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### **Draft Code of Professional Conduct for Authorised Financial Advisers**

The New Zealand Law Society (“Law Society”) appreciates the opportunity to comment on the draft Code of Professional Conduct for Authorised Financial Advisers (“AFAs”).

The Law Society welcomes the code and anticipates that it will play an important role in improving the overall quality of service provided by AFAs.

#### **1. Spirit of the Code**

In the Introduction Section B it is stated that AFAs “are also required to comply with the spirit of the Code”.

It is suggested that this is too vague and aspirational to be appropriately included. The “Spirit of the Code” is not articulated or defined anywhere in the Code. It does not seem appropriate that AFAs should be required to comply with some national spirit which underlies the Code, but is not clearly set out, particularly when disciplinary consequences can follow.

Section 101 of the Financial Advisers Act (“FAA”) allows the disciplinary committee (amongst other things):

- To make recommendations to the Commission that it cancel or suspend the AFA’s authorisation.
- To require the AFA to work for a period of up to three years subject to conditions of employment or supervision imposed by the complaints committee.
- To pay a fine of up to \$10,000.

In these circumstances the Code must provide certainty and it should not be incumbent upon an individual AFA to determine the “spirit of the Code”.

Also, this requirement appears to fall outside what is specified in s86(1) of the FAA which states that the Code must provide for minimum standards of professional conduct. The requirement to comply with the spirit of the Code does not appear to be a specification of minimum standards. The requirement is to state a minimum standard. In the interests of certainty the Code should not require an AFA to aspire to a higher undefined standard.

## **2. Format**

Whilst it is intended that the Code be user friendly and readily understood both by consumers and advisers, the view may be taken that its informal style may impact adversely on its legal effect.

The precise status of the additional provisions which follow the Code Standards is by no means clear. In the Introduction to the Code, it is stated that these provisions “do not limit the application of the overarching principle under which they are stated”. This does not assist greatly in determining the legal effect of these provisions.

In Code Standard 3 the provisions are stated to be no more than examples of lack of independence or examples of benefits which do not affect independence. In these circumstances, it may be difficult to determine what substantive effect is to be attributed to these provisions.

The provisions which follow Code Standard 4 are stated to be the minimum information an AFA must provide “for the purposes of this Code Standard”. In the Introduction to the Code, it is provided “unless otherwise stated, the additional provisions do not limit the application of the overarching principle under which they are stated”.

It would accordingly appear that, at least in some cases, an AFA must provide information beyond the stated minimum requirements in order to comply with Code Standard 4.

It is suggested that a better format would be that adopted in the *Lawyers and Conveyancers Act (Lawyers: Conduct and Client Care) Rules 2008*. In each chapter, the opening rule

comprises a general statement of principle with the ensuing rules then developing the opening rule. A copy of chapter 3 of the *Lawyers Conduct and Client Care Rules* is attached illustrating this.

If the current format is retained, it is submitted that it would be desirable in paragraph B – Introduction to state explicitly that the additional provisions comprise part of the Code.

### 3. Code Standard 1

This requires an AFA when providing financial adviser services to “place the interests of the client first”.

Placing the interests of the client first is a somewhat colloquial expression, the precise meaning of which may in certain circumstances be unclear. There will be some circumstances in which the legal obligations of an AFA may be inconsistent with this obligation. An example would be the legal obligations of an AFA falling within the definition of a “financial institution” under the Anti-money Laundering and Countering Financing of Terrorism Act 2009.

It is suggested that a preferable wording of this Code Standard would be along the following lines:

*Financial adviser services must at all times be provided by an AFA within the bounds of the law and the professional obligations of the AFA, solely for the benefit of the client.*

### 4. Code Standard 3

The drafting and format of the material which follows the text box needs improving.

The material which follows paragraph (c) appears to be limited to restricting the meaning of “benefit” in paragraph (c). On that basis, it is not appropriate for the lettering (d), (e) and (f) to be adopted.

Further, it is a contradiction in terms:

- (a) to state that an AFA will not be independent if he or she receives a **benefit**; and then
- (b) to set out examples of **benefits** that do not affect independence.

It would be preferable to state that the specified matters which do not affect independence are not “benefits” for the purposes of paragraph (c).

This Code Standard prohibits an AFA from stating or implying that the AFA is independent when the AFA would not be considered to be independent by a “non-expert third party [*a client*]”. It is suggested that this could suitably read “non-expert person”.

Paragraph (e) of Code Standard 4 strengthens Code Standard 3 by requiring an AFA to disclose any lack of independence to the client. We would mention that lawyers are not permitted to act at all where there is a conflict of interest – see Chapter 5 of the *Lawyers Conduct and Client Care Rules*. However, it is understood that such a requirement may be impracticable for at least some AFAs.

**5. Code Standard 4**

It is suggested that the requisite information could include reference to the right of a client to complain to the Securities Commission about the conduct of an AFA (s96, FAA).

**6. Code Standard 5**

The absolute prohibition on an AFA lending money to a client is perhaps too restrictive. It may be desirable to relax this to permit a loan where the client has first obtained independent legal advice. If considered appropriate, it could also be provided that the loan moneys must not be lent to a client by the AFA to enable the client to purchase an investment recommended by the AFA.

**7. Code Standard 7**

It is suggested that:

- (a) The following be added at the end of the last paragraph:

*In reporting a suspected breach the AFA must act in good faith.*

- (b) The following additional paragraph be inserted:

*This Code Standard does not require an AFA to report to the Securities Commission a suspected non-compliance with the Code or the Act, where the*

*AFA is aware or has reason to believe that the suspected non-compliance has already been reported to or is known to the Securities Commission.*

The Law Society would support the view that some legislative protection for informants who act in good faith is desirable.

**8. Code Standard 10**

It is suggested that it would be preferable for the paragraph which immediately follows item (d) to read:

*Where a client declines in writing or fails to provide some or all of the information sought by an AFA, the AFA is required to determine suitability under this **Code Standard** solely on the basis of the information provided by the client.*

The sequential lettering of items (e), (f), (g) and (h) is confusing as these items do not relate to items (a), (b), (c) and (d). It is suggested that the use of bullet points would be preferable.

**9. Code Standard 12**

The definition in the Code of “complaint” is relevant to this Code Standard. It is submitted that the definition “an expression of dissatisfaction or concern” is too broad. The expression “complaint” has a sufficiently understood meaning to render a definition unnecessary. Certainly, this is the approach taken in most complaints regimes in this country.

We understand that various commentators have suggested that a complaint should be in writing. We share this view. Many, if not most, complaints services in this country require complaints to be submitted in writing. The Lawyers and Conveyancers Act provides that a complaint concerning a lawyer or conveyancing practitioner must be in writing (s134). Equally, a complaint to the Judicial Conduct Commissioner must be in writing.

The relevant external dispute resolution scheme can provide reasonable assistance to a complainant to put a complaint in written form. Having a complaint clearly expressed in writing can assist materially in the processing of the complaint and generally is in the interests of all concerned.

**10. Code Standard 13**

It is suggested that an obligation could be imposed on an AFA to ensure that where reasonably practicable (and subject to any instructions to the contrary) interest is earned on moneys held in the AFA's trust account. Section 114 of the Lawyers and Conveyancers Act 2006 imposes this obligation on lawyers and conveyancing practitioners.

It is suggested that paragraph (c) be amended to read "all interest on client money (after deduction of any agreed handling charge, together with any withholding tax) is applied ...".

It may be desirable to provide at the end of this section that where an AFA is an agent of a Qualifying Financial Entity ("QFE"), the AFA may satisfy his or her obligations under this Code Standard by taking reasonable steps to ensure that the relevant measures taken by the QFE are consistent with the measures contemplated under this Code Standard.

**11. Code Standard 14**

It is suggested that consideration be given to including at the end of this section a paragraph along the same lines as the current last paragraph of Code Standard 13, together with a further paragraph relating to QFEs along the lines of that suggested in item 10 above.

**12. Code Standard 15**

It is suggested that it would be preferable for this Code Standard to be expressed as follows:

*An AFA must maintain adequate written records of all financial adviser services provided by the AFA.*

**13. Code Standard 16**

It is suggested that the absolute obligation imposed by this Code Standard could appropriately be modified in the case of AFA employees who have reasonable grounds to believe their employer is storing the necessary records for the required period. On this basis an additional provision could be inserted along the following lines:

*An AFA who is an employee is not in breach of his or her obligations under this Code Standard if the AFA has reasonable grounds to believe that the employer is storing the necessary records for the required period.*

**14. Code Standard 19**

It is submitted that in the last line of paragraph (e) “necessary” should be omitted. This is consistent with the Law Society’s recent submissions to the Parliamentary Commerce Select Committee.

**15. Code Standard 20**

It is suggested that in paragraph (a) it would be preferable to refer to “areas where it is desirable to undertake further training” rather than to “gaps”.

By way of consequential amendment, “areas” should then be substituted for “gaps” in paragraph (b).

**16. Investment Management Decisions**

We refer to the issue relating to investment management decisions raised by the Code Committee in its circular letter of 31 March 2010.

The Law Society considers that it would be desirable to have a separate Code Standard directed to investment management decisions. This could, among other things, state that an AFA in making investment management decisions must act within the scope of the authority granted by the client to the AFA or the AFA’s employer.

Yours sincerely



Jonathan Temm  
**President**