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T: +64 9 390 3228
M: +64 22 644 7193
E: simon@cygnuslaw.nz

Code Working Group

c/o Code Secretariat Ministry of Business, Innovation & Employment
Wellington

By email only: code.secretariat@mbie.govt.nz.

Cygnus Law Ltd
Level 8
West Plaza Building
3 Albert Street
Auckland 1010
PO Box 8142
Symonds Street
Auckland 1150

cygnuslaw.nz

Cygnus Law's Submissions on the draft Financial Advice Code

Thank you for the opportunity to provide feedback on the Code Working Group's draft Financial Advice Code (**code**). Cygnus Law's submissions are set out in the schedule to this letter. Cygnus Law provides advice to a wide range of financial service businesses, including financial advisers and financial advice firms, on commercial and regulatory matters.

Yours sincerely
Cygnus Law Ltd

s 9(2)(a)

Simon Papa
Director

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SCHEDULE

SUBMISSIONS ON THE DRAFT FINANCIAL ADVICE CODE

[Standard 1] Treat clients fairly and act in their interests

1. Overall, do you agree or disagree with this standard and proposed commentary? (Agree/Neither agree nor disagree/Disagree/Don't know)
2. Please provide any comments on this standard and the proposed commentary.
 - The commentary introduction refers to "fairness" but not "act in their interests". Yet the commentary appears to relate to both so I propose referring to "act in their interests" also in the commentary introduction.
 - I cannot see how the statements in the commentary that "fairness is not one-sided" and that fairness "depends on the particular circumstances" are helpful. "is not one-sided" suggests that the client has an obligation to be fair. However, this is not a client standard and advisers must still act fairly even if the client is being "unfair". So I propose "is not one-sided" be removed entirely. Nor do I see that fairness is circumstance specific- fairness is a universal value. So I propose that "depend on the circumstances" be removed.
 - Similarly, I propose that the word "usually" be removed and add "(and is not limited to)" after the word "includes". For example, it is difficult to imagine a situation where an adviser would not treat a client with respect or listen to a client.
 - "applying business practices that promote the interests of clients" is a very broad concept- it is difficult to see what this might mean in practice and it is likely to be difficult for smaller FAPs and individual advisers to give practical effect to that. I propose that it be clarified or removed.
 - I propose the following change: "acting in accordance with the spirit and intent of the person's legal obligations"

[Standard 2] Act with integrity

3. Overall, do you agree or disagree with this standard and proposed commentary? (Agree/Neither agree nor disagree/Disagree/Don't know)
4. Please provide any comments on this standard and the proposed commentary.
 - This integrity standard is similar to the Part 2 "fair dealing" standards and section 431D, in the FMC Act. I think there would be value in cross-referencing Part 2 and section 431D in Standard 2.

[Standard 3] Manage conflicts of interests

5. Overall, do you agree or disagree with this standard and proposed commentary? (Agree/Neither agree nor disagree/Disagree/Don't know)
6. Please provide any comments on this standard and the proposed commentary.
 - The principal requirements of the standard is to manage conflicts by "avoiding", "identifying", "controlling" and "disclosing" conflicts of interest and by having "arrangements" in relation to each of them. This creates a *de facto* risk management obligation. However, I don't consider that risk management processes are completely suited to this standard. The issue of

conflicts was carefully considered during drafting of the proposed law and the law reflects a policy to permit conflicts, provided that steps are taken to ensure that the advice is not affected by the conflicts. I don't think a requirement to "where practicable, avoid conflicts of interests" is appropriate, as that sets the starting point as being that conflicts should be avoided altogether. While that is usual in risk management processes it isn't appropriate given the policy settings underpinning the proposed law and section 431J(2). So I propose that that requirement be removed entirely or be replaced with "avoid unnecessary conflicts of interest".

- I'm not sure that "have arrangements" is helpful in all cases. For example, the first obligation is to "have arrangements to avoid conflicts of interest". It's difficult to think what pre-existing arrangements must be in place to avoid conflicts of interest. In some cases advisers may just not have conflicts- it doesn't then follow that they need additional measures to avoid conflicts.
- I don't consider that "ensure that conflicts of interests are controlled in accordance with the requirements of the FMC Act" is necessary or appropriate. "control" is the next step from "avoid" but, again, it appears to move away from the policy that conflicts are permitted. An adviser may choose to have conflicts but, rather than controlling them, may put measures in places to off-set the conflicts, for example a peer review of advice or simply rigorous processes that ensure advice is based on objective criteria that don't take into account factors such as commissions.
- With respect to the obligation to "adequately disclose conflicts", in the hierarchy of proposed management measures this is the least satisfactory and does not, in itself, address the fundamental obligation to ensure that advice is not materially influenced by conflicts. As I noted in submissions on the consultation paper, and based on my experience with other regimes, I think that there will be a continuing belief in some cases that disclosure is, in itself, sufficient to address conflicts. Also, the law itself will include detailed disclosure requirements so it's not clear how an additional disclosure standard will interact with that and whether it will be useful. I propose that, if a disclosure obligation is retained, that it is amended as follows "adequately disclose conflicts of interests to clients in accordance with the FMC Act and FMC Regulations".

[Standard 4] Take reasonable steps to ensure that the client understands the financial advice

7. Overall, do you agree or disagree with this standard and proposed commentary? (Agree/Neither agree nor disagree/Disagree/Don't know)
8. Please provide any comments on this standard and the proposed commentary.
 - I disagree that this standard is, as formulated, effective. It mixes two critical adviser/FAP functions, being to:
 - (1) ensure the "client understands the nature and scope of the advice being given, including any limitations on the nature and scope of the advice" (s431I of the FMC Act); and
 - (2) the client understands risks & consequences regarding following the advice including fees and costs (no specific related obligation at law).

(1) relates to client on-boarding and (2) relates to the final step in the advice process, so it's not clear why they are mixed into one standard, as there is no obvious conceptual link between the two other than that they relate to client understanding. I propose that a

separate standard is included in relation to (1) since it this is a critical feature of the new regime, given that the current advice and product categorisations will be removed, and current concerns about non-advice processes. That new standard could be named “Effectively communicate the nature and scope of financial advice being given”.

- The first part of the standard in relation to nature and scope simply repeats the s431I with the addition of the words “material risks and consequences”. This is inconsistent with the other code standards, which supplement the legal obligations rather than repeating them. So I propose the standard be an elucidation of that requirement. Accordingly the standard could be “A person who gives financial advice must effectively communicate the nature and scope of financial advice being given prior to providing the service”.
- The standard doesn’t clarify when the nature and scope of the financial advice must be provided to the client. I think it’s important that the standard addresses that and that the nature and scope is provided to the client, and necessary client understanding is obtained, prior to providing financial advice services. The example appears to take the opposite approach, and starts by reference to a recommendation and then refers the nature and scope, which seems to suggest that it is acceptable to only explain that once the advice is provided. This would be very unlikely to aid client understanding- clients may not be able to clearly distinguish between risks and consequences of the advice, and of the nature and scope of the advice, when they are discussed at the same time.
- I consider it is important that the standard includes a clearer obligation to disclose in relation to on-going services- it simply refers to “the nature of any on-going support”. I propose that advisers/FAPS are required to advise clients in writing whether the advice service is “one-off” and there are no on-going services (except at the client’s request) or otherwise the nature and extent of the on-going services.
- The standard should include an obligation to document the advice and to clearly identify the FAP and the person (or people) who will provide the advice.
- It is common in the sector for clients to be transferred between businesses, often with little or no notice to the client. I propose that this standard requires that the client contract clearly states whether or not the FAP has the right to assign the client contract to another FAP and that the contract include a process for that, including a requirement for notice to the client that the contract has been assigned and the identity of the new FAP.
- It’s not clear to me how the following is to be applied: “Clients should be able to make informed decisions about... whether to act on the financial advice”. This is obvious but it’s not clear what the obligation on the adviser is in that circumstance. I suggest this be reconsidered and something more concrete be included in the standard.
- Part of the commentary includes a restatement of section 431I (and effectively repeating s431I as reproduced as the code standard). I propose that this be included in a separate box as is the case for some other statements of the law in the code.
- I propose that the standard expressly addresses limited scope and requires that there is a clear statement of what is not covered by the advice, for example that the advice only addresses named products or the products of named providers and does not cover other products/providers.
- I propose that the requirement to take reasonable steps “to ensure that the client also understands the material risks and consequences of that nature and scope” be amended as follows: “to ensure that the client also understands the material risks and consequences of any limitations to the ~~that~~ nature and scope of the financial advice”.

- The commentary commences with “Clients should be able to make informed decisions about the financial advice”. This focuses on the client outcome and doesn’t say anything about what the adviser/FAP needs to do to meet that obligation, which is the focus of the code. I propose it be reworded as “The adviser must take reasonable steps to ensure that the client can make informed decisions about the nature and scope of the financial advice, including...”.
- I don’t consider that the example is appropriate. Given the concerns about conduct that have arisen out of the Royal Commission in Australia, including the way general advice processes were being used to give clients a false sense that they were receiving personalised advice, I don’t think that the example should focus on a clear example of limited advice. That’s particularly the case when it is not obvious why an adviser in the circumstances would consider it appropriate to give limited advice. For example, the RBNZ/FMA report *Bank Conduct and Culture: Findings from an FMA and RBNZ review of conduct and culture in New Zealand retail banks* (November 2018) states that “To maintain trust and confidence in our financial institutions and systems, banks need to think and act beyond minimum legal and regulatory standards, and champion business models that focus on customer interests.” It is surely in the customer interests in the example to consider the existing policies unless the customer herself makes it clear she is not interested in getting that advice.
- I don’t consider that the example is an appropriate example of explaining risks and consequences. The explanation is anaemic. It uses technical jargon (underwriting, loading) that a retail client is unlikely to understand. It appears to suggest that the word “risk” need not be used- in that absence of a clear statement that this is a “risk” the client may not understand the seriousness of the consequences.

[Standard 5] Give financial advice that is suitable for the client

9. Overall, do you agree or disagree with this standard and proposed commentary? (Agree/Neither agree nor disagree/Disagree/Don’t know)

10. Please provide any comments on this standard and the proposed commentary.

- I suggest that the following change be made: “Suitability, in this context, requires the financial advice to be matched to the client’s circumstances so that the product or plan is appropriate for the client, ~~having regard~~ subject to the nature and scope of the financial advice.”
- I comment on the following part of the commentary below: “In some situations, an in-depth analysis of the client’s circumstances may be required. In others, it may be reasonable to conclude that the financial advice is suitable where the client’s circumstances include particular characteristics.”

I don’t consider this is particularly helpful and I query whether the code should actively support more limited consideration of circumstances. The term “where the client’s circumstances include particular characteristics” incorporates an amorphous concept (“characteristics”) from the Financial Advisers Act. Also, as noted above, the recent concerns expressed by the FMA and RBNZ about bank conduct support a more robust approach. I propose the following alternative: “The person should ensure that sufficient information is obtained about the client’s circumstances to help to ensure that the advice is suitable.”

- I proposed the following amendment: “The person giving the advice ~~should~~ must be able to demonstrate that it is reasonable to rely on the other person.”
- The example is long and addresses multiple code standards. It is more in the nature of an example included in a regulator guidance note and in my view is not suitable for a code. For example, it addresses a limited service. As noted in relation to code standard 4, recent issues

identified as a consequence of the Australian Royal Commission mean that it wouldn't be appropriate for the code to actively support limited advice services. Other concerns I have with the example are:

- The client doesn't appear to receive any written advice at the time the advice is provided. While there may be circumstances where limited when that is appropriate in my view the client should always be provided with some form of written advice even if after the advice is provided.
- There is no indication that the client is advised of the material risks and consequences of the limited advice, as required by code standard 5.
- The reference to file note appears to reflect a desire to set a standard for record keeping. I don't think the example in relation to standard 5 is the appropriate place for this and standards regarding record keeping should be set out elsewhere and an example given, if necessary.

[Standard 6] Protect client information

11. Overall, do you agree or disagree with this standard and proposed commentary? (Agree/Neither agree nor disagree/Disagree/Don't know)

12. Please provide any comments on this standard and the proposed commentary.

- The Privacy Act and other specific law already addresses the matters covered by this code standard, as noted in the standard.
- The reality in almost all cases is that the law will specify the length of time client information must be held for. Accordingly, I don't think it's particularly helpful to state "Client information should only be held for as long as it is required for the purposes of the engagement".
- I think that this code standard could be removed. I think it could be helpfully turned into a record keeping standard. Poor record keeping has been a constant theme in Financial Advisers Disciplinary Committee decisions and FMA commentaries. So the code is an opportunity to set clear standards in that regard.

[Standard 7] Resolve complaints

13. Overall, do you agree or disagree with this standard and proposed commentary? (Agree/Neither agree nor disagree/Disagree/Don't know)

14. Please provide any comments on this standard and the proposed commentary.

- I propose the following changes:
 - “A person who gives financial advice must ~~have provide~~ arrangements for resolving complaints by clients.
 - A complaint is an expression of dissatisfaction (whether written or verbal) made to or about a person, related to ~~its a person's products, services, staff or conduct the handling of a complaint~~, where a response or resolution is explicitly or implicitly expected or legally required.”
- The code is a service code so I've deleted reference to "products" and added "conduct" since conduct is central to regulatory and code obligations.
- I've deleted "or the handling of a complaint" because that seems to be circular i.e. this could lead to complaints about complaints about complaints- it's probably better for the complaint

to be treated as a standard complaint e.g. a failure to properly consider a complaint is a conduct failure.

- I propose the following changes:

“Where reasonably practicable, the investigation and assessment of complaints (except minor complaints) should be independent of any individual who may have been involved in the cause of the complaint.”

The second change acknowledges that it should be possible for minor complaints to be resolved quickly and easily, without the need to escalate the complaint.

[Standard 8] Not bring the financial advice industry into disrepute

15. Overall, do you agree or disagree with this standard and proposed commentary? (Agree/Neither agree nor disagree/Disagree/Don't know)

16. Please provide any comments on this standard and the proposed commentary.

- This clarification at the end regarding not preventing comments in good faith etc does not refer to potential legal obligations that may apply, including under the Privacy Act. I suggest that the first bullet point be amended as follows (to avoid any doubt):

“commenting (subject to obligations in legislation) in good faith on the business, actions, or inactions of any other person (including any financial advice provider, financial adviser, regulatory authority, or industry body), or regarding the industry generally”

[Standard 9] Have general competence, knowledge, and skill

17. Overall, do you agree or disagree with this standard and proposed commentary? (Agree/Neither agree nor disagree/Disagree/Don't know)

18. Please provide any comments on this standard and the proposed commentary.

- With regard to the introduction to Part 2, it commences with the section 431K duty. Part 2 also relates to competence and skill, which is also provided for in the section 431H duty. So, if section 431K is referred to is the introduction section 431H should be referred to also.
- “Entities” is now a defined term in the Financial Services Legislation Amendment Bill (FSLAB) in relation to certain entities able to provide a financial advice service (see section 22(2) of FSLAB). Also, sole traders can be FAPs (and aren't “individuals” in that context) so the term “entity” is not a natural fit in that context. So I recommend you don't use the term “entities” in the code.
- I propose that the two bullet points under the “entities” heading clearly specify that first bullet point relates to non-roboadvice services and the second to roboadvice services (this probably won't be obvious to many people reading the code).
- With respect to nominated representatives I don't consider it helpful (or conceptually consistent) to imbue the nominated representative with the required skills and experience of a financial adviser by reference to the procedures, systems and expertise of the FAP. This isn't the concept advanced in the section 431Q, which requires the advice given by the nominated representative is commensurate with the nominated representative's competence, knowledge and skill. In that regard nominated representatives are not treated differently from financial advisers- they must all meet required standards. There is no reference in section 431Q to the nominated representative compensating for a lack of competence, knowledge and skill by relying on the FAP. The approach of the code would

appear to suggest the nominated representative is a form of “robo-adviser” who doesn’t need to exercise independent skill or judgment. Again, I don’t think this is consistent (or permitted by) section 431Q. I propose the following changes:

“complete the learning outcomes specified for their role by their financial advice provider that mean that, ~~together with the procedures, systems and expertise of the financial advice provider,~~ the nominated representative has the competence, knowledge and skill necessary to ensure that nominated representative complies with his or her duties under the FMC Act. ~~capabilities equivalent to those of an individual who alone has achieved the general qualification outcomes.”~~

I propose that the example be amended consistently with that.

- The requirement for the equivalence of the alternative qualification to be “independently verifiable” appears to set a very high standard and doesn’t add much to the requirement that the equivalence is “objective” and “measurable”, which already sets a high standard. I query whether the standard needs to be so high as to be nearly unattainable. This may be particularly onerous for advisers with high-quality off-shore qualifications, especially when advisers with older qualifications don’t have to meet such a high bar. So I propose that “independently verifiable” be deleted as a minimum.

[Standard 10] Keep competence, knowledge, and skill up-to-date

19. Overall, do you agree or disagree with this standard and proposed commentary? (Agree/Neither agree nor disagree/Disagree/Don’t know)

20. Please provide any comments on this standard and the proposed commentary.

- I strongly disagree with the draft code not including a set minimum requirement for CPD. That’s because the function of a code is to give clarity regarding such obligations. Without that thousands of individual advisers will have to determine what is appropriate without the necessary skills or framework in some cases to do so. This will likely lead to *de facto* market standards developing that undermine the intention of the proposed code standard of permitting flexibility. A minimum requirement does not preclude a requirement for more extensive CPD in individual cases and my own experience with lawyer CPD requirements is the minimum requirements are often significantly exceeded. However, without a minimum there is a risk that some advisers may do little or no appropriate CPD.

[Standard 11] Have particular competence, knowledge, and skill for designing an investment plan

21. Overall, do you agree or disagree with this standard and proposed commentary? (Agree/Neither agree nor disagree/Disagree/Don’t know)

- Please see my comments on code standard 9.

[Standard 12] Have particular competence, knowledge, and skill for other types of financial advice

22. Overall, do you agree or disagree with this standard and proposed commentary? (Agree/Neither agree nor disagree/Disagree/Don’t know)

23. Please provide any comments on this standard and the proposed commentary.

- Please see my comments on code standard 9.

General questions

24. Is there anything missing from the draft Code?

- Yes

25. If you answered yes, what is missing?

- Standard 3 of the Code of Professional Conduct for Authorised Financial Advisers imposes restrictions regarding the use of the word “independent”. The Australian Corporations Act includes express requirements regarding use of terms such as “independent”, “impartial” or “unbiased”. ASIC has recently taken steps to enforce those obligations with respect to financial advisers. Accordingly, I think it would be appropriate that the code includes provisions similar to those in code standard 3. I also think it’s appropriate because the FMC Act does not prohibit conflicts of interest- it is then important to ensure that truly independent advisers can get the benefit of using the term “independent”.

26. Do you have any feedback on the examples, or suggestions on other examples that should be included in the draft Code?

- Please see my comments above. I suggest that the code includes quite a few more examples to assist the many individual advisers who will need to implement code standards.

27. Is there anything else you want to say?

- The introduction to the code states “The code is part of a wider regulatory regime for financial advice. Persons who give financial advice also have obligations under other parts of the regime, including under the FMC Act and regulations made under that Act (FMC Regulations).” I propose that the code clarifies and confirms the status of the code by adding the following additional sentence “The code applies in addition to and does not replace those other obligations”.
- As noted in several places in the submissions, the code is inconsistent regarding how it refers to requirements set out in the FMC Act. In some cases those requirements are separately identified together with the relevant section. In other cases they are incorporated into the standard without reference to their derivation from the FMC Act or are not referred to at all though directly relevant to the particular code standard. I’ve made proposals for addressing some instances of that but I think the committee should attempt to develop a more consistent approach to referencing the FMC Act requirements to aid adviser and FAP understanding and compliance with their obligations.
- This code will have to be used and interpreted by thousands of individual advisers. While I appreciate that the code committee does not want to set prescriptive process requirements that does not mean that individual standards cannot be detailed and set fixed standards in some circumstances. In that regard I query whether abstract or nebulous terms, such as “arrangements” and “business practices”, should be replaced with more concrete language that gives clearer guidance to those advisers.

28. Is there anything in the proposed Code that you can identify that creates an inappropriate barrier to delivering to a consumer a product or service that such a consumer might otherwise reasonably expect to be available to them?

29. Is there anything in the proposed Code that creates a barrier to either the financial advice provider (including related Financial Advisers and Nominated Representatives) or the consumer from respectively offering or receiving the products or services within their respective capabilities and preferences?

Final questions – tell us about yourself *(Please note this information will be published with your submission unless there is a withholding ground under the Official Information Act. Responses are optional.)*

30. What is your name?

- Simon Papa

31. Your role or professional title

- Lawyer

32. Is this an individual submission or on behalf of an organisation?

- On behalf of an organisation.

33. If you give financial advice, are you an AFA, RFA, QFE adviser or other?

- NA

34. What types of financial advice do you or your organisation give?

- NA

35. What's your organisation's name?

- Cygnus Law Ltd

36. What type of organisation is it? (e.g. bank, dealer group, independent adviser, education provider):

- Law firm

37. Is your organisation's size small (1–10 staff), medium (10–50 staff) or large (50+ staff)?

- Small

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

39. 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.

- There is no confidential information in this submission and it can be included in a summary of submissions.

40. Please provide your contact details (email and/or phone number) Your contact details 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)