

#107

COMPLETE

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Q1 Overall, do you agree or disagree with [standard 1] and proposed commentary? **Agree**

Q2 Please provide any comments on [standard 1] and the proposed commentary.

We have a 9 comments on Code Standard 1, which we summarise below (and in respect of points 1 and 3, we provide additional reasoning / examples / illustrative drafting below).

1. We suggest adding “to the extent reasonable in the circumstances” to Code Standard 1. This could be done in the Commentary. This addition is necessary to clarify that Code Standard 1 does not require unreasonable behaviours from advisers. It is also necessary to impose limits on the obligation to act in clients’ interests, which otherwise could be interpreted as never-ending. The FMCA and current AFA Code have reasonableness limits (see in particular current AFA Code Standard 1, which provides that “What is required to place the interests of the client first for the purposes of the Code is determined by what is reasonable in the circumstances...”).
2. We suggest as an alternative that “acting in client interests” should be removed from the Code on the basis it is dealt with adequately in section 431J, and duplication promotes confusion and a lack of clarity, and is inefficient.
3. We support the acknowledgement fairness is not one-sided, and the flexibility arising from the acknowledgement that fairness depends on the particular circumstances.
4. We would like greater clarity on the meaning of fairness, and in particular the fairness “illustrations” appearing in the “Commentary” section.
5. We think illustrations 1-3, while laudable, should not be promoted to the level of regulatory obligations.
6. We would also like to see a materiality threshold, to exclude minor breaches.
7. “Promote the interests” in fairness illustration 5 is different from, and arguably more active than, the “act in their interests” standard in the heading and Code Standard itself. We would like to see consistent terminology and, if there is going to be a more active obligation to “promote” the interests of clients, that additional expectation should be more clearly justified.
8. Consistent with our submission above, however, we believe that “acting in the interests of the client to the extent reasonable in the circumstances” is a good illustration of fairness. Including it as an illustration may be preferable to having it as a separate requirement of Code Standard 1.
9. We suggest “spirit and intent” be removed from fairness illustration 6. Parliament intended the law to apply as it is written. Adding an overlay (which is likely to be unclear in practice), creates uncertainty when we believe the “mischief” is adequately covered without the need to refer to “spirit and intent”. If Parliament intended the legislation to be broadened, it could have said so.

Reasoning- Point 1: A requirement to “act in their interests” requires a “reasonableness” limit because otherwise the research expectations on providers can be never-ending. Without such a limit, advisers could be liable if they reasonably draw the line on research that, with the benefit of hindsight, would have exposed or better understood a risk relevant to the advice, or meant a

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different product not within the suite of products known to the adviser was more suitable. This was the reason the reasonableness standard was added to the Current Code, and we see no reason for changing that approach.

Some of the uncertainty around the use of “fairness” as a principle would also be addressed if the illustrations are qualified by “to the extent reasonable in the circumstances” generally or as relevant in each case. If the Committee has refrained from including this because it believes it would be implied by the Courts anyway, then why not include it expressly and avoid any doubt? That would be clearer and more effective.

Example – Point 1: a sharebroker advised purchasing shares in a company based on a reasonable understanding of its prospects. The share price falls due to an event (e.g. a delayed timeframe for, or increased costs of, a building completion, the likelihood of a medical patent, the prospect of disruption, the prospects of litigation, the predicted outcome of an inquiry or any other business risk) which could have been predicted with additional research that no reasonable adviser would have undertaken for the agreed fee. It can be shown that it would have been in the client’s interests that the additional research be done, but it would have been uneconomic for the adviser to go to such lengths. If there is a duty to act in client’s interests without a “reasonableness” limit, the adviser could be required to research each recommended investment decision to an unreasonable degree.

Reasoning-Point 3: While it sounds appealing as a general principle, at the fringe “fairness” on its own is a very subjective standard - what is fair to one person, may be unfair to another. It will be difficult therefore in some cases for financial advisers to be sure that they meet a “fairness” standard, particularly if the Code does not specify precisely what “fairness” means in practice.

We support “fairness” as a principle – it is unobjectionable - but suggest “fairness” be defined through improved guidance, adopting our points 5 – 9 above. We acknowledge the challenge of articulating fairness, particularly when its general concepts are already reflected in existing laws and the FMCA will include many of the aspects that would immediately be considered (such as care, diligence and skill, giving priority to client interests, ensuring the nature and scope is understood and ensuring advice is fit for purpose i.e. suitable). We have considered the approach in the UK and South Africa (where the obligations to treat clients fairly are illustrated in 6 desired outcomes), and found them to be of only limited assistance.

Drafting illustration – Point 3: We set out below a potential alternative suggestion for a specific definition of “fairness”:

Treating clients “fairly” means, in connection with giving advice, in all material respects:

- Complying with the duties and other obligations under the FMC Act, including the duty to exercise care, diligence and skill in relation to that advice;
- Complying with the obligations under the FMC Regulations, including any disclosure obligations relevant to the giving of that advice;
- Complying with the Code Standards;
- Complying with all other obligations of all laws and regulations applicable to that advice;
- Acting in the interests of the client to the extent reasonable in the circumstances;
- Not making statements which are misleading or deceptive or likely to mislead or deceive;
- Not benefiting unreasonably from the client’s lack of financial knowledge or understanding of the advice process;
- Where the adviser has agreed to undertake an action, completing such action in accordance with the agreed timeframe or, where no agreement is made as to the time for completion, a reasonable time in the circumstances, except where any material lateness is reasonable in the circumstances;
- Not entering into client agreements which are unreasonable in the circumstances;
- Charging only fees in connection with the advice which are reasonable in the circumstances for the services provided;
- Not obtaining a personal financial advantage for the adviser or the adviser’s related parties, other than a reasonable fee, without the client’s informed consent; and
- Not subjecting the client to duress or undue pressure in respect of any client decision, except where such decision benefits the client (as reasonably determined at the time of the decision).

Reasoning –Point 5: Some of the behavioural ideals in the draft’s fairness illustrations 1-3 would not ordinarily be regarded as matters of fairness and should be dealt with elsewhere, if at all. While it is ideal that advisers are consistently respectful, listen, consider client views, respond to all concerns and preferences, are timely, clear and effective, it may not be practical to do so in all cases, and advisers should not be liable for such failings, particularly if they are immaterial. The Code has legislative force. There are some ideals that should be left to the market, and not be subject to the weight of law and its enforcement.

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Reasoning –Point 8: “Spirit and intent” should be removed from example six of the commentary. Advisers already are required to comply with the FMCA, FMC Regulations and the Code, which will be interpreted in accordance with their purpose, so there will already be a purposive overlay. It is unclear what a requirement to comply with their “spirit and intent” adds to that. To the extent it adds anything, it would be unpredictable and arguably contrary to the intent of Parliament.

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Q3 Overall, do you agree or disagree with [standard 2] and proposed commentary? **Agree**

Q4 Please provide any comments on [standard 2] and the proposed commentary.

We agree with, and fully support, the duty to act honestly, but have concerns about the certainty of “does the right thing”. Again, the right thing for one, may not be the right thing for others. We suggest, if it is retained, it is defined as anything contrary to the fairness description in Code Standard 1.

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Q5 Overall, do you agree or disagree with [standard 3] and proposed commentary? **Neither agree nor disagree**

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Q6 Please provide any comments on [standard 3] and the proposed commentary.

1. We suggest removing the requirement to “where practicable, avoid conflicts of interest”.

2. As the note to the Standard acknowledges, conflicts of interests are dealt with under section 431J of the FMCA. Disclosure of conflicts would also likely be dealt with by the proposed disclosure regulations. We submit that nothing further is required, or as an alternative that the proposed FMCA wording is adopted as follows:

“A person must manage and disclose conflicts of interest in accordance with the requirements of the FMC Act and FMC Regulations”.

If this wording is retained, we see the potential for uncertainty as to whether a conflict must be “avoided” or “managed”. We consider the section 431J standard to be sufficient.

Reasoning – Point 1: A requirement to, when practical, avoid of conflicts of interest is potentially far reaching. Conflicts of interest occur in all advice situations. There are third party conflicts and conflicts between the interests of clients and the adviser. The adviser has limited resources in terms of time and capacity and needs to prioritise how they are allocated; any allocation of those resources (including time) when they are scarce involves a conflict of interest. Many of these conflicts could be removed practically, at a cost, and so this requirement could be potentially far reaching.

Section 431J does not require conflicts to be avoided, rather it requires their influence to be immaterial. We submit this is the appropriate approach. This is what Parliament has decided. To go substantially further on a matter specifically addressed by the FMC Act is, in our view, not the appropriate function of the Code.

Example-Point 1: Read as it is, the requirement arguably prevents (or requires providers to consider if it is practical avoiding) any form of vertical integration; vertical integration involves conflicts of interests (which can be managed). Those conflicts however can practically be avoided through outsourcing the vertically integrated activities. There has been no policy decision to remove vertical integration in the reforms more generally - section 431J does not go that far. Accordingly, we doubt the Committee intends to do so. We therefore suggest this requirement be removed.

Reasoning –Point 2: Duplication of requirements in the FMCA, particularly if they are worded differently but to the same effect, adds an unnecessary confusion and compliance costs. Accordingly, recast or repeated matters which are fully contained in the FMCA, should instead be incorporated by reference, as our Point 2 proposes.

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Q7 Overall, do you agree or disagree with [standard 4] and proposed commentary? **Agree**

Q8 Please provide any comments on [standard 4] and the proposed commentary.

Code standard 4 adds to the requirement in section 431I to ensure the client understands the nature and scope of the advice. The draft Code additionally requires that the client also understands the material risks and consequences of that nature and scope. Helpfully, the requirement excludes requiring unreasonable steps. On that basis, we have no comments on the proposed Code Standard 4.

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Q9 Overall, do you agree or disagree with [standard 5] and proposed commentary? **Agree**

Q10 Please provide any comments on [standard 5] and the proposed commentary.

Code Standard 5 is similar to the existing AFA Code Standard 9. However, AFA Code Standard 9 applies only when giving personalised advice. Class advice was not subject to the AFA Code's suitability requirements for the reason that it is often provided in a context where the client's particular circumstances are unknown. A lot of advice is given this way.

The application of the suitability requirement to class advice is significant. It effectively requires all regulated advice be personalised, because Code Standard 5 seems to require that the adviser has knowledge of the clients' circumstances – the client's situation, needs, goals and risk tolerance - when making any recommendation or giving any opinion on a financial product to a retail client (other for the excluded activities, journalists, lawyers etc). Clients may not want personalised advice or not be willing to pay for it. Imposing this requirement potentially diminishes client choice, which is contrary to the objectives of the reforms.

Another consequence is that published advice to unknown clients would be prohibited, except when given by a journalist or other excluded person. Broker reports, tip sheets, general recommendations of shares or other financial products would be prohibited or would need to be exempted, if there is a requirement for the adviser to know and have regard to a client's circumstances before giving the financial advice.

We are not suggesting a reversion to the old class / personalised divide. However, we do believe this issue could be easily resolved by adding the following to this standard:

"Code Standard 5 does not apply where the client consents or advice is provided to multiple recipients in a context where the recipients would not expect their particular circumstances to have been considered when preparing the advice".

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Q11 Overall, do you agree or disagree with [standard 6] and proposed commentary? **Neither agree nor disagree**

Q12 Please provide any comments on [standard 6] and the proposed commentary.

There is considerable overlap between Code standard 6 and the Privacy Act. We submit that the requirements be aligned and, for efficiency, any duplication should be removed. This would be best achieved by including solely a reference to the Privacy Act requirements. Alternatively, Code standard 6 could be removed, as the Privacy Act is sufficient.

We also submit that:

- the prohibition on using client information for other purposes in an anonymised form may prevent the useful collection of statistical information for market analysis or consumer trends, which could be to the benefit of the customer.
- destruction or return of client information when it ceases to be useful for the engagement may be inconsistent with other laws (AML/CFT requirements for example), and may also be inconsistent with good commercial practice and a client's desire to be remembered for further subsequent transactions. We suggest this aspect be removed.

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Q13 Overall, do you agree or disagree with [standard 7] and proposed commentary? **Agree**

Q14 Please provide any comments on [standard 7] and the proposed commentary.

For some complaints of a minor nature, it will be suitable and appropriate for the matter to be resolved promptly by the party involved, even if it would be practical for the complaint to be assessed and investigated by an independent person. We submit that the need for independent assessment and investigation should apply only if the matter is not promptly resolved.

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Q15 Overall, do you agree or disagree with [standard 8] **Agree** and proposed commentary?

Q16 Please provide any comments on [standard 8] and the proposed commentary.

The commentary turns a prohibition – not to harm the industry’s reputation - into a positive obligation to promote confident and informed participation. This begs the question, would advisers need to actively undertake promotion activities to satisfy the requirements in the commentary? We submit that the commentary be framed consistently, as a prohibition (so should be prefaced by the phrase “not do anything that would undermine”, or similar).

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Q17 Overall, do you agree or disagree with [standard 9] **Agree** and proposed commentary?

Q18 Please provide any comments on [standard 9] and the proposed commentary.

The draft Code provides flexibility on how persons can demonstrate competence, knowledge and skill. We consider that this flexibility is appropriate given the range of circumstances the Code will cover.

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Q19 Overall, do you agree or disagree with [standard 10] **Agree** and proposed commentary?

Q20 Please provide any comments on [standard 10] and the proposed commentary.

The draft Code provides flexibility on how persons can demonstrate continuing professional education, and has not prescribed a minimum number of hours per year. We consider that this flexibility is appropriate, again because of the range of circumstances the Code will cover.

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Q21 Overall, do you agree or disagree with [standard 11] **Agree** and proposed commentary?

Q22 Please provide any comments on [standard 11] and the proposed commentary.

The Committee's prior consultation indicated that a NZC FS (level 7) standard would be needed for providing investment plans. The draft has adjusted this requirement to a level 5 standard. On that basis, investment planning should not be treated differently to other forms of financial advice and code standards 11 and 12 should be combined.

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Q23 Overall, do you agree or disagree with [standard 12] and proposed commentary? **Agree**

Q24 Please provide any comments on [standard 12] and the proposed commentary.

We had expected that code Standard 12 would specify different levels of skill for each type of financial advice, but consistent with the principled approach this has not been done. There would be some forms of complex advice where higher competence standards might be expected by customers, such advice on CFD and other derivatives trading. We submit that the Committee should consider whether a more tailored approach should be adopted for the different types of advice.

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Q25 Is there anything missing from the draft Code? **No**

Q26 If you answered yes, what is missing? **Respondent skipped this question**

Q27 Do you have any feedback on the examples, or suggestions on other examples that should be included in the draft Code? **Respondent skipped this question**

Q28 Is there anything else you want to say?

The draft Code is a good starting point in our view. The Committee has recognised that the new Code will need to cater for many more situations than the existing AFA Code, which applied only to the provision of personalised financial advice by AFAs.

While we make some points of significance:

- the need for Code Standard 1 to be qualified by "to the extent reasonable in the circumstances";
 - removal of the requirement to avoid conflicts of interest in Code Standard 3; and
 - the need to permit non-personalised advice with client consent and to cater for published advice in Code Standard 5,
- in our view many of the Code Standards are largely suitable to the needs of both customers and advisers and will promote the efficient provision of advice to retail clients.

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Q29 Name

Chapman Tripp (Tim Williams, Brad Kidd and Penny Sheerin)

Q30 Your role or professional title

Law firm

Q31 Individual or organisational submission

This is a submission on behalf of an organisation (eg employer)

Q32 If you give financial advice...

I am not an AFA, RFA or QFE adviser

Q33 My organisation or I give the following types of advice...

Other (please specify):
Chapman Tripp is a leading law firm advising on compliance with the laws relating to giving financial advice

Q34 Organisation Name

Chapman Tripp

Q35 Type of organisation

Law firm

Q36 Size of organisation

Large firm (50+ staff)

Q37 If there are other things we should know about you or your business that would provide context to your answers, please provide details below.

Respondent skipped this question

Q38 Please indicate whether your submission contains any information that is confidential or whether you do not wish your name or any other personal information to be included in a summary of submissions.

Respondent skipped this question

Q39 Please provide your contact details (email and/or phone number) This is the only question that requires an answer. This information would not be released publicly. We may get in touch with you in order to help us understand particular points from your submission.

s 9(2)(a)