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Code Working Group

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Cygnus Law's Submissions on the Code of Professional Conduct for Financial Advice Services Consultation Paper

Thank you for the opportunity to provide feedback on the Code Working Group's Consultation Paper (**Paper**) on the proposed Code of Professional Conduct for Financial Advice Services (**Code**). Cygnus Law's submissions on key matters are set out in the introduction below with further detailed submissions in the Schedule using the submission template. I refer to the current *Code of Professional Conduct for AFAs* as the "Current Code".

Cygnus Law provides advice to a wide range of financial service businesses, including financial advisers and financial advice firms, on commercial and regulatory matters. I worked for 2½ years as a Senior Solicitor at the FMA, which including working on matters relating to financial advisers. While at FMA I was part of the work group that developed the licensing standards for market service licences. I have been a lawyer for 15 years and in that role I am subject to a detailed professional code, the *Rules of conduct and client care for lawyers (RCCC)*. The RCCC are comprehensive and clear and play an important role in guiding decision making in a complex world- I refer to my the RCCC in these submissions.

I commend the Working Group's efforts so far undertaking a complex task in a sometimes difficult environment.

INTRODUCTION

1. Principles-based Code

1.1 I don't consider adopting a "principles-based" Code is appropriate. A code is, by its very nature, intended to be a detailed set of rules for the area it relates to. For example, the *Butterworths New Zealand Law Dictionary* (2001) defines a "code" as (page 50):

"either a whole system of law, such as the Code Napoleon of France, or the whole of the law on a particular subject, such as the Bills of Exchange Act. A codifying statute is an Act which purports to be a complete statement of the law on the particular subject (both the statute law and the common law) at the time when it is passed...."

While the definition is focused on statutory law I consider that the same approach should apply with respect to the Code. The Code should be a complete statement of the matters to which it relates, being minimum standards of professional conduct. Regardless of what that means in practice, I don't think it supports a "principles-based" approach in the sense that

term is used. In particular, I don't consider that FMA's *A guide to the FMA's view of conduct* is an appropriate model or starting point for a code of conduct.

- 1.2 It follows from that codes are not usually short, simple or high-level documents. For example, the RCCC is 46 pages. I think the Code should provide as much practical guidance as possible. That approach does not mean it must exclude principles-based matters. However, there should be additional detail that underlies those principles to provide real guidance on what they mean in practice.
- 1.3 While the code must apply to businesses of very different sizes and models, I think in many cases that the Code standards will not differ markedly. And I query whether it is particularly helpful to designate the Current Code as an "occupational code" versus the Code as a "service code". The Code is still a code to "provide for standards of *professional conduct*" (emphasis added). In many cases what professional conduct looks like will be the same whether a person or entity engaging in conduct- the customer should be entitled to expect the same service in either case. For example, I would expect the ethical standards applied by a company to be the same as those applied by an individual adviser.
- 1.4 I think it is very important that the Code provides practical and detailed guidance for the large majority of financial advice firms that will be relatively small. The costs of principles-based approaches to law and regulation for such businesses are often significant. Most small businesses do not have the resource or capability to easily divine meaning from the increasing number of principles-based documents. I think it is entirely appropriate to allow larger firms to take a divergent approach to compliance in some cases where they wish to do so, provided they are satisfied that they meet the required standards.

2. Licence vs Code of Conduct

- 2.1 The firms subject to the Code will also be subject to a full licensing regime operated by FMA. I think that there are a number of areas where the proposed Code strays into the standards and requirements that will likely be mandated by FMA via the licensing process, including in relation to staffing, training, IT systems, operational capability, culture, governance and conflicts. I query whether the proposed approach to the Code creates a licensing-type process, with indications that firms will need to, for example, put in place "assurance processes" and "document the processes they have in place to avoid conflicts of interest".
- 2.2 I don't think there is a good reason to have the same or similar requirements in different regimes and I've tried to identify some potential overlaps in the submissions. More broadly, while the Code should be a detailed document, it was not intended to create a quasi-licensing regime and I think it should focus on practical guidance. Statements such as "organisational arrangements support the delivery of good advice outcomes" are only meaningful to experts in compliance systems - I don't think they have a place in a code of conduct.
- 2.3 The purpose of the Code in my view is to articulate "what" a firm and adviser should do. I'm not sure the Code always needs to articulate "how" the firm or adviser does that. So it will be necessary, for example, to set ethical standards (the "what") but I don't think it necessarily follows that the "how" needs to be stated in all cases e.g. the firm must provide training in ethics to staff. Training in that context could be safely left to the discretion of the firm, which will already have the capability to implement and operate appropriate compliance systems for that purpose through licensing. Also, in the case of a small firm staffed entirely by financial advisers (outside administrative roles), who are likely to receive ethics training as part of meeting minimum education requirements, it may be satisfied that ethical conduct can be achieved without having to implement particular training requirements for the firm as a whole.

3. Good Advice Outcomes

- 3.1 I don't consider that it is appropriate or necessary to apply the concept of "good advice outcomes" to aid in developing the Code, for the following reasons:
- a The Paper notes that "Building blocks for the principles of good conduct are outlined in the Financial Markets Authority's conduct guidance note". The FMA itself in that guidance note states that it does "not create, replace, or even supplement, existing legal obligations". The concept of "good outcomes" is not used anywhere in New Zealand statute or regulation. In my view the term "good advice outcomes" has very little explanatory force that can guide the creation of Code standards in a meaningful way. Taking those factors into account, I don't think it is appropriate to use a concept with little explanatory force, that has no basis in law, and that was first adopted in a non-legally binding guidance note, as the key organising principle for the Code.
 - b I fully agree that the Code should be client centric. The Code itself exists within a statutory framework that governs financial advice services and the standards expected. A duty of care will be specified in the proposed section 431K of the FMC Act- "A person who gives regulated financial advice must exercise the care, diligence, and skill that a prudent person engaged in the business of giving regulated financial advice would exercise in the same circumstances.". This in my view is a better standard for considering what conduct should be exhibited by advisers and what outcomes should be expected by clients.

Yours sincerely
Cygnus Law Ltd

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Simon Papa
Director

SCHEDULE

Principles for drafting the Code

<i>Share your views</i>	
A.	<p>What comments do you have regarding the overarching theme of “good advice outcomes” and the underlying principles?</p> <p>See my comments above at paragraph 3- I don’t think inclusion of that theme is necessary, appropriate or particularly helpful.</p>
B.	<p>Are there any further principles that should be included, or existing principles that should be removed?</p> <p>I strongly disagree with the principle that the Code should be “drafted on the assumption that most retail clients have basic knowledge but not the Financial Advice Provider’s expert understanding”. I don’t consider that will contribute to good advice outcomes. This appears to be designed to protect advisers rather than to develop a Code that ensures clients get appropriate advice that they can understand. The reality is that many people lack basic knowledge in key areas governed by this regime- that’s often why they’re seeking advice. The Code should accommodate the needs of those people.</p>

Ethical behaviour

Act with honesty, fairness and integrity

<i>Share your views</i>	
C.	<p>Do you agree with a requirement to act with honesty, fairness and integrity? If not, please set out your reasoning.</p> <p>Yes, I agree with that requirement. I query the assumption that different types of ethics will apply in different types of firms or that there are different categories of ethical behaviour, one focused on advice-giving and the other on organisational standards. I also query whether it is helpful to try to break down ethical behaviour into so many categories and with a focus on the different status of the relevant organisations and their personnel. Ultimately ethical behaviour will be determined by the conduct of individuals within the organisation. I propose that the ethical standards apply to both organisations and individuals. In most cases the requirements should not differ markedly, whether the matters relate to independence, conflicts, rewards etc.</p> <p>With respect to the minimum standards specified in paragraph 84, while I accept that it is appropriate to “Manage and fully disclose conflicts of interest”, the firms are already subject to a statutory obligation to “give priority to” their clients’ interests. Based on my experience with other regimes, I think that there will be a continuing belief among some advisers that disclosure is, in itself, sufficient to address conflicts. I propose that where disclosing conflicts of interest is referred to the Code, the Code makes it clear that disclosure is not, in itself, sufficient to meet the statutory duty to “give priority to” clients’ interests.</p>

Keep the commitments you make to your client

D.	<p>Should minimum standards for ethical behaviour for the provision of financial advice extend beyond strict legal obligations, to include meeting less formal understandings, impressions or expectations that do not necessarily amount to strictly legal obligations? If no, please give reasoning. If yes, please propose how a standard for such commitments might be framed.</p> <p>I don’t think that it is necessary to specifically address commitments in the context of ethics. Many other parts of the FMC Act, regulations and the Code govern behaviour towards clients. And the law of contract (statutory and common law) in New Zealand provides very significant guidance as to how and when legal obligations arise. Some of that law will favour clients in any case. This is a very complex area so I don’t think it is necessary, and may be confusing, to try to address these matters in the context of ethical obligations in the Code.</p>
E.	<p>If there was a minimum standard requiring Financial Advice Providers – or Financial Advice Providers in some situations – to have their own code of ethics in addition to the Code, how would you frame the requirement for it to deal with keeping commitments?</p> <p>I don’t think it would be easy to frame that. Even the term “strict legal obligations” is problematic in my view. Obligations are either legal or they are not- being “strict” implies some sort of sliding scale that does not exist.</p>

Manage and fully disclose conflicts of interest

<p>F.</p>	<p>Should the Code include a minimum standard on conflicts of interest in addition to the legislation?</p> <p>I think the Code should include minimum standards. However, as the Paper notes, the law itself will include a detailed standard with regard to conflicts, in the “Duty to give priority to client’s interests” in the proposed section 431J of the FMC Act. Accordingly, the minimum standards should follow and be consistent with section 431J. It follows, and as noted in answer to question C, particular care is required with respect to statements in the Code about disclosure and communication of conflicts - the Code should make it clear that disclosure does not remedy a conflict that breaches law, including section 431J. So while paragraph 94 states that “They are just a part of the way that business model works” that does not permit legal obligations to be overridden.</p> <p>On the other hand, the proposed law does not prohibit conflicts but rather sets limits on their impact where they do arise (tacitly accepting the possibility of conflicts). So I think it follows that the Code should not set, as a starting point, that conflicts should be avoided altogether.</p> <p>Likewise with regard to requiring processes to manage conflicts of interest- these must take into account and be consistent with the statutory obligations in section 431J.</p>
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Do no harm to the client or the profession

<p>G.</p>	<p>Do you agree that a person who gives financial advice must not do anything or make an omission that would or would be likely to bring the financial advice profession into disrepute? If not, please set out your reasoning.</p> <p>I agree.</p>
<p>H.</p>	<p>Is an additional minimum standard on doing no harm to the client necessary? If so, what standard do you propose?</p>

Keep your client’s data confidential

<p>I.</p>	<p>In which situations, if any, should the retention, use or sharing of anonymised bulk customer data be subject to Code standards?</p> <p>Retention is likely to be a matter covered by licensing requirements so I propose that it is not addressed in the Code.</p>
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J.	<p>Do you agree that the Code should cover the various aspects of maintaining client confidentiality discussed in this paper?</p> <p>Yes. However, matters relating to physical security are likely to be addressed in licence requirements. So I suggest confidentiality obligations are limited to obligations to clients rather than how those obligations are met in a practical sense.</p> <p>With respect to “Client information should only be held for as long as it is required, then should be disposed of, or deleted, securely”- if a statement to that effect is included in the Code I propose that the statutory record keeping obligation is also referred, to avoid any suggestion that relevant information can be held for a lesser time based on the Code standard.</p>
K.	<p>Are there other aspects of maintaining client confidentiality to consider?</p>

Ethical processes in Financial Advice Provider entities

L.	<p>Do you agree that the Code should require the Financial Advice Provider to document and maintain its “ethical processes”?</p> <p>No. As noted in the introduction, this creates significant burden, especially with respect to small businesses, and likely overlaps with licensing requirements, including those in relation to “culture”.</p>
M.	<p>Should the Financial Advice Provider be required to have a publicly available corporate code of ethics? Are there particular situations where a corporate code of ethics should be or should not be required?</p> <p>I don’t think this should be addressed by the Code. This will likely be relevant in the context of the licence and the also FMA’s <i>Corporate Governance Handbook</i>.</p>
N.	<p>Should Financial Advice Providers also be subject to additional standards in respect of leadership and culture? If so, how should these be framed?</p> <p>Again, this is likely to be covered by the licence, including in relation to “capability”, “culture” and “governance”.</p>
O.	<p>Do you propose other additional standards of ethical behaviour that should apply to Financial Advice Providers?</p>

Ethics training

P.	<p>Do you agree that Financial Advice Providers should be required to meet standards relating to ethics training? If not, please state your reasoning.</p> <p>As noted in the introduction, I think that should be left to the educational standards for advisers and to the firms themselves to decide based on their particular circumstances and needs.</p>
Q.	<p>Should ethics training requirements apply to all officers and employees of a Financial Advice Provider, as appropriate to their role and contribution to the process of financial advice provision? If not, please state your reasoning.</p> <p>As noted, this should be left to be determined by the firm.</p>
R.	<p>Should there be a requirement for ongoing refresher training on ethics?</p>

Resolving ethical dilemmas

S.	<p>Do you agree that Financial Advice Providers should be required to have in place, and use, a framework for resolving ethical dilemmas that may arise in giving financial advice? If not, please set out your reasoning.</p> <p>I query whether there should be many instances where ethical dilemmas arise. The RCCC, for example, set out detailed rules in many areas of ethics. In my experience it is very rare that there is not an obvious answer in the circumstances. The IOSCO report process for resolving ethical dilemmas is, in my view, of little practical help.</p> <p>Requiring processes for “resolving ethical dilemmas” is not a legal requirement for any other type of financial services business (some of which are subject to specific ethical obligations) so I can see no reason to require it for a financial advice business.</p> <p>More broadly, I’m concerned that including the concept of “ethical dilemmas” in the Code will create a culture or acceptance of “balancing” ethical considerations with respect to clear ethical standards.</p>
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Compliance functions

T.	<p>Should there be a requirement for explicit sign-off on the soundness of financial advice provided directly by a Financial Advice Provider?</p> <p>I’m not sure there is much benefit to be gained from that. I don’t think it’s necessary in all cases for the Code to specify how particular conduct standards are met.</p>
U.	<p>Do you agree that Financial Advice Providers should be required to have in place a compliance function aimed at following up on concerns raised by employees and other stakeholders? If not, please set out your reasoning.</p> <p>No. What is required will differ very much depending on the size of the particular firm.</p> <p>I don’t think the reference to “other stakeholders”, without more explanation as to what that means, is particularly helpful- it’s unlikely most providers will be able to articulate a clear process to deal with that.</p>

V.	<p>Should this extend further into an internal audit obligation, having in place processes to systematically test for and detect violations of ethical behaviour?</p> <p>This is getting into detailed internal operational matters- if appropriate it is better dealt with as part of the licensing standards.</p>
W.	<p>Are there any potential compliance costs for small and/or large Financial Advice Providers that need to be considered?</p> <p>Yes. The very large majority of firms will need to obtain a licence for the first time. Based on the other licensing regimes that have been implemented in the last 5 years, licensing in itself will be a difficult and costly process for many (on top of other new requirements for RFAs). Having to implement further licence-type requirements via the Code will impose even greater cost and effort. In my view those costs do not justify the related benefit.</p>

Responsibility for the whole advice process

X.	<p>Do you agree that Financial Advice Providers should be required to be able to demonstrate that they meet the standards of ethical behaviour as if the Financial Advice Provider carried out the whole advice process directly itself? If not, please set out your reasoning.</p> <p>Yes. That is critical. However, the firm cannot contract out of its obligations at law. So I query whether it's actually necessary to impose this requirement. If it is included I suggest that it is stated "for the avoidance of doubt".</p>
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Reinforcing good ethical behaviour

Y.	<p>What principle or mechanism do you propose the Code could include to reinforce good ethical behaviour on a day-to-day basis?</p> <p>This seems ambitious and, given the other disclosure and conduct obligations that will apply in any case, I can't see this providing much, if any, benefit. If not properly implemented it's more likely in my view to add additional complexity to the advice process with little real benefit for the client.</p>
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Conduct and client care

Advice situations

<i>Share your views</i>	
Z.	<p>Are there other delivery methods that should be considered when testing our thinking?</p> <p>The proposal for “organisational standards” overlaps with licensing requirements, which will already impose similar requirements to support compliance. So I see little merit in including such standards in the Code. I doubt many small businesses have the resource to divine much meaning from a very broad concept like “organisational arrangements support the delivery of good advice outcomes”. As I noted in the introduction the Code should be a detailed guide to conduct - it should not introduce concepts that are difficult to apply in practice.</p>

Advice-giving standards

AA.	<p>How do the current client care standards work in practice, especially in advice-giving situations not previously covered by the AFA Code? In answering this question, please ignore “scope of advice” (CS-8) and “suitability” (CS-9 and part of CS-10).</p>
BB.	<p>Could any aspect of the current client care standards be worded better? (For example, we are aware that the definition of “complaint” could be improved.)</p>
CC.	<p>Are there any aspects of the current client care standards that could be expanded or clarified (for example, in light of the published findings of the Disciplinary Committee)?</p>
DD.	<p>Are there any potential compliance costs for small and/or large Financial Advice Providers that need to be considered?</p>
EE.	<p>Are there any additional matters that should be addressed in the advice-giving standards? Those listed above? Others?</p> <p>I don’t think that cyber risk and security need to be addressed- these matters are likely to be addressed in licensing requirements.</p> <p>I do think transfer of clients should be addressed- this should be a more client-centric process than currently.</p> <p>It is unclear to me what the trail commission standard is addressed at. If it relates to arrangements between product providers, dealer groups, firms and/or advisers (but not clients) in relation to advice on insurance or loans, I’m not sure the Code is the appropriate place to address that, unless there are ethical or other considerations arising relevant to clients.</p>

Advice process

FF.	Do you think there are any other components that should be included in the design considerations of an advice process?
GG.	Should the Code include guidance material to help determine what needs to be considered when designing an advice process?
HH.	<p>Are there any other important aspects you think should be included in the advice process for all types of financial advice activities under the new regime?</p> <p>With regard to verbal advice, there should be a requirement that the advice is provided in writing promptly after providing the verbal advice.</p>
II.	<p>Should any of the key aspects that we have listed above be removed? If so, why?</p> <p>I do not see how having the “client actively acknowledges that they understand the risks and benefits of following the recommendation” is of particular benefit to the client. This appears to be a process more focused on protecting the adviser, which may draw focus away from ensuring the adviser has followed an appropriate advice process and communicated effectively with clients. Risks and benefits can be appropriately recorded in the statement of advice.</p>
JJ.	Are there any situations in which an advice process need not be followed?

Personalised suitability

KK.	<p>What comments do you have about a proposed minimum standard on personalised suitability analysis? What are your views on the example above?</p> <p>I don't think the standard of “good advice outcomes” is helpful in this context. Rather, I think the focus should be on ensuring the scope is clear and properly communicated to the client so the client understands the limitations. Ultimately it is for the client to decide what type of advice they are seeking. In that regard I think the example in paragraph 141 is largely appropriate. Following that process it will be possible to provide affordable advice, being the advice the client is seeking in the circumstances.</p>
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Organisational standards

LL.	<p>What are the practical advantages and disadvantages of including organisational standards as described? What explanatory material or examples could we provide in the Code that might help to make these standards easier to comply with in practice?</p> <p>These organisational standards will likely replicate many of the licence standards and so provide little additional benefit but will impose significantly more costs of the licensed firms. The FMA guide to conduct is high-level and conceptual and will be difficult to utilise in a practical way by the many small firms that will be operating under the Code.</p>
MM.	<p>Would implementing these organisational conduct and client care standards create a particular compliance burden for your firm? If yes, please explain why.</p> <p>Yes, as noted at LL, these standards will likely overlap with licence standards and are generally not appropriate for a code governing professional conduct.</p>

General competence, knowledge and skills

<i>Share your views</i>	
NN.	<p>Do you agree with our interpretation of the meaning of “competence, knowledge, and skills”? If not, why not?</p>
OO.	<p>Are there other factors, which contribute to combined expertise, that we have not listed? We are particularly interested in factors that are relevant to financial advice that is given by a Financial Advice Provider directly, including by digital means.</p> <p>It’s likely that the licensing process will require that the financial advice provider has the required expertise via the “capability” minimum standard that is included in all current market service licence application guides. That will also cover the required expertise when the service is delivered by digital means. So I don’t think it is necessary to include the type of standard proposed in paragraph 166.</p>
PP.	<p>What do you think are the advantages of this approach to general competence, knowledge and skills?</p>
QQ.	<p>What do you think are the disadvantages of this approach to general competence, knowledge and skills?</p>
RR.	<p>In what ways do you think this proposed standard contributes to, or detracts from, the legislative purposes (for example ensuring the quality and availability of advice, avoiding unnecessary compliance costs, and promoting innovation and flexibility)?</p> <p>As noted, there are mechanisms in place in the proposed regime to contribute to meeting the proposed minimum standard, so I don’t think the proposed standard contributes, in a cost-effective or meaningful way, to meeting the legislative purposes.</p>

SS.	What factors should we consider in determining whether to make the proposed unit standard a renewing obligation?
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Particular competence, knowledge and skills

<i>Share your views</i>	
TT.	What are the advantages and disadvantages of our approach of identifying two types of financial advice? What impact would it have on the type of advice you give and on your compliance costs?
UU.	How should RFA's experience be recognised?
VV.	What do you think are the advantages of this approach to particular competence, knowledge, and skill?
WW.	What do you think are the disadvantages of this approach to particular competence, knowledge, and skill?
XX.	In what ways do you think this proposed standard contributes to, or detracts from, the legislative purposes (for example ensuring the quality and availability of advice, avoiding unnecessary compliance costs, and promoting innovation and flexibility)?
YY.	What alterations, if any, would you suggest to the baselines we have nominated: specialist strand for product capability, Level 5 for discipline capability, and relevant degree (or other degree plus Level 6) for planning capability?

Other comments

<i>Share your views</i>	
ZZ.	Are there any other comments you would like to make to assist us in developing the Code?