

**SOVEREIGN**

**SUBMISSION TO THE CODE COMMITTEE**

**ON**

**CONSULTATION PAPER RELATING TO THE PROPOSED MINIMUM STANDARDS  
OF ETHICAL BEHAVIOUR AND CLIENT CARE FOR AUTHORISED FINANCIAL  
ADVISERS DATED 17 NOVEMBER 2009**

**18 December 2009**

## Introduction

1. Sovereign Limited makes this submission to the Code Committee in response to the consultation paper ("**Consultation Paper**") dated 17 November 2009 relating to the proposed minimum standards of ethical behaviour and client care for authorised financial advisers ("**AFAs**").
2. Sovereign is New Zealand's largest life insurer, protecting the lives of more than 600,000 people through the provision of personal insurance (including life, income protection, and disablement and trauma, and major medical policies) and employer sponsored compulsory and voluntary workplace schemes. Sovereign is also New Zealand's third largest provider of health insurance, New Zealand's largest non-bank lender and has New Zealand's sixth largest retail fund with over \$3 billion in funds under management. Sovereign is part of the ASB group of companies, which in turn is part of the Commonwealth Bank of Australian group.
3. Sovereign has a business model under which its products are distributed exclusively through third-party financial advisers, while all policy processing, underwriting, claims management and customer services are provided directly to customers. Sovereign has relationships with over 3,700 advisers, ranging from sole traders through to the employees of large institutions. Sovereign also has a number of employees that will be providing financial adviser services for the purposes of the Financial Advisers Act 2008 ("**FA Act**").
4. Sovereign's contact for matters regarding this submission is:

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## Consultation Questions

*Question 1: Are the ethical behaviour principles (client first and integrity; independence, objectivity and managing conflicts of interest; and good conduct) appropriate to base ethical standards upon? If not, what are the appropriate principles?*

5. Including "independence" as an ethical standard implies that an adviser that is not independent is not ethical. Sovereign submits that is not the case, provided that the lack of independence is disclosed. Subject to the preceding sentence Sovereign agrees that the proposed ethical behaviour principles are appropriate.

*Question 2: Are the proposed client care principles (professionalism; suitability; capability and capacity; effective communication; effective dispute resolution; compliance and custody) appropriate ones to base client care standards on? If not, what would be the appropriate principles?*

6. Sovereign agrees that the proposed client care principles are appropriate.

*Question 3: Do you think that the proposed over-arching ethical standard (proposed standard 1) is appropriate? Should it apply to all AFAs?*

7. Sovereign is of the view that, in general terms, the proposed standard is appropriate and should apply to all AFAs. However, the standard needs to reflect the nature of the relevant adviser-client relationship and the services that

the adviser has agreed to provide to the client. For example, where an adviser is aligned or tied to a product provider, there may well be situations where there is a better product offered by another provider. Provided that the adviser has disclosed the limitations on the range of products on which he or she is able to sell, and only recommends suitable products, the adviser should not necessarily be in breach of the standard.

*Question 4: Should proposed standard 2 include a requirement that the client must expressly consent to a lack of independence and/or lack of objectivity?*

8. Sovereign submits that it is not necessary for a client to expressly consent to a lack of independence and/or lack of objectivity. The key issue is to ensure that the lack of independence/objectivity is disclosed to the client. It is then up to the client to make (an informed) decision as to whether to not to proceed with that adviser. In effect, the client would be consenting if they do continue to receive financial advice from that adviser so it is therefore not necessary to obtain an express consent.
9. If the Code Committee determines that express consent is necessary, Sovereign submits that it should be sufficient for the adviser to obtain such "consent" by having the client sign an acknowledgement on the adviser's disclosure statement, rather than having to have a separate document prepared and signed.
10. There appears to be some duplication between proposed standards 2 and 3.

*Question 5: Are the safeguards listed in proposed standard 2(2) appropriate? Are there other safeguards that should be included?*

11. The safeguard in proposed standard 2(2)(a) appears to be appropriate. However, it would be helpful if the Code Committee could provide some guidance around the nature of the procedures that will be required for the purposes of satisfying the proposed standard 2(2)(b). Sovereign does not consider that any other safeguards need to be included in the Code.

*Question 6: Is it sufficient that AFAs who receive commission or payments from financial product providers or others in addition to, or instead of, payments from clients cannot call themselves "independent" or "objective"? Or should AFAs be required by the Code to indicate that they are not independent by specifying that they are "non-independent" or "aligned" or some other similar term?*

12. Sovereign considers that it is sufficient that advisers are not able to call themselves "independent". Sovereign submits that "objective" should not be confused with "independent" in this context. Given the disclosures required by proposed standards 2 and 3 (and the disclosure regulations) it is unnecessary for advisers to also be required to indicate that they are not independent by specifying that they are "non-independent" or "aligned" or some other similar term.

*Question 7: Do you agree with the proposed independence, objectivity and managing conflicts of interests standards (proposed standards 2-4)? Should the standards be modified or expanded in any way? Are there other independence, objectivity or conflict of interests standards which should be included in the Code?*

13. Subject to the responses to earlier questions, Sovereign agrees in principle with the proposed independence, objectivity and managing of conflicts interests.

14. It would be helpful if the Code Committee could provide some guidance around the nature of safeguards it anticipates will be appropriate for the purposes of proposed standard 3(b).
15. The way in which disclosures required under the Code fit in with those under the disclosure regulations will need to be considered to ensure that they are consistent. In addition, please refer to our responses to earlier questions as to how Sovereign considers that the standards should be modified.

*Question 8: Some overseas regulatory bodies have considered stopping financial advisers from accepting commission. The Committee would like to hear your feedback and submissions on whether you think such an approach would be appropriate in New Zealand (so that receiving a commission without rebating it to the client would be a breach of the Code). What effect would this have on consumers and the industry in various sectors: insurance, investment, financial planning, credit contracts and any other relevant sector?*

16. Sovereign submits that it would be more appropriate for the issue of commissions to be dealt with separately to the Code consultation process. However, some issues relevant for the consideration include:
  - a. Whether the fact that financial advisers would start charging fees where previously they did not would discourage some consumers from seeking financial advice.
  - b. Whether AFAs may use fees as a mechanism to recover their compliance costs under FA Act from consumers, so that consumers ultimately end up paying more for financial advice/financial products.
  - c. Whether such a ban would relate to all financial services or only some, such as investment and savings advice.
  - d. Whether it is necessary to prohibit commissions where appropriate disclosure has been made. In particular, the focus should be on transparency of all remuneration structures and not necessarily targeted as commissions.

*Question 9: Do you consider that non financial benefits should be taken into account in determining whether an AFA is independent and objective?*

17. Sovereign agrees that non-financial benefits should be taken into account in determining whether an AFA is independent. However, the relevant standard needs to include appropriate materiality thresholds. Sovereign submits that non-financial benefits should only be taken into account to the extent they are provided in connection with the adviser providing some sort of valuable consideration to the person providing the financial benefit (such as selling certain products or agreeing to sell a specified amount/proportion of certain products). For example, the provision of a newsletter containing useful information to advisers by a provider should not compromise independence unless the adviser is required to do something in return. Sovereign also notes that the receipt of benefits (financial or otherwise) does not necessarily mean that an AFA is unable to give objective advice.
18. Given that an AFA may potentially receive a wide range of non-financial benefits from a relatively large number of product providers, it will be necessary to ensure that disclosure requirements are such that disclosure statements do not become too lengthy and complicated for consumers.

*Question 10: Do you consider an AFA is independent and objective if his or her financial adviser services are limited to financial products available through a particular platform where the AFA and all connections of the AFA have no financial interest in the platform?*

*(A platform in this context is any defined range of financial products made available by a particular financial service provider, or any form of portfolio administration or reporting service.)*

19. Although the AFA's range of products will be limited in such circumstances, Sovereign submits that a distinction needs to be drawn between a situation where an AFA uses a product platform because they receive a financial incentive to do so (which, in Sovereign's view, would mean they are not independent) and a situation where an AFA uses an appropriate platform for other reasons, such as efficiency (for example, the platform may enable client reporting to be a more straightforward process). There should be a distinction between relatively open platforms, which are open to almost all investments, and closed platforms, where the investment menu is constrained for any reason related to remuneration. It is not possible for an adviser to be an expert in every single product, so the range of products they advise on will always be limited to an extent. That does not necessarily mean that the adviser is not "independent".

*Question 11: Are the definitions of "connection of the AFA" and "member of the AFA's family" appropriate? If not, why not?*

20. Sovereign submits that:
- a. it would also be appropriate to include siblings of the AFA in the definition of "family"; and
  - b. the use of the word "prospective" is very broad and needs to be qualified in an appropriate manner.

*Question 12: Do you agree that the proposed standards concerning lending and borrowing to/from, and joint investments, with clients (set out in standards 5-6) should be included in the Code? Are there any other standards concerning dealings with clients that should be included in the Code?*

21. Sovereign submits that a carve-out is needed from proposed standard 5(2) to make it clear (for the avoidance of doubt) that nothing in that standard prevents an AFA's employer (or a related company of the employer) from lending money where that employer/related company is in the business of lending money. Other than that, proposed standard 5 appears to be appropriate.
22. Sovereign submits that the limitation in proposed standard 6(1)(a) (limiting the carve-out to securities offered to the public under the Securities Act 1978) should be deleted. Provided that the AFA complies the remainder of proposed standard 6 and the other requirements in the Code and the requirements in the FA Act, it should not be necessary to limit the carve-out in such a way.
23. There are no other standards concerning dealings with clients that Sovereign considers should be included in the Code.

*Question 13: Do you consider that the Code should include standards governing AFAs who take on personal trusteeships and act as directors of corporate trustees of family trusts? If yes, what standards should be included?*

24. No specific standards are required given that the requirements of the Code and the FA Act (and other legislation and laws applying to trustees) will apply. However, to the extent that restrictions are placed on AFAs being trustees, there should be a carve-out for a family trust of the AFA.

*Question 14: Are there any other good conduct standards that should be included in the Code?*

25. Sovereign considers that the proposed good conduct standards, when combined with the requirements of the FA Act, are sufficient.

*Question 15: Should the Code include a good conduct standard which restricts the ability of AFAs to criticise other AFAs or include other standards which regulate dealings and interactions between AFAs?*

26. Sovereign is of the view that nothing specific is required given that this concept is already covered (for example, by proposed standard 7).

*Question 16: Should the proposed standards of good conduct (or any other section of the draft Code) include standards providing guidance on advertising and/or marketing of financial adviser services over and above the restrictions in the Financial Advisers Act? If so what should the standards require?*

27. Sovereign does not consider that any specific standards of advertising are required. This is already sufficiently covered by the FA Act, other legislation (such as the Fair Trading Act 1986) and the Code (for example, proposed standard 8).

*Question 17: Do you consider the proposed over-arching client care standard is appropriate (proposed standard 9)?*

28. Yes, Sovereign considers that the over-arching client care standard is appropriate.

*Question 18: Do you agree that a standard concerning scope of services should be included (proposed standard 10)?*

29. Sovereign agrees that, in principle, a standard concerning scope of services should be included in the Code. However, it needs to be considered how this relates to the AFA's disclosure statement and terms of engagement. There could potentially be significant duplication between these documents which may lead to confusion.

*Question 19: Is it appropriate to require that where a trail commission or monitoring fee is charged, the AFA must provide ongoing proactive advice?*

30. Sovereign submits that the proposed standard should be revised so that it instead simply requires an adviser to provide the services that it has agreed with the client it will provide. It should not be assumed that a client wants or expects additional services based on the fees/commissions an adviser may be receiving. If there is a requirement linked to the receipt of such commissions/fees the requirement should be to provide a monitoring "service" as opposed to advice. This appears to be consistent with the actual wording of the proposed standard.
31. If a standard of the nature proposed is included in the Code it should not apply to existing arrangements. Many product providers will be party to existing contractual arrangements whereby, for example, they have agreed to provide trail commission to an originating adviser. That adviser may no longer have a

relationship with the relevant client. However, the product provider is contracted obliged, and the adviser entitled, to continue to receive the trail commissions.

Question 20: *Should there be a standard requiring written terms of engagement with clients?*

32. Sovereign agrees that it is appropriate for AFAs to have written terms of engagement. However, such terms should only be required to be provided to clients at the commencement of the adviser-client relationship (and not each and every time an AFA receives an instruction from that client) and as and when the terms of engagement are amended.

Question 21: *Should AFAs be permitted not to undertake a suitability analysis (see proposed standard 11)? The Committee seeks your views on two different options:*

- (a) *Should AFAs always be required to carry out a suitability analysis and provide advice that is suitable for the client?; or*
- (b) *Should AFAs be permitted not to carry out a suitability analysis and to provide services that are not necessarily suitable for the client, provided that the benefits of the suitability analysis are clearly explained to the client and the client consents in writing not to receive such advice?*
33. Sovereign anticipates that, in practice, some clients may not wish their adviser to carry out a suitability analysis in all situations. Therefore, Sovereign submits that an AFA should be able to provide services without carrying out a suitability analysis in the circumstances described in paragraph (b) of question 21. However, Sovereign submits that there should be a “unless it is not practicable” qualifier to the requirement to obtain written consent.

Question 22: *Is it appropriate that where the suitability analysis shows that the financial adviser services offered by an AFA are unsuitable for the client, the AFA must not provide the financial adviser services or should the AFA be able to provide the services if the AFA informs the client that the services are not suitable but the client still wishes the AFA to provide the services? (See proposed standard 13.)*

34. Sovereign is of the view that the most important thing is to ensure that the client has been properly advised. It is then up to the client to make an informed decision as to how he or she wishes to proceed. Therefore, Sovereign submits that an AFA should be able to provide the services in the situation contemplated by question 22. If that were not the case a situation could arise where a client goes to an AFA who carries out a suitability analysis (which shows the service is not in the best interests of the client) and is then prohibited from providing the service notwithstanding that the client may still want it. The client could then go to a different adviser, consent to not getting a suitability analysis carried out and receive the service that the first AFA is not permitted to provide because he or she carried out a suitability analysis.

Question 23: *Do you agree that the proposed standards concerning suitability (proposed standards 10-16) should be included in the Code? Are there any other standards concerning suitability that should be included in the Code?*

35. Subject to the responses to earlier questions and to the following points, Sovereign generally agrees with the proposed standards concerning suitability:
- a. There appears to be some overlap between proposed standards 15 and 20.

- b. Sovereign suggests that proposed standard 15 should be subject to a “unless it is not practicable to do so” carve-out (as is the case with proposed standard 20). Written advice will not always be practicable (for example, a client may telephone an AFA asking whether they should buy or sell shares at a particular time).
  - c. Sovereign also queries whether a client should have the ability to waive receiving a written statement of advice. For a variety of reasons, at least some clients are unlikely to want written advice on all occasions that they receive services from a financial adviser. Please also refer to our response to question 26.
36. Sovereign does not consider that there are any other standards concerning suitability that should be included in the Code.

*Question 24: How long should AFAs be required to keep records in relation to proposed standard 16? Should there be specific standards relating to electronic records?*

37. Sovereign submits that the relevant requirement should be set having regard to applicable periods in Limitation Act 1950 and other legislation.
38. In terms of electronic records, it is important that appropriate back-up systems are in place to ensure that such records are maintained and are readily as and when required.

*Question 25: Are the proposed capability and capacity standards appropriate (standards 17-19)? Should the standards be modified or expanded in any way? Are there other capability and capacity standards which should be included in the Code?*

39. Sovereign generally agrees that the proposed standards are appropriate. However, Sovereign suggests that:
- a. Proposed standard 17 needs to go beyond an AFA having to “consider” that he or she has sufficient time and resources available. Instead, the standard should require that the AFA must ensure that, when agreeing to provide financial adviser services, that he or she does in fact have sufficient time and resources available.
  - b. Proposed standard 18(i)(a) and (b) should include a qualification that the AFA has reasonable grounds to believe that the other adviser is “a suitable qualified person” or has “the appropriate skills or resources”, as the case may be.
40. There are no other capability and capacity standards which Sovereign considers should be included in the Code.

*Question 26: Do you agree that information and/or advice should be provided in writing unless that is not practicable?*

41. Sovereign submits that a client should be entitled to waive the receipt of written advice. However, it would be good practice for the adviser to maintain accurate records of the advice given in these circumstances.

*Question 27: Should the client be able to waive this requirement by agreeing in writing that subsequent disclosure of specified information or advice is not required to be in writing?*

42. Please refer to our answer to question 26.

*Question 28: Proposed standard 21 requires AFAs to have an internal dispute resolution process. Is this practical? How should an individual AFA who does not practise with other AFAs be required to deal with complaints?*

43. Sovereign submits that the relevant standard should instead be focussed on the behaviour of AFAs when dealing with complaints rather than the actual process. For examples, AFAs should be required to give due consideration to complaints and use reasonable efforts to resolve them and should be required to act in relation to complaints in a timely manner.

44. If standards around dispute resolution processes are to be included in the Code, Sovereign submits that further guidance is required around what is required in terms of a “dispute resolution process”. This is particularly relevant for individual AFAs. For example, is a timetable by which time a financial adviser must respond to a complaint sufficient? If that is the case, then the term “initial dispute resolution” may be more appropriate. If more than this is required, one option for individual AFAs may be to refer the complaint to an independent AFA for consideration.

*Question 29: Are the proposed internal dispute resolution standards (standards 21-23) appropriate?*

45. Please see our response to question 28. In addition, Sovereign considers that it may be appropriate for proposed standard to be amended so that it requires an AFA to deal with a complaint promptly and fairly rather than having to resolve the complaint. It could be that a complaint is totally unjustified and in such circumstances it would not necessarily be reasonable for an AFA to be required to seek to “resolve” it. However, the AFA should be required to deal with it fairly and promptly.

*Question 30: How long should records of complaints be kept under proposed standard 23?*

46. Sovereign submits that the relevant requirement should be set having regard to applicable periods in Limitation Act 1950 and other legislation.

*Question 31: Are the proposed compliance standards (standards 24-26) appropriate? Should the standards be modified or expanded in any way? Are there any other compliance standards that should be included in the Code?*

47. Sovereign has the following comments in relation to proposed standards 24-26:

- a. Sovereign submits that standard 24 should be subject to “take reasonable steps” qualification.
- b. Sovereign considers that further clarification is required in respect of the scope of proposed standard 25. For example, if an AFA employees or appoints another AFA, will the first AFA be in breach of proposed standard 25 if the ‘employee AFA’ breaches the Code?
- c. An AFA should be required to have “reasonable grounds” for his or her belief before informing the relevant authorities under proposed standard 26.

48. Sovereign is not aware of any other compliance standards that should be included in the Code.

*Question 32: The general rule in proposed standard 28 is that an AFA must not disclose information without the client's prior express written consent. Are the exceptions to this general rule (set out at standard 28(1)(a)-(e)) appropriate? Should they be modified or expanded in any way? Are there any other exceptions that should be added?*

49. Sovereign submits that it may assist AFAs if the Code provides some guidance as to what is acceptable (and/or not acceptable) for the purposes of obtaining "prior express written consent".

50. Exceptions allowing disclosure should be included where:

- a. the disclosure of the information is one of the purposes in connection with which the information was obtained or is directly related to the purposes in connection with which the information was obtained; and
- b. where required under the Code (for example, to an auditor for the purposes of proposed standard 35) should be included.

*Question 33: How long should records for trust accounts, client money and client assets be held under proposed standards 30, 33 and 34?*

51. Sovereign submits that the relevant retention requirements should be set having regard to applicable periods in Limitation Act 1950 and other legislation.

*Question 34: Is it appropriate to require trust accounts to be audited annually by a chartered accountant (see proposed standard 35)?*

52. Sovereign agrees that this proposed standard is appropriate.

*Question 35: Are the proposed custody standards (set out in standards 27-35) appropriate? Should the standards be modified or expanded in any way? Are there other custody standards which should be included in the Code?*

53. Subject to the responses to earlier questions, Sovereign considers that the proposed standards are appropriate. Sovereign does not consider any other custody standards need to be included in the Code.

*Question 36: Noting the Ministry of Economic Development's targeted consultation on the regulation of investment transactions, are there any standards that you think should not apply to those who only make investment transactions (as defined in s 5 the Act) and who do not provide other financial adviser services?*

54. It is necessary to understand the outcome of consultation before a definitive response can be provided in relation to this question. However, Sovereign submits that it is likely that only those standards relating to custody will be relevant.

*Question 37: Is there anything else you would like to comment on in relation to the proposed minimum standards of ethical behaviour and client care?*

55. The Code Committee's consultation paper on competency refers to a category of AFAs who provide services exclusively to "wholesale financial service providers". Depending on the definition of "wholesale financial service providers", it may not be appropriate for all of the proposed standards to apply to such category of

AFAs. Sovereign would be pleased to submit further in relation to this issue once there is further clarity around the meaning of "wholesale financial service provider".

56. Sovereign submits that some of the requirements proposed by the standards may be overly prescriptive even though they are entirely appropriate conceptually (such as the requirement to be courteous in proposed standard 9).

*Question 38: Do you consider there are areas other than competence; knowledge and skills; ethical behaviour; client care; and continuing professional training that should be covered in the Code?*

57. Sovereign considers that the proposed areas are appropriate. Additional areas could be included at a later date, following consultation, if issues within the financial services industry are identified and justify additional standard and requirements.