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Code Working Group
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Submission by Kensington Swan in relation to the Code of Professional Conduct for Financial Advice Services

- 1 This is a submission by Kensington Swan on the Consultation Paper dated Monday 12 March 2018 ('Paper') released by the Code Working Group in relation to the proposed Code of Professional Conduct for Financial Advice Services ('Code').

About Kensington Swan

- 2 Kensington Swan is one of New Zealand's premier law firms with a legal team comprising over 100 lawyers acting on government, commercial, and financial markets projects from our offices in Wellington and Auckland. The 2018 editions of the *Chambers and Partners Asia-Pacific Guide* and *The Legal 500* rank Kensington Swan as Band 1 in Investment Funds, and rank financial markets partners Catriona Grover and David Ireland as Band 1 lawyers and leading individuals.
- 3 We have extensive experience advising a range of organisations that provide financial adviser services, from major fund managers and insurers to brokers and sole adviser practices. We act for many advisers, QFEs, brokers, and other financial markets participants. We assist our clients with their regulatory compliance obligations and initiatives aimed at providing effective, relevant financial advice services to consumers.
- 4 Like the Code Working Group, we submitted to the Economic Development, Science and Innovation Select Committee following the first reading of the Financial Services Legislation Amendment Bill ('FSLAB'). A number of the points we made would impact on the content of the Code, meaning that a number of the points we raise below are subject to the final form of FSLAB. As recommended in the Paper, we have proceeded on the assumption that the Code Working Group's submissions on FSLAB will be adopted, but note that there are a number of variables in the legislation yet to be finalised.

General comments

- 5 Rather than submitting on each of the numbered questions, we have limited our submission points to those we have identified as having legal or compliance assurance implications, or that raise jurisdictional concerns.
- 6 As an initial background comment, we note the content of the Code must support the new purposes of the Financial Markets Conduct Act 2013 ('FMC Act') proposed by FSLAB, of regulating the giving of financial advice and provision of financial advice services with a view to

ensuring both the availability of financial advice for persons seeking that advice, and the quality of financial advice and financial advice services. We are also mindful of the other purposes of the FMC Act which remain in play. These include the avoidance of unnecessary compliance costs and the promotion of innovation and flexibility in financial markets. We urge the Code Working Group not to lose sight of those additional purposes of the FMC Act.

- 7 A key theme underpinning our submission relates to the fact that the Code is required to provide for minimum standards of professional 'conduct' that must be demonstrated (FSLAB, Schedule 2, clause 32). Whether those standards will be expanded to include ongoing financial advice obligations will depend on the final wording of FSLAB, but we are not aware of any suggestion that the final form of FSLAB will see the Code move away from specifying minimum standards of **conduct**. While standards must be able to be imposed on an organisation as well as an individual, we do not believe that imposing a requirement to have a particular document or process is consistent with the concept of a minimum standard of 'conduct'. In the context of a regime that provides for Financial Advice Provider licensing, such requirements better fit within the licensing process, and are out of place in the Code.
- 8 One of the key distinctions drawn in the Paper is between individual standards and organisational standards. We agree that the Code must provide for organisational standards. However, we believe that distinctions should be minimised, given the statutory requirement for the Code to focus on standards of conduct. This could be achieved by, as far as possible, expressing Code Standards in neutral terms so as to focus on what the person providing the financial advice to the client must do, whether that person is an individual delivering financial advice on behalf of a Financial Advice Provider, or the Financial Advice Provider itself. In other words, the focus should be on what must be done, as opposed to the machinery behind how it is done.

Principles for drafting the Code

- 9 We agree that the appropriate focus for the Code is one that is client-centric. However, we believe that a focus on 'good advice outcomes' for clients is inherently problematic. Irrespective of what the Code Working Group might intend by expressing such a focus, and irrespective of how it is explained, consumers will inevitably view that focus as meaning financial advice must deliver a good outcome for them if it is to comply with the Code. We were pleased to see the Code Working Group acknowledge that concern, and support removal of any reference to 'outcomes' as a focus of the Code.
- 10 However, we believe that simply deleting reference to 'outcomes' as a focus and leaving it at 'good advice' does not remove that inherent concern. We believe a risk remains that consumers and commentators will view financial advice that delivers a bad outcome as bad advice, no matter how sound the process followed. We also believe a simple focus of 'good advice' is too vague to add value.
- 11 We believe the headline principle for drafting the Code should be on practical minimum standards that reflect a 'good advice process', with a good advice process framed as a process that is sound and client-centric. To reinforce this, we would support a 'client first' concept being incorporated into a spirit of the Code section. We recognise the challenges inherent in phrasing a client first or client best interests obligation in the form of a Code Standard. With FSLAB's

inclusion of a statutory obligation to give priority to the interests of the client in the event of conflict, there is now a risk that including such a standard in the Code will conflict with statutory duties. However, including an interpretation principle that captures the spirit of the Code and requires Financial Advice Providers to refer to that spirit and take a client-centric approach in applying the Code Standards would provide an appropriate compromise between trying to impose an inherently problematic and potentially ultra vires client first/client best interests duty and abandoning the principle altogether.

- 12 Other than adjusting the phrasing of the overall objective of the Code Standards, as noted above, we support the five principles outlined in the Paper. In particular, we strongly support the Principle 3 approach of drafting the Code in a clear, concise, and effective manner, with a principles-based approach that allows for flexible application to a wide range of situations. In our view, this translates to ensuring that the Code is no wider and no more complex than is necessary. We encourage the Code Working Group to minimise the creation of multiple Code Standards.

Ethical behaviour framework

- 13 We support the requirement for financial advice providers and financial advisers to act with honesty, fairness, and integrity. We believe the way this obligation is expressed in the Paper, and the definitions used, are appropriate (Question C).
- 14 In response to question D, we do not support the inclusion of minimum standards that extend to imposing an obligation to meet non-binding, informal understandings. We believe such an imposition would interfere with the laws of contract, and is unnecessary when there is already a Code Standard imposing obligations to act with honesty, fairness and integrity. Requiring a Financial Advice Provider to meet any informal understanding, impression or expectation that a client may have, that does not amount to a strict legal obligation on the part of the Financial Advice Provider, and with which compliance is not required in order to discharge the obligation to act with honesty, fairness and integrity, is not appropriate. It has the potential to impose an unreasonable compliance burden on all financial advice providers, and may drive an opportunistic layer of complaints.

Conflicts of interest

- 15 We believe that including an appropriate, principles-based standard covering the obligation to manage and disclose conflicts of interest is an essential component of the Code (Question F). However, as raised in our submission on FSLAB, we are concerned with the potential for conflict between the statutory provisions and the Code. Whatever is provided in the Code will need to supplement the eventual wording of the FMC Act in relation to the duty to give priority to client interests.
- 16 We believe the current Code Standard 5 in the Code of Professional Conduct for Authorised Financial Advisers ('AFA Code') provides a reasonably robust starting point for the appropriate standard to include in the Code, adjusted to the extent necessary to align with the eventual statutory duty. We would also support such a minimum standard being supported by principles-based guidance, to help clarify the expectations that are being placed on Financial Advice Providers, but it should not focus on particular situations.

Confidentiality of client data

- 17 We believe any obligations in respect of the retention, use, or sharing of customer data should be left to the provisions of the Privacy Act 1993. That Act is currently under review, and we do not believe it is helpful for the Code to impose an additional layer of confidentiality obligations on Financial Advice Providers.

Ethical processes

- 18 In response to Questions L to O, we do not believe it is appropriate for the Code to require Financial Advice Providers to document and maintain their ethical processes, and they should not be required to have a publicly available corporate code of ethics. We do not believe that imposing an obligation to maintain such a document or process is consistent with the concept of a minimum standard of 'conduct' that the Code is required to provide for. Rather, what is proposed in the Paper is simply something that Financial Advice Providers might consider as a means of ensuring that they comply with the standard of honesty, fairness, and integrity (and evidencing that during the licensing process). Accordingly, if such an obligation is to be imposed, it sits more squarely in the licensing process.
- 19 In addition, requiring Financial Advice Providers to have a Code of Ethics in place as part of the Code, even if that could be rationalised as a conduct standard, would then bring that requirement into play at the commencement of the new regime, when Financial Advice Providers are only operating under a transitional licence. In order to minimise the compliance burden they need to deal with during the transition period, Financial Advice Providers might be tempted to minimise the content of such a Code of Ethics, treating it as a 'tick box' requirement.
- 20 Perversely, imposing a requirement to have and maintain a Code of Ethics within the Code carries a risk of Financial Advice Providers reducing the scope of what they might otherwise be prepared to document in this area, especially if it needs to be in place and operational from the commencement of a transitional licence. Without prescribing any minimum requirements for such a Code of Ethics, requiring one to be in place as part of the Code adds minimal practical value. However, if such an obligation is to be imposed, we agree with the Code Working Group's position taken in the Paper that it would be inappropriate to attempt to prescribe any of the content of a Code of Ethics over and above the duty to act with honesty, fairness, and integrity.
- 21 In response to Question P, we agree with the proposal that continuing professional development requirements should include a minimum standard relating to ethics training. Ethical behaviour is a key component underpinning the new regime, with expectations of ethical behaviour prone to evolving over time, making it important for Financial Advice Providers to maintain the currency of their thinking in this regard. However, any obligation should not go beyond requiring a component of continuing professional development to include ethics training, without prescribing any detail that might need to be covered.
- 22 In response to Question S, we see the requirement to have in place, and use, a framework for resolving ethical dilemmas as a matter of good business process that sits outside the Code. Financial Advice Providers are obliged to act with honesty, fairness, and integrity, meaning there is an incentive for providers to ensure that they have good processes in place for

resolving ethical dilemmas. This does not mean that it is appropriate to include the maintenance of such processes as a minimum standard of conduct.

Compliance functions and responsibility

- 23 We do not believe it is appropriate for the Code to include a requirement for explicit sign off on the soundness of financial advice provided, nor is it appropriate for the Code to go further and require Financial Advice Providers to have in place compliance functions and internal audit obligations. All of those requirements are simply part and parcel of an organisation's internal business processes to ensure that they are meeting their Code obligations. Different businesses will have different needs and different pressure points in this regard. While we do not believe the requirements discussed at Questions T to W fall within the concept of the standard of conduct, we do not believe it would be appropriate to include this level of prescription as to internal business processes within the Code in any case.
- 24 In response to Question X, we believe that placing an onus on Financial Advice Providers to demonstrate that outsourced providers meet standards of ethical behaviour as if the Financial Advice Provider carried out the whole advice process direct itself would amount to an undue intrusion into commercial relationships. Financial Advice Providers will be responsible for ensuring any regulated financial advice provided to a retail client satisfies the minimum standards of conduct under the Code regardless. We are also conscious that the FMA's licensing process will likely address the issue of outsourcing, as was the case for all existing FMC Act licensing processes. At most, a Code Standard could be phrased to confirm that Financial Advice Providers must ensure that minimum standards of conduct are observed, irrespective of any outsourcing of functions. It would then be up to the Financial Advice Provider to determine the most effective way of ensuring that this is the case. Requiring Financial Advice Providers to demonstrate this as an operative Code Standard introduces an additional layer of regulatory compliance and contractual constraint that cuts across the purposes of the FMC Act.

Conduct and client care

- 25 We are not aware of any particular concern with the efficacy of the AFA Code Standards in relation to conduct and client care, over and above some advisers adopting a very conservative approach in ensuring compliance, which has resulted in potentially unnecessary levels of processes and paperwork.
- 26 The one client care aspect we wish to comment on is hinted at in Question BB. An observation was made that the definition of 'complaint' could be improved. We are aware that the definition in the AFA Code is more limited in determining what will count as a 'complaint' than is the case with dispute resolution concepts. In our view, the definition used in the AFA Code is an appropriate one to use for the purposes of a Code of Professional Conduct. In particular, we support the idea of a client being able to indicate that they do not wish an expression of dissatisfaction to be treated as a complaint, which might otherwise give rise to particular conduct obligations arising under the Code.

General competence, knowledge and skills

27 Kensington Swan supports the proposed approach of assessing combined expertise in determining whether or not minimum standards of competency are satisfied in the delivery of regulated financial advice. We believe this is a useful innovation to assist in ensuring the availability of financial advice, without compromising on the quality of that advice. We see this approach as supporting the retention of advisers who, for one reason or another, are unable to satisfy minimum standards at an individual level. We think this will be particularly important to facilitate the introduction of new financial advisers as they build up their expertise. The onus would then be on the Financial Advice Provider to ensure that appropriate mechanisms are in place to be able to satisfy itself that financial advice is provided with the requisite minimum standard of competence, knowledge, and skill.

Particular competence, knowledge and skill

28 We agree that the Code is required to identify different types of financial advice products or other circumstances for the purposes of setting minimum standards of particular competence, knowledge, and skill. We also support the principled approach that has been taken by the Code Working Group in differentiating product advice from planning services, in identifying two different types for this purpose. We believe this represents a reasonably elegant approach to addressing the statutory obligation, consistent with the currently proposed two-limb definition of 'financial advice'.

29 As a legal service provider, we do not feel it is appropriate for us to comment as to the adequacy of the minimum standards proposed for the two types of advice identified. However, we are concerned about the potential for unintended consequences inherent in the approach proposed by the Code Working Group. There is a significant jump proposed from the minimum standard required in relation to product advice when compared with the minimum standard proposed for planning services. If individual financial advisers perceive that the bar set for planning services is beyond their reach, a pragmatic response could be to reduce the level of service they provide to product advice. This would run counter to the purposes of FSLAB of ensuring availability and quality of advice, with planning services potentially becoming unobtainable for some, with product advice that is inherently of lower quality given its less holistic nature.

30 We assume that the Code Working Group will be carefully testing the robustness of the minimum standards eventually proposed, with the above concern in mind. Ensuring that there is a relatively straightforward mechanism available for experienced financial advisers to be able to demonstrate that their experience overcomes any deficiency in their qualifications will be a key element to ensure that any restriction on the availability of financial advice created by the new minimum standards proposed is minimised. We urge the Code Working Group to explore options for recognising past experience in a reliable fashion. While this has been achieved in part through granting relief to AFAs, the robustness of doing so in all cases is questionable, and by comparison significantly disadvantages advisers who have operated professionally in the insurance and consumer credit space for many years.

31 Regardless, we also assume that the Code Working Group has undertaken sufficient research to be satisfied that requiring planning service providers to have attained one of the Level 7 qualifications identified will actually assist in ensuring the quality of advice. The basis for

imposing this requirement set out in the Paper is not well developed. We would like to see some further analysis provided to demonstrate that this requirement will indeed add value, over and above simply requiring a number of Level 6 planning-specific credits to be attained.

Further information

32 We are happy to discuss any aspect of our feedback on the Code.

33 Thank you for the opportunity to submit.

Yours faithfully
Kensington Swan

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