides:

"An Authorised Financial Adviser must not provide financial advice to a retail client in relation to a financial product that is not offered to the public if the Authorised Financial Adviser is a related person of the product provider of that financial product."

It appears from the first consultation draft of the Code, and the Code Committee's response to major submission points published on 6 July 2010, that this standard has altered in the course of consultation, becoming progressively narrower in response to concerns raised.

I appreciate the rationale for the core provision, which seeks to place limits on the circumstances in which an authorised financial adviser (AFA) can give advice to a retail client if the AFA is a related person of the product provider. I can see that the Code Committee took a decision to limit the application of this standard to financial products that are not offered to the public, on the basis that public offerings have their own consumer protection rules.

The concern I have is that the standard as written may leave AFAs and consumers (who will not necessarily have the benefit of knowing the history of this draft standard) with the impression that the Code is endorsing the provision of advice on wholesale products to retail clients in any case where the product provider is not a related party of the AFA. In respect of securities (which make up the majority of category 1 products) this will in most cases be inconsistent with section 38 of the Financial Advisers Act.

Section 38(1) of the Act says:

- (1) *An authorised financial adviser (A) must not recommend to a person that that person acquire securities if-*
- (a) *when the securities were or are offered for subscription, the offer was or is illegal; and*
 - (b) *the illegality has not been remedied; and*
 - (c) *A knows or ought to know that, when the securities were or are offered for subscription, the offer was or is illegal.*

If securities are not "offered to the public" then the offer of those securities to a retail client (which is a subset of "member of the public") would be illegal in the great majority of cases.

Even in instances where such advice might not breach section 38 of the Act, such as where the product concerned is not a security, or where a client has opted out of being a wholesale client under section 5G, great care will need to be taken to ensure that any recommendation that a retail client buy a product that is not offered to the public is consistent with the general obligation to exercise due care, diligence, and skill in section 33 of the Act (taking into account the nature and requirements of the client).

I understand that Code Standard 5 is intended to protect the interests of retail clients in the rare situations where such a client may appropriately be given advice on a product that is not offered to the public, and that the draft standard is of very limited application. I believe it is important that the standard does not give the inadvertent impression that the Code endorses advice that is inconsistent with the Act. I direct that this standard be revised to ensure that such an impression is not created.

Code Standard 8

This draft Code Standard establishes a general obligation on an AFA, when providing a personalised service to a retail client, to take reasonable steps to ensure that the personalised service is suitable for the client.

I endorse this obligation. My concern is that the additional provisions, providing relief from this standard where a client instructs an adviser not to determine the suitability of the personalised service provided, fails to alert advisers and clients to the fact that such an election by a client may have the effect that the service sought is no longer a “personalised service” as defined in the Act and the draft Code, but becomes “class advice” (with the consequences this has to the application of Code Standards 9 and 10 to the service provided).

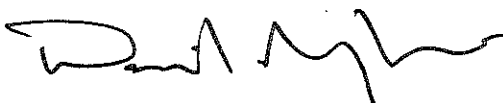
I appreciate that there are instances where advice amounts to a personalised service for the purposes of the Act, but does not involve a full assessment of the suitability of the product for the client. In other cases, a decision by the client to decline a suitability assessment may mean that the service to be provided is a class service.

As the legislation and the draft Code have established a distinction between class and personalised services, I am of the view that consistency with the Act requires it to be very clear that, where a client has sought personalised advice but has then opted out of an assessment of suitability, the client has a clear understanding of whether the service provided remains a personalised service by reason of taking into account the client’s particular financial situation or goals (or any one or more of them); or whether it becomes a class service. At present the draft standard refers only to personalised services, and in my view is potentially confusing in this regard. I direct that this standard be revised to address this.

Process

I understand that the Code Committee is meeting later this week. I understand that there are a few other changes, of a minor nature, that committee members have identified as desirable. I should be pleased if you could consider this letter and my direction and provide me with a revised draft Code as soon as practicable.

Yours sincerely



David Mayhew
Commissioner for Financial Advisers