Response of the UK Institute of Business Ethics to the consultation of NZ Ministry of Business, Innovation & Employment the proposed Code of Professional Conduct for Financial Advice Services

The Institute of Business Ethics is a UK registered educational charity whose purpose is to promote high standards of business behaviour based on ethical values. We are engaged on ethical matters in a number of ways with the financial sector in the UK, including codes of conduct in financial institutions. We are also active in the New Zealand market having recently published a research based publication titled Setting the Tone : A New Zealand Perspective on Ethical Business Leadership; prepared the e-learning tool for Directors on Business Ethics for IoD New Zealand; and undertaken numerous in-house business ethics training and workshop initiatives across the corporate sector. We regularly undertake webinar and seminar style training for members of the Institute of Financial Advisors as part of their CPD requirements.

We are pleased to respond to this consultation, but will confine ourselves to the section specifically addressing ethics given that this is most relevant to our experience.

Codes of behaviour that apply to individuals are increasingly accepted as a useful tool by a range of businesses in different sectors. To be effective they must be both visible and explicit.

Out of the leading companies represented in the FTSE 100, over 95 have such codes and both use and apply them to make employees aware of what is expected of them, to help guide them through difficult decisions and to assess their behaviour.

To be effective codes have to have the explicit support of top management, and senior leaders must be seen to follow them, keeping them alive through training, periodic refreshment and being used as a reference in decision making, reward and performance appraisals.

In our in-house research we note fewer New Zealand companies have codes and apply them in this fashion but we anticipate that changing.

We agree that a code applying to individuals involved in the sale of retail financial products would be useful in the New Zealand market, but it should be structured to ensure effective sponsorship and engagement at senior level. The key benefit should be encouragement of an approach with allied training that goes beyond mere box-ticking compliance with regulations and is strongly focused on delivering appropriate outcomes for the customer. This should build trust within and across the industry which is vital to its continuing professional development.

As a general point we feel that some of the suggestions contained in the consultation appear to represent a compromise arising out of debate with the industry. While any code should be practical and rooted in reality, it should not compromise on core ethical standards. For example the exhortation to *do no harm* to the customer dilutes the fundamental ethical point which is that the investment industry should always aim to do the right thing for its customer and deliver value to them.

As supporting material we are pleased to attach a PDF version of key IBE material which may help with understanding of the role of Codes and how to write them. We would be happy to be involved in the development of training around ethics either through adaptation of these materials, training of trainers or the development of an on-line course.

Our answers to the relevant questions are as follows:

C. Do you agree with the requirement to act with honesty, fairness and integrity? If not, please set out your reasoning

The five bullet points based on the IOSCO model code are good starting points. However, as presented, they appear to dilute the key principle which should be to act at all times in the interests of the client. The exhortation to "do no harm" to the client or the financial service industry comes across as too negative. We are not sure about the word integrity as it is not clear what it means.

We further believe that an ability to address conflicts of interest is important if advisers are to act in the clients' interest. Disclosure of conflicts to retail clients need to be handled carefully because it may confuse and worry them. We consider that codes and the principles around them should always be written in simple language that is clear and easily accessible. The five bullet points might be re-written as follows:

"Financial advisers should always seek to act in the best interests of the client. This means:

- being fair, honest, open and transparent in dealings with them, including details of any fees they may pay or commissions they, as advisers, may receive,
- acknowledging and managing conflicts of interest, if necessary by seeking appropriate advice (internally, from the professional body or industry ombudsman),
- keeping commitments made to clients,
- keeping personal data confidential
- providing the same level of service to clients regardless of investment size or complexity

D. 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 to strictly legal obligations?

Yes

E. If there was a minimum standard requiring Financial Advice providers 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?

We support the idea of a separate code for Financial Advice providers as set out in paragraph 90 of the document but the overarching code should address keeping commitments as IOSCO suggests. We do not agree that the overarching code should allow or encourage signatories to take a legal view (as suggested in paragraph 88) around issues such as whether a reasonable client should have known that a commitment was mistaken or wrong or that there could be no obligation to honour a fee that was wrongly quoted. Recourse to such a legal justification for reneging on a stated commitment will tend to undermine trust in the adviser and in the industry he or she represents. <u>The presumption should be that in keeping commitments, the adviser will not seek to correct errors in a way that brings additional expense to the client</u>.

F Should the Code include a minimum standard on conflicts management? Should it focus on particular situations?

The Code should include guidance on managing conflicts. Individual providers' codes could then be more specific. Managing conflicts should also be part of on-going training.

G. 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?

Yes. The formulation in paragraph 96 is appropriate. The wording would benefit from clarity around what constitutes 'disrepute' to reduce a variety of interpretations.

H. Is an additional minimum standard on doing no harm to the client necessary? If so, what standard you propose?

The idea that advisers should 'do no harm' is grudging and sounds self-serving, when they should be seeking to benefit their clients and deliver value to them. The principle, as stated above, should be that advisers will at all times seek to act in the interests of their clients and they are seen to withdraw / turn down the opportunity to engage, if they are unable to deliver value to the client.

I. In which situations, if any, should the retention, use or sharing of anonymised bulk customer data be subject to Code standards?

Sharing of bulk data has become sensitive in the wake of the Facebook revelations and is likely to become the subject of regulation in many jurisdictions. By and large, we agree with the analysis set out in paragraph 99, <u>though the principle might be established that it should not be sold on to third parties or used for any commercial purpose by the financial services provider –</u>

even in anonymised form - without the client's knowledge and explicit consent.

J. Do you agree that the Code should cover the various aspects of maintaining client confidentiality discussed in this paper?

K. Are there any compliance costs or other aspects of maintaining client confidentiality to consider?

The various aspects outlined in paragraph 100 seem sensible. Some of them in any case are likely to be covered by regulation in which case the compliance costs are obligatory. This does not stop the code also covering confidentiality, both because this is an important issue with regard to the trustworthiness of the industry and because the way in which any regulations or protocols are implemented matters. A tick-box approach to compliance is not necessarily helpful. The outcome will be more robust if all those concerned understand why client confidentiality is important. The code and subsequent training could reinforce this message.

L. Do you agree that the Code should require the Financial Advice Provider to document and maintain its "ethical processes?"

Yes. Providers should have policies around ethical issues including matters such as speak-up and conflicts of interest. These should be clear, accessible to all those involved and regularly updated. Providers should also monitor conformity with policies through surveys and ensure that advisers receive adequate training.

M. 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?

Yes, this should be required. Since ethics applies to all aspects of business it is difficult to understand why any business seriously concerned with ethics would want to define situations where a code is not necessary. Waivers, such as that adopted by the Enron board in the US, involve a high risk of backfiring. Consistency of approach is needed to engender trust.

N. Should the Financial Advice Providers also be subject to additional standards in respect of leadership and culture? If so how should these be framed?

Leadership should be public in its commitment to the ethical code and demonstrate its compliance with the code, including participating in training. It should set the example in establishing an ethical culture and behaviours based on the values of the organisation. How business is undertaken is crucial in building trust with customers and clients and is equally as important as profitability.

O. Do you propose other additional standards of ethical behaviour that should apply to Financial Service Providers?

No.

*P. Do you agree that the Financial Advice Providers should be required to meet standards relating to ethics training? If not, please give your reasoni*ng?

Yes and such training should be monitored and a register of completion of such training kept.

Q. Should ethics training requirements apply to all officers and employees of a Financial Advice Provider involved in financial advice processes, as appropriate to their role and contribution to the process of financial advice provision?

Yes. Furthermore we believe there is advantage in requiring a proportion of face to face training through workshops for the more hands on advisers rather than just webinars, or e-learning where focussed engagement, and understanding of the issues is frequently variable.

R. Should there be a requirement for ongoing refresher training in ethics?

Yes.

S. 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?

Yes. Employees at the coal face will periodically need support in making the right decision. Such a framework is a mechanism for providing support and can also provide useful feedback to the leadership in understanding the frequency and nature of the conflicts faced by employees. One of the biggest dangers in financial and other companies arises when conflicts are ignored at the top of the organisation and simply passed down the hierarchy to be dealt with by junior employers who lack the power to resolve them.

T. Should there be a requirement for explicit sign-off on the soundness of financial advice provided directly by a Financial Service Provider?

Yes although sound advice may still result in negative investment outcomes. What matters is the processes that underlie the advice. Advisers may reasonably be held to account for following proper process in accordance with their stated commitments to clients and their ethical responsibilities, including those around the management of conflicts. The need for such a sign-off will act as a regular reminder to advisers of what is expected of them.

U. 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?

Yes. A reliable speak-up line is critically important. The IBE has extensive research available on the topic of speak up which we can share. Of particular significance is the availability of independent, third party and anonymous speak up lines or programmes, in addition to in-house programmes.

V Should this extend further into an internal audit obligation, having in place processes to systematically test for and detect violations of ethical behaviour.

Yes. Internal audit can and should play an important role in monitoring aspects of culture, provided such a requirement is proportional in terms of the size of the business. In other scenarios risk management processes can also be necessary and valuable in preventing ethical lapses.

W. Are there any potential compliance costs for small and/or large Financial Advice Providers that need to be considered?

Handled properly a code backed up by the right framework will reduce compliance costs because it will mitigate conduct risk.

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X. 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.

Yes. Individual advisers should not be able to contract out of parts of the obligations and clients have a right to know what to expect.

Y. What principle or mechanism do you propose the Code could include to reinforce good ethical behaviour on a day-to-day basis?

Advisers should state up front to each client that they are committed to the Code and that the advice delivered will reflect the principles set out in the Code.

In addition visible reinforcement of the expectations under the Code could be given through a sign off sheet being attached to each client proposal or review.