Unlike Australia, there is no compulsory superannuation scheme in New Zealand. There is, however, a state pension — somewhat misleadingly called "New Zealand superannuation". This state pension is paid to all New Zealanders at the age of 65 and is not means-tested. It is funded out of current taxes and is the biggest expenditure component from tax revenue. As of 1 April 2010, the single rate (living alone) was $318.12 net per week and the married, civil union or de facto rate was $244.71 net each per week.

For some years, however, the provision of the state pension has been under pressure. In response, the Government lifted the age of eligibility from 60 to 65. Nonetheless, there are still some worrying trends. Firstly, birth rates have fallen implying there will be fewer persons in the workforce to pay for retired persons. Secondly, those in retirement are living longer. As a result, the Government now encourages New Zealanders to become more self-reliant in their retirement planning. This is reflected in the establishment of the Retirement Commission — an autonomous Crown entity set up in 1993.[4] The core purpose of the Retirement Commission is to help New Zealanders prepare financially for retirement through education, information and promotion. In particular, the Retirement Commission works to develop a more trusted financial services sector and a more financially educated population.

We mentioned earlier that the dominant financial assets held by New Zealanders comprise bank deposits. Suppose now the term interest rate for bank deposits paid by registered banks is 7 per cent. Suppose also that non-bank financial intermediaries such as finance companies pay a term interest rate of 8 per cent. Given New Zealanders' predilection for bank deposits it is not surprising that deposits with such finance companies might be regarded by many ordinary investors as a close but better yielding proxy for bank deposits.[5] Of course, such a view is inaccurate as demonstrated by the collapse of a string of finance companies in New Zealand during the first phase of the so-called global finance crisis of 2008–2009. The finance company collapses of

4 See <www.retirement.org.nz>.

5 "An important element [in finance company collapses in New Zealand] has been that many investors have not received appropriate returns for their risk. For example, although finance companies engage in riskier lending than banks, this is only partly reflected in the returns on short-term deposits. The average difference between the interest rates on 1-year term deposits at banks, and 1-year finance company debentures has been consistently around 1 percent. So one can ask why an investor would put money into a finance company and not go off to a bank like Westpac or Rabobank and earn a monthly rate of interest . . . of around 8.2 or 8.4 percent." Dr Richard Worth MP (19 February 2008) 645 NZPD 14344.

2007–2008 (in which it is claimed that New Zealand investors lost over a billion dollars) gave further impetus to better regulation of the financial services sector with the aim of improving the quality of investment advice provided to the public.[6]

In the event, in late 2008 the New Zealand Government introduced a new regulatory regime for "financial service providers" under the Financial Advisers Act 2008 (FA Act) and Financial Service Providers (Registration and Dispute Resolution) Act 2008 (FSP Act). During 2009–2010, preparatory work for the implementation of the new regime was undertaken. In the process, the original legislation was drastically altered. The original legislation was amended in 2009 by the Financial Advisers Amendment Act 2009 and then again in 2010 by the Financial Service Providers (Pre-Implementation Adjustments) Bill. This Bill was divided into two pieces of amending legislation in June 2010 and two amending Acts were passed. These were the Financial Advisers Amendment Act 2010 and the Financial Service Providers (Registration and Dispute Resolution) Amendment Act 2010.[7] As a result, the final shape of the new regime only emerged on 1 July 2010.

The key players in the new regime for financial service providers are as follows:

- the *New Zealand public*, consumers of financial advice especially with regard to retirement planning
- the *financial service providers industry* comprising about 23,000 persons, and
- the *regulators and enforcement agencies* such as the Securities Commission (Commission), the Registrar of Financial Service Providers, the Commissioner for Financial Advisers and the Disciplinary Committee.

We now describe the securities regulation regime in New Zealand. Understanding the New Zealand securities regulation regime is important for two reasons. Firstly, the new financial service provider regime will eventually replace that contained in Part 4 of the Securities Markets Act 1988. Secondly, the Commission has a pivotal role in the administration of the new regime. For example, the Commission is the licensing authority for authorised financial advisers (AFAs) and qualifying financial entities (QFEs) under the

6 "This bill comes off the back of the Government's review of Financial Products and Providers . . . Since that review process commenced in earnest, we have seen a number of second tier lenders collapse. What that has meant for some 58, 000 individual investments — not investors, but investments — and what the loss of approximately $1.3 billion in investors' funds has meant is that the magnifying glass has gone on to this process quite significantly. It has taken on a new level of importance in recent months." Simon Power MP (11 December 2007) 644 NZPD 14002.

7 The assent date of each of these Acts was 30 June 2010.

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Financial Advisers Act: see Schedule 2 of the Financial Service Providers (Registration and Dispute Resolution) Act. We note, however, that the Government is considering replacing the Commission (and other regulatory bodies) with a new "super-regulator" to be known as the Financial Markets Authority (FMA) with a proposed commencement date of October 2011.[8]

¶102 Securities regulation in New Zealand

"Securities regulation" is the term lawyers use to describe the legal regulation of securities markets. Legal regulation focuses on the "primary market" where financial claims such as equity and debt securities are first issued to the public and the "secondary market" where such claims are traded on markets such as the New Zealand Stock Exchange (NZSX).[9]

There was no separate securities legislation in New Zealand until the Securities Act 1978. Before that time, the subject was embedded in company legislation such as the Companies Act 1955 and the common law. The collapse of the merchant banker, Securitibank, provided the impetus for the present legislation.[10] Securitibank had attracted funds in a manner that avoided the

8 The suggested creation of a new body to oversee capital markets in New Zealand appeared in the report of the Capital Market Development Taskforce: see Capital Market Development Taskforce *Capital Markets Matter: Report of the Capital Market Development Taskforce* (December 2009) <www.med.govt.nz>. The New Zealand Government response appeared on 18 February 2010. It said the Government was considering the creation of a new "super-regulator" in October 2011 to be known as the Financial Markets Authority (FMA). Press reports indicate that the new FMA would bring together the regulatory powers of the Commission, the Ministry of Economic Development, the Government Actuary and the New Zealand Exchange. On 22 June 2010, Commerce Minister Simon Power released a discussion document on the matter: Ministry of Economic Development *Review of Securities Law Discussion Paper* (June 2010) <www.med.govt.nz>. As this book went to press, the Financial Markets (Regulators and KiwiSaver) Bill 2010 was introduced in the New Zealand Parliament. As far as financial advisers and brokers are concerned, the key changes proposed in the Bill are as follows:

- The Financial Markets Authority (FMA) will take over the existing regulatory functions of the Securities Commission.
- The office of the Commissioner for Financial Advisers will be abolished and the Commissioner will become a member of the board of the FMA.
- The FMA will take over the functions of the Commissioner.
- The proposed changes will not come into force before late 2011 and after the Financial Advisers Act 2008 is fully in force.

9 There is a brief topical discussion in Gordon Walker, Terry Reid, Pamela Hanrahan, Ian Ramsay and Geof Stapledon *Commercial Applications of Company Law in New Zealand* (3rd ed, CCH New Zealand Ltd, Auckland, 2009) at ch 27.

10 See generally, Frank Partnoy, "Why Markets Crash and What Law Can Do About It" (2000) 61 U Pitt L Rev 741.

prospectus provisions of the Companies Act 1955. The legislative response embodied in the Securities Act was designed to regulate the *activity* of fund raising generally thereby defeating technical avoidance of the pre-existing legislation.[11]

The principal legislation consists of:

- the Securities Act, and
- the Securities Markets Act 1988.

In the recent past, the New Zealand Labour Government instituted a "four-step" reform programme of New Zealand's securities regulation regime. As of early 2008, the third step of that programme was complete. Reform of the substantive legislation occurred in 2006 pursuant to the Securities Legislation Bill 2004 and included investment advisers and brokers. The Acts passed on 24 October 2006 did not come into effect until February 2008. The Commentary accompanying the Securities Legislation Bill as reported back from the Commerce Committee stated:

> This bill is designed to ensure confidence in New Zealand's capital markets by increasing the effectiveness of securities, securities trading, and takeover laws. The bill simplifies the current substantial security holders' disclosure regime; introduces comprehensive prohibitions against practices involving the creation of a false impression of securities trading activity, price movement, or market information; strengthens the law relating to insider trading; *improves the quality of advisor and broker disclosure and business practices across the advisory industry;* and overhauls the penalties and remedies available under securities and takeover laws to deter illegal behavior and encourage compliance. This bill is an omnibus bill and amended the Securities Act 1978, the Securities Market Act 1988, the Takeovers Act 1993, and the Fair Trading Act 1986.[12]

The Bill followed (in part) Australian legislative models pursuant to the earlier *Memorandum of Understanding between the Government of New Zealand and the Government of Australia on Coordination of Business Law* signed in August 2000.[13]

In summary, the main aspects of the 2008 reforms to securities regulation in New Zealand were:

- the introduction of a new insider trading regime following the Australian model
- new market manipulation laws

11 For a full review of the history of securities regulation in New Zealand until 1998, see G Walker "Reinterpreting New Zealand Securities Regulation" in G Walker (gen ed) *Securities Regulation in Australia and New Zealand* (2nd ed, LBC Information Services, Sydney, 1998) at pp 88–126.

12 Emphasis added.

13 The current *Memorandum of Understanding on Coordination of Business Law between Australia and New Zealand* was signed on 23 June 2010.

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- fine-tuning of the substantial shareholder disclosure requirements
- new rules for the regulation of investment advisers and brokers
- changes to the takeovers regime, and
- a carve out of the application of the Fair Trading Act 1986 to conduct covered by securities and takeovers legislation.

As stated, all of these changes came into effect in February 2008.

Thus, the so-called "third step" of the reform process included arrangements for investment advisers and brokers. These arrangements did not last for long. Change occurred within the year. In late 2008, the FA Act removed regulation of investment advisers from the Securities Markets Act and established a new regime for the regulation of such persons. It did so by repealing Part 4 ("Investment advisers and brokers") of the Securities Markets Act. The repeal, however, was only to become effective on a date to be appointed by the Governor-General by Order in Council. The date is expected to be 1 July 2011.

¶103 The regulators

Ministry of Economic Development

The Ministry of Economic Development in New Zealand has general oversight of securities legislation, the Companies Office and financial service providers.

Securities Commission

The Securities Commission (the Commission) is a creation of the Securities Act and is the chief governmental agency with responsibility for securities regulation.[14] Ultimate responsibility for the Act itself resides with the Ministry of Economic Development.

The Commission consists of not less than five and not more than eleven members appointed by the Governor-General on the recommendation of the responsible Minister.[15] One of the members of the Commission must be the Commissioner for Financial Advisers (Commissioner).

The Chairperson of the Commission is a barrister and solicitor of not less than seven years standing. He or she serves on a full-time basis. The remaining members serve on a part-time basis. The day-to-day work of the Commission is performed by an office of full-time staff headed by the Director.

14 There is an extended discussion of the Commission in Gordon Walker, Terry Reid, Pamela Hanrahan, Ian Ramsay and Geof Stapledon *Commercial Applications of Company Law in New Zealand* (3rd ed, CCH New Zealand Ltd, Auckland, 2009), at pp 41–50.

15 As of June 2010, the members of the Commission were: Jane Diplock (Chairman of the Commission since 2001), David Mayhew (Commissioner for Financial Advisers), Simon Botherway, Shelley Cave, Annabel Cotton, Keitha Dunstan, John Holland, Neville Todd and Mark Verbiest.

Section 10 of the Securities Act sets out the functions of the Commission as follows:

- to perform the functions and duties conferred or imposed on it by or under this Act or any other enactment
- to keep under review the law relating to bodies corporate, securities, *financial advisers* and unincorporated issuers of securities, and to recommend to the Minister any changes thereto that it considers necessary
- to keep under review practices relating to securities and *financial advisers*, and to comment thereon to any appropriate body
- to co-operate with any overseas regulator and for that purpose, but without limiting this function, to communicate information obtained by the Commission to that overseas regulator
- to keep under review activities on securities markets, and to comment on those activities to the appropriate body
- on the Minister's request, to advise the Minister on the conduct rules . . . proposed by securities exchanges
- to promote public understanding of the law and practice relating to securities and the law and practice relating to *financial advisers*
- to keep under review the law and practices relating to settlement systems (as defined in Part 5C of the Reserve Bank of New Zealand Act 1989, but not including any designated settlement system that is declared to be a pure payment system in accordance with s 156N(3)(d)) and to perform the functions and duties, and exercise the powers, given to it under that Part, and
- by agreement with the Takeovers Panel, to provide administrative and support services to the Panel.

There are two points to note regarding the functions of the Commission. The first is that the Commission has the functions and duties imposed on it by the Act itself "or any other enactment". The FA Act also imposes functions and duties on the Commission. The second is that s 10 refers to "financial advisers" not financial service providers generally. This is because it is the Commission that *authorises* financial advisers (AFAs), including qualifying financial entities (QFEs).[16]

16 Somewhat confusingly, the FA Act refers to authorised and licensed financial advisers. There is no distinction between the terms; they are synonymous. It would have been preferable if the legislation had only used one of these terms.

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The Companies Office and the Registrar of Financial Service Providers

The Ministry of Economic Development has overall responsibility for companies via the Business Services branch which is headed by a Deputy Secretary. This responsibility is discharged by one of its business units, the Companies Office.

The Registrar of Companies heads the Companies Office. The Registrar of Companies is a position created by statute and the Registrar is the principal regulator of companies in New Zealand. The role and powers of the Registrar are contained in Part 20 of the Companies Act 1993.

Pursuant to s 35 of the FSP Act, the Registrar of Companies is the Registrar of Financial Service Providers responsible for the registration of financial service providers. The Registrar does not deal with the authorisation (sometimes called "licensing") of AFAs and QFEs. The Commission deals with all matters relating to authorisation.

As stated, the Registrar of Companies heads the Companies Office. Immediately beneath the Registrar is the National Manager of Business Registries. There are five main operational units beneath the National Manager of Business Registries. These are:

- National Enforcement Unit: The manager of the national enforcement unit has responsibility for prosecutions and the director prohibitions. This unit is based in Auckland. It is this unit that will perform the Registrar's enforcement powers under the Part 2, Subparts 4 and 5 of the FSP Act.
- Central Region: The manager of this unit has responsibility for client services and the insurance and superannuation unit.
- Internet Support: The manager of this unit has responsibility for Internet support and online promotions.
- Contact Centre and Southern Region: The manager of this unit has responsibility for the contact centre, client services and quality control.
- Northern Region: The manager of this unit has responsibility for legal services, client services, compliance, other registers, document processing and document imaging.

Details of the organisational structure, functions and legislation administered by the Companies Office can be found at the website of the Companies Office: see www.companies.govt.nz. One of the principal functions of the Companies Office is to maintain registers containing information about companies that can be accessed by members of the public. Most of the following information about the function of the Companies Office is extracted from the Companies Office *Online with NZ Business: Strategic Business Plan 2005–06*.

The Companies Office is responsible for the provision of services relating to the registration of companies and other corporate entities and public access to corporate and securities information. The Companies Office has compliance and enforcement functions under the FSP Act, Companies Act, Securities Act, Corporations (Investigation and Management) Act 1989, Financial Reporting Act 1993 and the Friendly Societies and Credit Unions Act 1982.

Registers maintained by the Companies Office

The Companies Office maintains and manages 17 registers including the following:

- New Zealand and overseas companies
- co-operative companies
- incorporated societies
- industrial and provident societies
- charitable trusts
- unit trusts
- friendly societies
- credit unions
- building societies, and
- (as of 2010) financial service providers.

Administration of the registries falls into four areas:

- new registrations
- maintenance of registered information
- removal of defunct entities, and
- ensuring compliance with statutory disclosure obligations.

The Companies Office monitors compliance and time frames for filing changes to registered information, as prescribed by the associated legislation.

The information held on the registers is available for public search. Searches can be conducted online via the Companies Office website or at the regional office where the company is registered.

The Registrar of Companies has a number of statutory responsibilities in relation to the supervision of corporate bodies and issuers of securities. The Securities and Corporate Compliance Unit of the Companies Office is based in Auckland and has three main functions:

- *Market supervision:* The unit analyses and vets financial statements, investment prospectuses and similar information to be disclosed under the Securities Act, the Financial Reporting Act and related legislation.

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- *Investigation:* Where issues of non-compliance with the various statutory regimes arise from information disclosed, the unit may conduct investigations under the Companies Act, the Securities Act or the Corporations (Investigation and Management) Act. As of 2010, the unit may investigate pursuant to the FSP Act.
- *Enforcement:* where investigations identify serious issues of non-compliance that remain unresolved, civil or criminal sanctions may be pursued. This can include prosecutions of companies or their directors, referrals to other agencies such as the Serious Fraud Office or commencement of director disqualification proceedings.

The remaining operational units of the Companies Office are the Insurance and Superannuation Unit, the Internet Support Advisory team, the National Compliance Unit and the Contact Centre.

Commissioner for Financial Advisers

The FA Act creates the position of Commissioner for Financial Advisers (Commissioner) and this person is a member of the Commission. The Commissioner is also Chairperson of the disciplinary committee.

Pursuant to ss 80–82 of the FA Act, the Commissioner is to appoint a code committee to draft a *Code of Professional Conduct for Authorised Financial Advisers* (Code). The Code as approved by the Minister of Commerce is used in this book.

Proposed Financial Markets Authority

We mentioned earlier that the New Zealand Government proposes to create a new "super-regulator" for financial markets in 2011. The role of the proposed Financial Markets Authority (FMA) will be to enforce securities, financial reporting and company law as those laws apply to financial services and securities markets. It will also regulate and oversee financial advisers and financial service providers: see Financial Markets (Regulators and KiwiSaver) Bill 2010.

¶104 Overview

The legislation forming the core of the new regime comprises:

- the Financial Service Providers (Registration and Dispute Resolution Act) (FSP Act), and
- the Financial Advisers Act (FA Act).

There is one other relatively minor piece of legislation that is part of the legislative package. This is the Reserve Bank of New Zealand Amendment Act 2008. This Act imposes standards, disclosure requirements and accountability measures on non-bank deposit takers.

The new legislation will repeal the Sharebrokers Act 1908 and Part 4 of the Securities Markets Act no later than 1 July 2011.

By way of introduction, the two key Acts are now described in broad overview. More detailed examination appears later in the commentary.

¶105 The Financial Service Providers (Registration and Dispute Resolution) Act

Introduction: definitional cascades

First, we alert readers to "definitional cascades" in the legislation. Imagine a pyramid of champagne glasses. Now imagine that champagne is poured into the glass at the top of the pyramid. When the glass becomes full, the champagne overflows and cascades downwards into the glasses in the next tier of the pyramid.

A similar phenomenon occurs in the new regime. The FSP Act requires that "financial service providers" be registered. The FSP Act then goes on to define that term. The definition leads us on to another definition and so on. In this way, we observe a "definitional cascade".

So, for example:

- The FSP Act says that "financial service providers" must be registered: Part 2, FSP Act.
- Section 4 of the FSP Act says that a "financial service provider" means "a person who provides or offers to provide a financial service".
- Section 4 of the FSP Act says that the term "financial service" has the meaning given to that term in s 5 of the FSP Act.
- Section 5 of the FSP Act lists 16 types of financial service. These break down into three categories: a financial adviser service, a broking service and 14 other types (eg a registered bank).
- A "financial adviser service" is defined in s 4 of the FSP Act as having the meaning given in s 9 of the FA Act.
- Section 9 of the FA Act says that financial adviser services are: giving financial advice, providing an investment planning service and providing a discretionary investment management service.
- To complicate matters further, s 8 of the FA Act says that a financial adviser is a person who provides a financial adviser service and s 16 of the FA Act states that there are five types of "financial advisers". These are authorised financial advisers (AFAs), individuals who are registered but not authorised financial advisers, qualifying financial entity (QFE) advisers, a QFE or any other entity that is registered but does not have QFE status and any other person who is an exempt provider.

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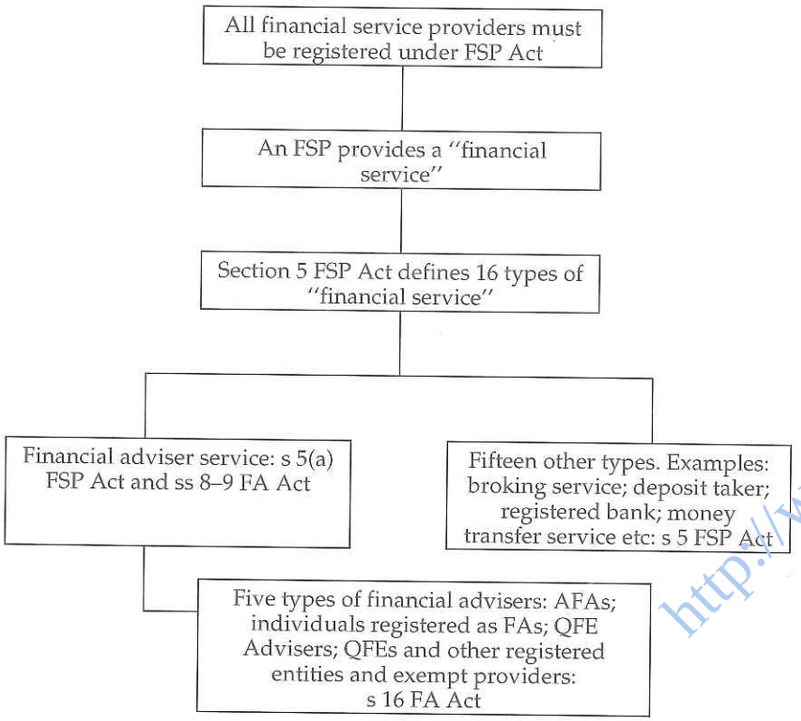
A "broking service" is a category of financial service: s 5(ab) of the FSP Act. A broking service must be registered under the FSP Act. The terms "broker" and "broking service" are defined in ss 77A and 77B of the FA Act. Brokers have their own set of disclosure and conduct obligations: see Part 3A of the FA Act. These would typically apply to a discount broker who merely offered order execution services. Some "full service" brokers, however, will meet the definition of a financial adviser service in s 9(3) of the FA Act and will be required to be authorised accordingly.

Figure 1: Types of financial service provider



Compulsory registration system for financial service providers

The FSP Act establishes a *compulsory registration system* for *financial service providers*. The term, "financial service providers" is defined in s 4 of the FSP Act. It is an "umbrella" term for various types of industry participants of which financial advisers are perhaps the most important sub-category. Certain persons are excluded from the operation of the FSP Act. Generally speaking, lawyers, accountants and real estate agents are excluded: see s 7.

Purpose of the registration system

The purpose of the registration system is stated in s 9 of the FSP Act. In summary, s 9 states that the purpose of the FSP Act is:

- to establish a compulsory public register to enable the public to access information about financial service providers and to enable the Registrar and other regulators to regulate them
- to prohibit certain people (ie those with criminal convictions) from being involved in management or direction of registered financial service providers, and
- to conform to New Zealand's obligations under the Financial Action Task Force Recommendations on Money Laundering.

The Financial Services Provider Register

All financial service providers must be formally registered under the FSP Act. The register is maintained by the Registrar of Financial Service Providers who is the Registrar of Companies.

In 2010, the Companies Office announced that the register — to be known as the Financial Service Providers Register (FSPR) — would go live in August 2010. The date was chosen to accommodate legislative timetables involving registration and authorisation fees, dispute resolution schemes and the Financial Service Providers (Pre-Implementation Adjustments) Bill. It is envisaged that all financial service providers will be registered by 1 December 2010.

Registration is the first step to compliance

Normally, registration under the FSP Act will be the first step taken by individuals and entities seeking to comply with the new regulatory scheme. For example, registration under the FSP Act is required before an individual can become an authorised financial adviser under the FA Act.

Qualifications required for registration as a financial service provider

The FSP Act sets out the *qualifications required for registration*: ss 13–14. To qualify for registration a person must not be disqualified under s 14 (eg for having a criminal conviction), must be a member of a dispute resolution scheme and, where required, be a "licensed provider": s 13. Disqualified persons include undischarged bankrupts, persons subject to management banning orders and persons convicted of certain offences under the Crimes Act 1961: s 14.

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In passing, we observe that the qualifications for registration under the FSP Act are minimal. No formal training requirements whatsoever are required of the applicant. Essentially then, all the fact of registration tells us is that the registered person is not an undischarged bankrupt and has not been convicted of an offence within the last five years. The register will also disclose whether or not a registered person is also an authorised or licensed provider: s 27 FSP Act.

Applications for registration

Applications for registration are made to the Registrar of Financial Service Providers who is the Registrar of Companies: see s 15. As stated, the information required is minimal. Significantly, s 16 says that if the Registrar accepts that an applicant is qualified to be registered, he must enter the applicant's name on the register. Having regard to the terms of s 13 (qualifications for registration), it is plain that an applicant will be registered so long as the s 13 criteria are met.

Public access to the register

The register is available for access and searching by members of the public: s 25. Section 26 of the FSP Act states that the purposes of the register include enabling the public to identify registered financial service providers and access information about them. Data sharing from the register (for example, with the New Zealand Police) is permitted: s 34.

Dispute resolution scheme

A key requirement of the FSP Act is that — generally speaking — financial service providers be members of an *approved dispute resolution scheme* or the reserve or default dispute resolution scheme (as described in s 71 of the FSP Act). Membership of an approved dispute resolution scheme is one qualifying criterion for registration: s 13 (b).

Enforcement

The FSP Act imposes obligations on industry participants such as the obligation to register under the FSP Act. Those obligations are backed up by criminal sanctions enforced by the Registrar. A key obligation as far as "retail clients" are concerned is that the financial service provider be a member of an approved dispute resolution scheme or the reserve scheme. The intention of the legislation is that all disputes involving retail clients will be resolved exclusively by reference to the dispute resolution scheme: s 63(g) FSP Act.

The Registrar is granted inspection powers under s 37 and it is an offence to obstruct or hinder the exercise of the Registrar's inspection powers. Failure to comply with these inspection powers is also a criminal offence. Where an entity that is a financial service provider commits an offence, every director

who knowingly authorises or knowingly fails to prevent the offence commits an offence: s 40. False or misleading representations by a person in any documents or information required by the Act are subject to criminal sanction: s 41.

¶106 The Financial Advisers Act

Purpose of the Financial Advisers Act (FA Act)

Section 3 of the FA Act describes the purpose of the Act. It states as follows:

> **3 Purpose of Act**
>
> (1) The purpose of this Act is to promote the sound and efficient delivery of financial adviser and broking services and to encourage public confidence in the professionalism and integrity of financial advisers and brokers.
>
> (2) To this end, the Act—
>
> (a) requires financial advisers and brokers to take an appropriate degree of care in providing services to investors and consumers and prohibits certain conduct by financial advisers and brokers; and
>
> (b) in addition,—
>
> (i) requires disclosure by financial advisers and brokers to retail clients, so ensuring that clients can make informed decisions about whether to use the financial adviser or broker and, in the case of an adviser, whether to follow a financial adviser's advice; and
>
> (ii) imposes competency requirements on certain financial advisers who deal with retail clients, so ensuring that there are available to retail clients financial advisers who have the experience, expertise, and integrity to match effectively a person to a financial product that best meets that person's need and risk profile; and
>
> (iii) ensures that financial advisers are held accountable for the services that they give to retail clients and that there are incentives for financial advisers to manage conflicts of interest appropriately.

Section 3 makes it clear that the FA Act is a consumer protection statute. New Zealand courts will interpret the legislation accordingly.

Financial advisers are legal persons

The term, "financial adviser" is widely defined. In s 8 of the FA Act, the term was originally defined as "an *individual* who performs a financial adviser service". The reference to an "individual" meant that only natural persons

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¶502 What is a conduct obligation?

Conduct obligations are rules that financial advisers and brokers must adhere to when providing services to investors. Conduct obligations applying to financial advisers are set out in ss 33 to 48 of the FA Act. Sections 77J to 77O deal with brokers' conduct obligations. A "conduct obligation" in relation to a financial adviser means an obligation described in s 32. Brokers' conduct obligations are described in s 77J.

¶503 Conduct obligations applying to all financial adviser services

According to s 32 of the FA Act, a "conduct obligation" is an obligation under ss 33 to 48. These sections address matters such as minimum standards of behaviour and the statutory duty of care.

Overview of main requirements

Conduct obligations are primarily intended to ensure that financial advisers deal fairly and competently with their clients. Table 1 provides a guide to the main requirements applicable to financial advisers under the FA Act.

Table 1: Overview of conduct obligations under the FA Act

Conduct obligation applies to	Conduct obligation	Sections under the FA Act
All financial advisers	Financial adviser must exercise care, diligence and skill	s 33
	Financial adviser must not engage in misleading or deceptive conduct	s 34
	Advertisement by financial adviser must not be misleading, deceptive or confusing	s 35
AFAs	AFA must comply with the Code	s 37
	AFA must not recommend securities if offer for subscription illegal	s 38
	AFA must comply with terms and conditions of his or her authorisation	s 45
	AFA may report breach of Act to Commission	s 45A

QFEs	QFE must comply with terms and conditions of grant of QFE status	s 46
	QFE must not engage in misleading or deceptive conduct	s 47
	Advertisement by QFE must not be misleading, deceptive or confusing	s 48
Advisers providing a class service to a retail client	Regulations may impose specific conduct obligations for class services to retail clients	s 36

¶504 Conduct obligations applying to all financial advisers

The FA Act creates a set of obligations that uniformly apply to all financial adviser services. These are:

- duty to exercise reasonable care, diligence and skill: s 33
- obligation not to engage in misleading or deceptive conduct: s 34
- obligations in respect of advertising of financial products and services: s 35.

We turn now to discussing these obligations.

Reasonable care, diligence and skill

Section 33 of the FA Act is fundamental to the operation of the Act. The provision imposes a standard of reasonable care on financial advisers. It states:

> **33 Financial adviser must exercise care, diligence, and skill**
>
> (1) A financial adviser, when providing a financial adviser service, must exercise the care, diligence, and skill that a reasonable financial adviser would exercise in the same circumstances.
>
> (2) In determining the degree of care, diligence, and skill that a reasonable financial adviser would exercise, the following matters must be taken into account (without limitation):
>
> (a) the nature and requirements of the financial adviser's client or (if it is a class service) of the clients intended to receive the service; and
>
> (b) the nature of the service provided and the circumstances in which the service is provided; and
>
> (c) the type of financial adviser.

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The wording of s 33 of the FA Act is similar to that contained in s 137 of the Companies Act 1993. Section 137 states:

> **137 Director's duty of care**
>
> A director of a company, when exercising powers or performing duties as director, must exercise the care, diligence, and skill that a reasonable director would exercise in the same circumstances taking into account, but without limitation,—
>
> (a) the nature of the company; and
>
> (b) the nature of the decision; and
>
> (c) the position of the director and the nature of the responsibilities undertaken by him or her.

Hence, the standards imposed on financial advisers are essentially the same standards imposed upon directors under s 137 of the Companies Act. Judicial interpretations of s 137 may be accepted by courts in the context of s 33. It is of particular significance that courts distinguish between different types of directors, ie executive and non-executive directors, when applying s 137. This reasoning will be extended to s 33 of the FA Act. The court will have regard to the type of financial adviser performing the service.

What standards are applied?

It is appropriate to divide the duty in s 33 of the FA Act into three categories:

- care
- diligence, and
- skill.

Whether a person has breached the standard of care imposed by s 33 of the FA Act is determined by considering the following circumstances:

- the nature and requirements of the financial adviser's client
- the nature of the service performed for the client and the circumstances in which the service was performed, and
- the status of the financial adviser.

The court will examine the actual degree of care, diligence and skill exercised by the financial adviser and compare this with the degree of care, diligence and skill that a reasonable person would exercise if they were in a similar position and performed the same service for the client as the financial adviser.[1] We now discuss the standards of care, diligence and skill. It is clear that all these standards are objective.

1 See generally Gordon Walker, Terry Reid, Pamela Hanrahan, Ian Ramsay and Geof Stapledon *Commercial Applications of Company Law in New Zealand* (3rd ed, CCH New Zealand Ltd, Auckland, 2009) at ch 12.

Care

Financial advisers are subject to a duty of care. They must exercise the degree of care that a reasonable financial adviser would exercise in the adviser's circumstances and with the same responsibilities as the adviser, taking into account the nature of the service provided and the client's requirements.

AFAs, registered individuals and advisers performing financial adviser services as part of a QFE will be subject to different standards of care, diligence or skill. Higher standards will be expected of some financial advisers. Thus, the standard of care expected of AFAs will be higher than that expected of registered individuals.

At a minimum, all financial advisers can be expected to have a basic understanding of:

- financial matters
- the subject matter of the advice
- the financial circumstances, objectives and needs of a retail client, and
- the nature of the service provided.

Diligence

The degree of diligence required is assessed by reference to a reasonable financial adviser (see below). One must consider the degree of diligence that a reasonable financial adviser would exercise if he or she were an adviser providing the advice to the client, taking into account the nature of the advice, the status of the adviser and the nature of the responsibilities undertaken.

Skill

Section 33 imposes the standard of the reasonable financial adviser, thus introducing an objective standard. Section 33 also states that the circumstances of the financial adviser should be considered. The standard of skill may depend upon several factors, including whether the adviser is registered, authorised or an employee or nominated representative of a QFE.

For example, if it is alleged that a QFE adviser has breached his or her duty, the conduct of the QFE adviser would be tested against an objective body of expertise and knowledge possessed by QFE advisers in the same position. The court will consider what an ordinary, reasonable QFE adviser with the knowledge and experience of the defendant might be expected to have done in the circumstances if he was acting on behalf of the client.[2]

2 For an articulation of this test in the context of s 180 of the Australian Corporations Act, see *Australian Securities Commission v Gallagher* (1993) 11 ACLC 286; 10 ACSR 43 at ACLC 295; ACSR 53.

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Section 33 makes no reference to the standards of skill expected of each type of adviser. However, even though these standards are not specifically mentioned, the courts are likely to develop specific standards as part of the general law in line with the approach taken by the courts with respect to s 137 of the Companies Act 1993.

Section 33 attempts to assist in the application of an objective standard by outlining the relevant factors to be taken into account. As stated, these factors include: the status of the financial adviser; the nature and requirements of the financial adviser's client and the nature of the service performed for the client.

The degree of financial competence required of a reasonable person in the position of an AFA will be higher than that of a reasonable person in the position of a registered individual. The matters which fall within the scope of an AFA's services may require a higher level of skill and care.

Misleading or deceptive conduct

The FA Act contains a general prohibition on misleading and deceptive conduct: s 34(1). It is an offence to knowingly or recklessly engage in conduct in relation to the provision of a financial adviser service that is misleading or deceptive, or likely to mislead or deceive: s 34(2). Further, a financial adviser must not advertise his or her services in a way that is misleading, deceptive or confusing: s 35.

¶505 Conduct obligations applying to all financial advisers providing class services to retail clients

Specific obligations apply to financial advisers providing "class services" to retail clients: s 36 of the FA Act. If required by regulations, the financial adviser must ensure that a warning is given that the class service is not personalised: s 36(1)(a). Further, the adviser must ensure that persons involved in providing the service comply with competency requirements and exercise adequate care, diligence and skill: s 36(1)(b). Finally, when providing the class service, the financial adviser must comply with any prescribed record-keeping or procedural requirements: s 36(1)(c).

Section 36 of the FA Act is only applicable if the service in question satisfies the requirements of s 15(3) of the FA Act. The service must be a "class service" rather than a "personalised service". Personalised services are generally provided to clients in circumstances in which the client can reasonably expect the adviser to take his or her financial situation or goals into account: s 15(1).

Moreover, for s 36 to apply, the service must be provided to a "retail client" as defined in s 5B of the FA Act. The definition of "retail client" was considered in ¶404.

¶506 Conduct obligations applying to AFAs

While the conduct obligations discussed above extend to all types of financial advisers, in this paragraph we discuss the conduct obligations that apply to AFAs only. AFAs must:

- comply with the *Code of Professional Conduct for Authorised Financial Advisers* (Code): s 37
- not recommend securities if the offer for the subscription is illegal: s 38
- adhere to the terms and conditions of their authorisation: s 45.

These requirements reflect the higher quality of advice that AFAs are expected to provide.

Recommendations

An AFA must not recommend the acquisition of securities to a person when he or she knows or ought to know that, when the securities were or are offered for subscription, the offer was or is illegal: s 38 of the FA Act. An AFA who contravenes this requirement commits an offence under s 121.

Terms and conditions of authorisation

Section 45 of the FA Act imposes an obligation on AFAs to comply with the terms and conditions of his or her authorisation. Failure to do so constitutes an offence under s 126.

Reporting

The FA Act provides that AFAs may report material breaches of the Act or the Code to the Commission: s 45A(1). AFAs are not obliged to report but can choose to do so. Section 45A(2) precludes the Commission from bringing civil, criminal or disciplinary proceedings against an AFA in respect of a report provided by the AFA if the AFA acted in good faith. The Commission is also prohibited from disclosing information that might identify the AFA, unless the AFA consents in writing to the disclosure or the Commission believes that disclosure is otherwise essential: s 45A(2)(d). Further, the Commission is obliged to protect the confidentiality of information that might identify a client of an AFA: s 45A(3). This obligation, however, does not apply if the client consents in writing to the disclosure of the information or the Commission considers the disclosure to be essential.

Compliance with the *Code of Professional Conduct for Authorised Financial Advisers*

AFAs are subject to the Code: s 37 of the FA Act. The Code contains minimum standards which may be divided into four categories:

- minimum standards of ethical behaviour (Code Standards 1–5)
- minimum standards of client care (Code Standards 6–13)

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- minimum standards of competence, knowledge and skills (Code Standards 14–16), and
- minimum standards for continuing professional training (Code Standards 17–18)

The Code distinguishes between personalised services and class services. AFAs are expected to comply with more stringent obligations when providing personalised services. Code Standard 8 states that when providing a personalised service to a retail client an AFA must take reasonable steps to ensure that the personalised service is suitable for the client. Personalised financial advice is generally given to or in respect of a named client or a client that is readily identifiable by the AFA. A class service is a financial adviser service that is not a personalised service: see Code Standard 10.

Standards of ethical behaviour

Standards of ethical behaviour require AFAs to act with integrity. AFAs must, amongst other things:

- place the interests of the client first and act with integrity (Code Standard 1)
- not do anything or make an omission that would bring the financial advisory industry into disrepute (Code Standard 2)
- not misstate that they are independent (Code Standard 3)
- not borrow from or lend to a retail client (Code Standard 4)
- not provide financial advice to a retail client in relation to a financial product that is not offered to the public if the AFA is a related person of the product provider of that financial product (Code Standard 5).

Certain terms contained in the Code are defined in the Definitions Schedule to the Code. AFAs are not deemed to be independent if they or a "related person" receive a "benefit" from a transaction. A "benefit" is defined as "any money, property or valuable consideration". Some examples of financial benefit include:

- receiving financial benefits in relation to a financial product or financial service recommended to the client, or
- receiving financial benefits indirectly through a related person.

The Code provides a definition of a "related person" in the Definitions Schedule. Related parties include:

- a parent, child, sibling, spouse, de facto spouse, civil union partner, employer or business partner
- corporate entities which have substantially the same shareholders as the relevant body corporate (A), or
- are under the "control" of the same person or persons as A, or

- a person who is able, directly or indirectly, to exercise, or control the exercise, of 25% or more of the voting at a meeting of the shareholders of A, or
- a person who is able, directly or indirectly, to appoint or control 25% or more of a governing body of A.

A "retail client" is defined in the Definitions Schedule as a client who is not a "wholesale client." The Code defines "wholesale client" by reference to s 5C of the FA Act. A "client" means, in relation to an AFA:

- a person who receives a service from the AFA (whether or not on payment of a charge), but
- does not include a person who receives any services from the AFA if the service is both provided and received in the course of, and for the purposes of:
  - (i) the same business, or
  - (ii) the businesses of related bodies corporate, or
  - (iii) the businesses of members of a QFE group

  irrespective of whether the person providing or receiving the service is the person carrying on the business, a controlling owner, a director, an agent or any other person: s 5A.

The concept of "control" is not defined in the Code. The Takeovers Code provides some guidance on how the expression should be interpreted. The term control is defined in Rule 3(1) of the Takeovers Code to mean, in relation to a voting right, "having directly, or indirectly, effective control of the voting right," and the term "controller" has a corresponding meaning. Rule 6(2) of the Takeovers Code provides that a person will have control if that person acts jointly or in concert with other persons, or if a person joins another person or group of persons controlling voting rights as an associate.

According to the Definitions Schedule to the Code, a "product provider" means:

- the issuer, in the case of a security
- the creditor, in the case of a consumer credit contract (within the meaning of the Credit Contracts and Consumer Finance Act 2003)
- the insurer, in the case of a contract of insurance (other than an investment linked contract of insurance)
- the person specified by regulation, in any other case.

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The requirements which AFAs must meet in order to comply with the minimum standards of ethical behaviour are outlined in Table 2.

Table 2: Code Standards — minimum standards of ethical care

Code Standard number	Code Standard	Requirements
1	An AFA must place the interests of the client first and must act with integrity.	Give advice to a client only in relation to financial products or matters that are within the scope of the AFA's financial adviser services, as advised to the client in writing.
2	An AFA must not do anything or make an omission that would bring or would be likely to bring the financial advisory industry into disrepute.	The AFA must behave professionally, having regard to the duties that apply to AFAs under the FA Act and the Code. This Code Standard does not prevent an AFA from commenting in good faith on the actions of any other financial adviser.
3	An AFA must not state or imply that the AFA is independent, or that any financial adviser services provided are independent, if a reasonable person in the position of a client would consider that the AFA or the services provided are not independent.	An AFA is not considered to be independent if: • a related person of the AFA, or a related person of the AFA's employer or principal, is the product provider of a financial product relevant to the financial adviser service provided • the AFA is subject to a contractual obligation to recommend a particular financial product or financial products, or to limit the AFA's recommendations to a particular financial product or financial products, attain or maintain a target in relation to a particular financial product or financial products, or • the AFA or a related person of the AFA will or may directly or indirectly receive a benefit from a person other than the client for providing the services or from the client's acquisition of a financial product or products.

4	An AFA must not borrow from or lend to a retail client.	There are exceptions to this Code Standard. The Standard does not apply if the client is a related person of the AFA, or is in the business of borrowing or lending money or valuable property and the AFA's borrowing or lending is in the ordinary course of the client's business on terms consistent with the client's normal business terms.
5	An AFA must not provide financial advice to a retail client in relation to a financial product that is not offered to the public if the AFA is a related person of the product provider of that financial product.	There are exceptions to this Code Standard.

Standards of client care

The Code also requires AFAs to comply with minimum standards of client care. Thus, AFAs must:

- behave professionally (Code Standard 6)
- ensure each retail client is provided with sufficient written information to enable the client to make an informed decision about whether to use the AFA's financial adviser services (Code Standard 7)
- when providing a personalised service to a retail client, take reasonable steps to ensure that the personalised service is suitable for the client (Code Standard 8)
- when providing a personalised service to a retail client that is an investment planning service or that relates to a category 1 product, provide a written explanation to the client of the basis on which those services are provided. The AFA must also take reasonable steps to ensure the client is aware of the principal benefits and risks involved (Code Standard 9)
- when providing a class service to a retail client, provide an appropriate statement as to the limitations of the service provided (Code Standard 10)
- ensure that an appropriate process is in place for resolving client complaints (Code Standard 11)
- record in writing adequate information about any personalised services provided to a retail client (Code Standard 12), and
- ensure records are kept for seven years (Code Standard 13).

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9	Where an AFA provides a *personalised service* to a retail client that is an investment planning service or that relates to a category 1 product, the AFA must provide a written explanation to the client of the basis on which those services are provided. The AFA must also take reasonable steps to ensure the client is aware of the principal benefits and risks involved in following any financial advice provided as part of that service, having regard to the characteristics of the personalised service.	All explanations must be provided to the client at the time the personalised service is provided or as soon as practicable thereafter. However, the requirement to provide an explanation does not apply where: • the AFA has previously provided the client with an explanation covering the personalised service, or • the client has either instructed the AFA (or the AFA's employer or principal) or confirmed a prior instruction that an explanation is not required. Any such instruction or confirmation need not be in writing but must reflect an unambiguous, active instruction or confirmation that is relevant to the personalised service currently being provided. The extent of any explanation required is determined by what a retail client would reasonably require for the purpose of deciding whether to follow any advice or guidance provided by the AFA. An AFA must not direct or influence a client to decline the explanation contemplated under this Code Standard. However, this does not prevent an AFA from: • drawing the client's attention to the client's ability to opt out of receiving the explanation, or • quoting or estimating a reasonable fee for providing an explanation.
10	When providing a *class service* to a retail client, an AFA must provide an appropriate statement as to the limitations of the service provided.	

11	An AFA must ensure there is an appropriate internal process in place for resolving *client complaints* in relation to the AFA's financial adviser services.	If the client makes a complaint, the AFA must: • acknowledge the client's complaint • provide the client with information about the *internal complaints handling process* • provide information about how to complain to the Commission and utilise the external dispute resolution scheme • keep a register recording all complaints, and action taken to resolve complaints.
12	An AFA must record in writing adequate information about any personalised services provided to a retail client	The records must include information in relation to each retail client about: • any personalised service provided or any financial product recommended to the client, and • any required explanation, and advice as to suitability, given to the client in relation to a financial adviser service or financial product, and • the results of any inquiry or any oral confirmation from the client declining an explanation or suitability assessment under Code Standards 8 and 9. The records must also include copies of all information and documents provided to the client in writing, or received from the client, in connection with the AFA's personalised services including: • any information provided under Code Standard 7 • any provision or confirmation of financial advice • any explanation provided in accordance with Code Standard 9 • any instructions from the client declining to provide information or declining an explanation required under Code Standards 8 and 9

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		• any instructions from the client declining or acknowledging any limitations of a suitability analysis in accordance with Code Standard 8, and • details of any complaint received in relation to the AFA's services.
13	An AFA must ensure that records of all information and documents required under the Code are kept for a minimum of seven years.	The seven-year minimum period commences on the last date that the AFA provides a financial adviser service to the client. The records may be kept in electronic form, provided the records are readily retrievable.

Standards of competence, knowledge and skills

A third group of Code Standards focuses on the competence, knowledge and skills of AFAs. According to these standards, AFAs must:

- ensure they have the competence, knowledge or skills to provide a service (Code Standard 14)
- have a knowledge of the Act, the Code and other legal obligations relevant to the operation of the AFA's practice as a financial adviser (including relevant consumer protection laws) that is adequate for the proper operation of that practice (Code Standard 15)
- attain the Unit Standards Sets (Code Standard 16).

Table 4 summarises these requirements.

Table 4: Code Standards — minimum standards of competence, knowledge and skills

Code Standard number	Code Standard	Requirements
14	Before providing a financial adviser service, an AFA must have the competence, knowledge and skills to provide that service.	An AFA must demonstrate that the AFA has a reasonable basis for believing that the AFA has a level of competence, knowledge and skills to provide a particular financial adviser service.

15	An AFA must have a knowledge of the FA Act, the Code and other legal obligations relevant to the operation of the AFA's practice as a financial adviser (including relevant consumer protection laws) that is adequate for the proper operation of that practice.	The AFA must attain Unit Standard Set B and be able to demonstrate the adequacy of the AFA's knowledge of relevant legislative obligations.
16	An AFA must attain the Unit Standard Sets within the National Certificate in Financial Services (Financial Advice) (Level 5) that are relevant to the financial adviser services provided by the AFA. For the purposes of the Code, an AFA is deemed to have attained a particular Unit Standard Set where the AFA has attained an alternative qualification or designation to that Unit Standard Set specified in the Code's Competence Alternatives Schedule.	There are exceptions to this requirement.

Standards for continuing professional training

The fourth category of Code Standards comprises standards for continuing professional training. AFAs are expected to undertake sufficient training to keep up to date with new developments and maintain their competence, knowledge and skills. Table 5 provides an overview of the main requirements.

Table 5: Code Standards — minimum standards for continuing professional training

Code Standard number	Code Standard	Requirements
17	An AFA must maintain and keep current a professional development plan for each CPD period.	CPD refers to "continuing professional development or training relevant to the financial adviser services the AFA provides or intends to provide".

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Miscellaneous	Offence of false declaration in support of application for authorisation or grant of QFE status	s 136
	Failure to comply with summons by Commissioner to attend disciplinary committee hearing	s 137
Orders	Failure to comply with banning order	s 137E
	Failure to comply with Commission's orders	s 137S
	Failure to comply with any other order	s 137J

As can be seen from Table 1, the FA Act establishes several offences related to misleading and deceptive conduct or disclosure. Offences of this type carry severe penalties under the Act because they undermine investors' confidence in the market.

¶604 Restrictions on providing services and holding out

Criminal offence: performing financial adviser service without registration

Section 17 of the FA Act prohibits persons from providing a financial adviser service without being registered, unless the person:

- is permitted to provide the service under ss 18 to 20 of the Act or is acting through a person under these provisions, or
- is an exempt provider acting through a person who is permitted to provide that service under ss 18 or 20, or
- is a QFE or a member of a QFE group acting through a QFE adviser who is permitted to provide the service under ss 18 to 20.

Section 114(1) of the FA Act states as follows:

> (1) A person who performs a financial adviser service set out in s 18 when not permitted to do so under that section and s 17 commits an offence and is liable on summary conviction,—
>
> (a) in the case of an individual, to a fine not exceeding $10,000:
>
> (b) in the case of an entity, to a fine not exceeding $50,000.

Similarly, it is an offence for a person to provide a service set out in ss 19 or 20 when not permitted to do so under those sections and s 17: s 114(2)(a). The person commits a criminal offence and is liable on summary conviction in the case of an individual, to a fine not exceeding $5,000. In the case of an entity the penalty is a fine not exceeding $10,000: s 114(2)(b). The Act establishes a

defence under s 114(3). A person has a defence to a charge under s 114(1) if the person proves on a balance of probabilities that the person did not know, or ought not reasonably to have known, that the person did not come within the requirements of the Act.

Criminal offence: performing financial adviser service without authorisation

Section 115 states as follows:

> A person who knowingly or recklessly contravenes section 20A, 20B, or 20C commits an offence and is liable on summary conviction,—
>
> (a) in the case of an individual, to a fine not exceeding $10,000:
>
> (b) in the case of an entity, to a fine not exceeding $50,000.

Pursuant to s 20A of the FA Act, a person must not hold out that the person or any other person is in fact authorised under the regime.

Similarly, s 20B of the FA Act prohibits persons from holding out that the person or any other person is a financial planner or an investment planner. The section also prohibits persons from offering investment planning or financial planning services where the person is not authorised to provide such services under s 55 of the Act. Section 20C is directed at persons holding themselves out as a QFE or an entity that has QFE status.

Section 115 is not a strict liability offence. Hence, it is necessary to prove knowledge and recklessness for the defendant to be guilty.

¶605 Breach of disclosure obligations

This paragraph addresses the consequences that arise as a result of failed or defective disclosure. More specifically, we consider the application of s 117 of the FA Act which seeks to hold financial advisers to account for failing to comply with their disclosure obligations.

Criminal offence: knowingly or recklessly contravening a disclosure obligation

The FA Act contains a general offence provision for contraventions — including breaches and omissions — of disclosure requirements in the Act. Section 117 of the FA Act constitutes the main source of liability under the Act for defective or omitted disclosure in connection with financial products. The provision states:

> A person who knowingly or recklessly contravenes a disclosure obligation commits an offence and is liable on summary conviction to a fine.

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Under s 117 of the FA Act, it is an offence for a person to *knowingly* or *recklessly* contravene a disclosure obligation. Section 117 applies to brokers and all types of financial advisers, including registered financial advisers, AFAs and QFEs.

However, the consequences that attach where a person contravenes s 117 differ between individual persons and entities. Section 117 stipulates that persons are liable on summary conviction to a maximum fine of $100,000, whereas entities are liable to a maximum fine of $300,000.

Section 117 may be invoked where an adviser makes disclosure in breach of the FA Act. Chapter 4 drew attention to the circumstances in which disclosure obligations imposed by the FA Act may be contravened. Thus, defective disclosure is most likely to occur if the financial adviser makes available information that is misleading, deceptive or confusing. In addition, the adviser may fail to comply with a positive obligation to make available certain information to investors. A breach of a positive obligation to make disclosure may occur where new information becomes available to the adviser but this information is not disclosed to the investor, despite being materially relevant. The defect or omission must have arisen recklessly or knowingly for s 117 of the FA Act to be effective. This is an important limitation. Section 117 is not a strict liability offence. The courts will consider the circumstances in which the non-disclosure or defective disclosure took place.

Recklessness element

"Recklessness" implies carelessness or wilful blindness. The concept of wilful blindness cannot be equated with actual knowledge of misleading or deceptive conduct.[4] Thus, the adviser may be subjectively aware that there is a substantial risk that a disclosure statement may contain misleading or deceptive information, yet the adviser fails to make inquiries about the truthfulness of the information. The adviser will be deemed to have acted recklessly where it is shown that it was unjustifiable for the adviser to take the risk, having regard to the totality of the circumstances.

Knowledge element

Showing intention, knowledge or recklessness will satisfy this requirement. In *Yorke v Lucas*, the High Court of Australia was asked to consider what level of knowledge was necessary to prove a contravention of s 52 of the Trade Practices Act.[5] The High Court held that it must be shown that the defendant had knowledge of the essential matters which make up the offence or contravention. Generally, a "combination of suspicious circumstances, and the failure to make appropriate inquiry when confronted with the obvious, makes it possible to infer knowledge of the relevant essential matters."[6]

4 *Pereira v Director of Public Prosecutions* (1988) 82 ALR 217.

5 *Yorke v Lucas* (1985) ATPR ¶40-622; 158 CLR 661.

6 *Pereira*, above n 4.

Negligence

The wording of s 117 precludes the application of the section to situations where there is negligent non-disclosure or defective disclosure. Negligence is not an element of s 117.

¶606 Breach of conduct obligations

The FA Act contains a wide range of provisions which deal specifically with contraventions of the conduct requirements. The provisions reflect a distinction between the different types of financial advisers. Some offence provisions extend to all types of financial advisers, while other provisions are restricted in their application to QFEs or AFAs. Table 2 provides a checklist of the requirements that apply to the different types of financial advisers and brokers.

Table 2: Checklist — conduct offences

Offence	AFA	QFE	Brokers
Misleading or deceptive conduct	√	√	√
Misleading, deceptive or confusing advertisement	√	√	√
Contravening restriction on use of term sharebroker			√
Recommending or receiving money in connection with offer of securities when subscription illegal	√		
Failing to comply with terms and conditions of authorisation	√		
Failing to comply with the Commission's direction	√	√	
Failing to comply with condition of disciplinary committee's order	√		
Complying with terms and conditions of QFE status grant		√	
Failing to comply with obligations in relation to AFAs		√	
Provision of annual report		√	
Broker must not receive client money if offer for subscription illegal			√
Broker must pay client money into separate trust account			√

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Broker must account for client money and client property			✓
Broker must keep records of client money and client property			✓
Restrictions on use of client money and client property			✓
Offence of false declaration, etc, in support of application for authorisation or grant of QFE status	✓	✓	
Failure to comply with summons by the Commission to attend disciplinary committee hearing	✓		
Failure to comply with banning order	✓	✓	✓
Failure to comply with temporary banning order	✓	✓	✓
Failure to comply with any other order	✓	✓	✓

As can be seen from Table 2, the majority of offences apply to AFAs and QFEs.

¶607 Conduct offences applying to all financial advisers and brokers

Criminal offence: engaging in misleading and deceptive conduct

Section 118 makes it a criminal offence for a financial adviser or broker to engage in misleading or deceptive conduct:

> **118 Offence of misleading or deceptive conduct by financial adviser or broker**
>
> A person who knowingly or recklessly contravenes s 34(1) or s 77L commits an offence and is liable on summary conviction to a fine,—
>
> (a) in the case of an individual, not exceeding $100,000:
>
> (b) in the case of an entity, not exceeding $300,000.

Similarly, it is an offence for a financial adviser or broker to advertise in a misleading, deceptive or confusing manner in contravention of ss 35(1) or 77M of the FA Act: s 119. The maximum fine is $100,000 in the case of an individual and $300,000 in the case of an entity. In ¶413 we discussed the meaning of "misleading" and "deceptive". The concepts of knowledge and recklessness were explored in ¶605.

¶608 Conduct offences applying to AFAs

Table 3 summarises the conduct obligations and offence provisions that specifically apply to AFAs.

Table 3: Checklist — conduct obligations and offence provisions applying to AFAs under the FA Act

Conduct	Contravention of	Offence provision	Fine
Recommending or receiving money in connection with offer of securities when subscription illegal	s 38(1)	s 121	not exceeding $100,000
Failing to comply with terms and conditions of authorisation	s 45(1)	s 126	not exceeding $5,000
Failing to comply with Commission's direction	s 61(3)	s 127	not exceeding $5,000
Failing to comply with any conditions of disciplinary committee's order	s 101(3)(e)	s 128	not exceeding $5,000

Criminal offence: recommending or receiving money in connection with offer of securities when subscription illegal

Under s 121 of the FA Act it is a criminal offence for an AFA to contravene s 38(1). The key element of s 38(1) is that the AFA knows or ought to know that, when the securities were or are offered for subscription, the offer was or is illegal.

Criminal offence: failing to comply with terms and conditions of authorisation

Section 126 of the FA Act makes it a criminal offence to fail to comply with the terms and conditions of authorisation, as required by s 45(1) of the Act. The terms and conditions may require disclosure of specific items in order to improve the quality of information provided to clients.

Criminal offence: failing to comply with Commission's direction

The Commission can give directions to AFAs: s 61(3) of the FA Act. AFAs are expected to comply with such directions. For example, the Commission may ask the AFA to produce documents, provide information or answer questions. Non-compliance results in the AFA committing a criminal offence under s 127 of the FA Act.

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Criminal offence: failing to comply with disciplinary committee's order

AFAs who contravene a condition of an order made by the disciplinary committee under s 101(3)(e) may be charged with a criminal offence under s 128 of the FA Act.

¶609 Conduct offences applying to QFEs only

Offences specifically relating to QFEs are covered in ss 129 to 134 of the FA Act. Table 4 provides a checklist of the conduct obligations and offence provisions applying to QFEs.

Table 4: Checklist — conduct obligations applying to QFEs under the FA Act

Conduct obligation	Contravention of	Offence provision	Fine
Complying with terms and conditions of QFE status grant	s 46(1)	s 129	not exceeding $25,000
Not to engage in misleading or deceptive conduct	s 47(1)	s 130	not exceeding $300,000
Not to engage in misleading, deceptive or confusing advertising	s 48(1)	s 131	not exceeding $300,000
Compliance with Commission's direction	s 75F(3)	s 132	not exceeding $25,000
Compliance with obligations in relation to AFAs	s 76(1)(e)	s 133	not exceeding $50,000
Provision of annual report	s 77(1)	s 134	not exceeding $25,000

Criminal offence: failing to comply with terms and conditions of QFE status

A fundamental requirement under the FA Act is that every QFE and every partner entity of a QFE must comply with the terms and conditions of the grant of QFE status: s 46(1). It is important to distinguish between contraventions by the QFE itself and by partner entities of a QFE.

A QFE commits a criminal offence if the QFE does not comply with the terms and conditions of the QFE status: s 129 of the FA Act. Where a QFE breaches s 46(1), each of the following persons is deemed to have committed an offence and is liable to a fine not exceeding $25,000:

- the QFE, and
- every partner entity of the QFE: s 129(1).

If a partner entity of a QFE contravenes s 46(1), every partner entity of the QFE commits a criminal offence and is liable on summary conviction to a fine not exceeding $25,000: s 129(2).

Criminal offence: misleading and deceptive conduct

Pursuant to s 47(1) of the FA Act:

> A QFE or a member of a QFE group must not, in acting through an employee, agent, or nominated representative, engage in conduct in relation to a financial adviser service that is misleading or deceptive or likely to mislead or deceive.

QFEs may be brought to account under s 130 of the FA Act for violation of s 47(1). The offence carries a maximum penalty of $300,000.

The QFE must have knowledge of the contravention or be reckless with respect to the contravention. Thus, in determining whether the offence has been committed, regard must be had to the circumstances in which the allegedly misleading or deceptive conduct took place. Generally, a person is considered to be reckless if the person acts without taking reasonable care, having regard to all the circumstances. Where a QFE knowingly or recklessly contravenes s 47(1), the QFE and every partner entity of the QFE is deemed to have committed an offence under s 130(1). If an associated entity of a QFE knowingly or recklessly contravenes s 47(1), liability attaches to:

- the associated entity of the QFE
- the QFE, and
- every partner entity of the QFE: s 130(2).

Criminal offence: misleading advertisement of financial adviser service

A QFE or a member of a QFE group must not advertise a financial adviser service in a way that is misleading, deceptive or confusing: s 48(1) of the FA Act. Section 131 of the FA Act makes it an offence for a QFE to knowingly or recklessly contravene this requirement and imposes liability not only on the QFE itself but also every partner entity of the QFE: s 131(1). Each of these persons would be liable on summary conviction to a fine not exceeding $300,000. Where an associated entity of the QFE knowingly or recklessly commits a contravention of s 48(1), the associated entity of the QFE, the QFE and every partner entity of the QFE would be deemed to have committed an offence: s 131(2).

Criminal offence: non-compliance with directions

If the QFE, any partner entity or any associated entity of the QFE fails to comply with a direction by the Commission under s 75F, the QFE and every partner entity commits an offence: s 132. The maximum fine is $25,000.

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Criminal offence: breaching obligations in relation to AFAs

A contravention of s 76(1)(e) gives rise to the offences described in s 133 of the FA Act. Pursuant to s 76(1)(e), QFEs must ensure that advisers of the QFE or a member of the QFE group are authorised when performing services that only AFAs can perform under the Act. Section 133 states that if a QFE or a partner entity contravenes s 76(1)(e), the QFE and every partner entity of the QFE commit an offence and are liable on summary conviction to a fine not exceeding $50,000.

Criminal offence: failing to provide annual reports

Section 134 of the FA Act makes it a criminal offence for a QFE to fail to provide an annual report as required by s 77(1). Liability is imposed on both the QFE and every partner entity of the QFE. The maximum fine is $25,000.

¶610 Defence to offences relating to entities in QFE groups

Section 134A states:

> **134A Defence to offences relating to entities in QFE groups**
>
> An entity, being the QFE of a QFE group or a partner entity, has a defence to an offence under any of sections 129 to 134 if the entity proves that the entity—
>
> (a) was not involved in the contravention that constitutes the offence; and
>
> (b) took all reasonable steps to ensure that the members of the QFE group complied with the requirements of this Act.

¶611 Broker's offences

Table 5 provides a checklist of the key provisions applying to brokers.

Table 5: Checklist — conduct obligations applying to brokers under the FA Act

Conduct obligation	Contravention of	Offence provision
Misleading and deceptive conduct	s 77L	s 118
Advertisement of broking services must not be misleading, deceptive or confusing	s 77M	s 119
Restriction on use of term sharebroker	s 77N	s 120

Broker must not receive client money if offer for subscription illegal	s 77O	s 134B
Broker must pay client money into separate trust account	s 77P	s 134C
Broker must account for client money and client property	s 77Q	s 134D
Broker must keep records of client money and client property	s 77R	s 134E
Restrictions on use of client money and client property	s 77S	s 134F
Failing to comply with Commission's direction	s 77V	s 134G

Criminal offence: misleading and deceptive conduct

It is a criminal offence for a broker to knowingly or recklessly engage in conduct in relation to the provision of a broking service that is misleading or deceptive or likely to mislead or deceive: s 118. The maximum fine in the case of an individual is $100,000. In the case of an entity it is $300,000.

Criminal offence: misleading advertising

Knowingly or recklessly contravening s 77M of the FA Act gives rise to a criminal offence under s 119 which stipulates a maximum penalty of $100,000 in the case of an individual and, in the case of an entity, $300,000.

Criminal offence: falsely using the term "sharebroker"

A person who contravenes s 77N by knowingly or recklessly using the term sharebroker in any advertising or promotional material, unless being a member of the registered exchange or being employed by such a member, commits an offence under s 120 of the FA Act. Section 120 carries a maximum penalty in the case of an individual of $10,000; and in the case of an entity $50,000.

Criminal offence: receiving client money if offer for subscription is illegal

It is an offence for a broker to receive client money for the acquisition of securities if the securities are or were offered illegally, and the broker knows or ought to know of the illegality: s 134B. Section 134B imposes a maximum penalty of $100,000 for individuals, and $300,000 for entities contravening s 77O.

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Investigation of complaints

The Commission must investigate a complaint if it is practicable to do so, having regard to the nature and number of complaints to be investigated, the Commission's regulatory priorities as reflected in its statement of intent, and available resources: s 97(1) of the FA Act. The Commission need not investigate a complaint if the complaint is vexatious or not sufficiently serious: s 97(2). The investigation of such complaints is not considered to be in the public interest. The Commission has the discretionary power to pursue its own priorities and may refuse to investigate a particular matter where the Commission considers that no contravention has taken place. In short, the Commission has a wide discretion when deciding whether or not to pursue a complaint.

¶702 The role of the Commissioner

Part 4 of the FA Act deals with the functions of the Commissioner. Section 79 of the FA Act provides that there must be a Commissioner for Financial Advisers who is a member of the Commission. Section 80 specifies the functions of the Commissioner. It states that the Commissioner is responsible for:

- appointing members of the code committee
- reviewing the *Code of Professional Conduct for Authorised Financial Advisers* (Code)
- proposing amendments to the Code
- chairing the disciplinary committee, and
- performing powers and functions under the FA Act or other legislation.

¶703 The committees

Section 153(2) of the FA Act allows the Commission to raise levies so as to set off the costs of the Commission, the Commissioner, the code committee and the disciplinary committee.

Disciplinary committee

Section 103 of the FA Act requires the Minister to establish a disciplinary committee. The functions of the disciplinary committee are defined in s 104. These include:

- conducting disciplinary proceedings arising out of complaints regarding AFAs referred to it by the Commission, and
- taking any of the actions referred to in s 101(3) as a result of disciplinary proceedings.

Under s 154(1)(q), the Governor-General may, on the recommendation of the Minister, make regulations prescribing the procedure of the disciplinary committee.

Section 105 deals with membership of the disciplinary committee. The appointment of a member of the disciplinary committee must be for a specified period: s 105(2). The Minister has the power to at any time appoint a member of the disciplinary committee: s 105(1). Moreover, the Minister must appoint the Commissioner as the chairperson of the disciplinary committee: s 105(3).

Section 105(4) says that the disciplinary committee must have a minimum number of four and a maximum number of six members including the chairperson. It is the responsibility of the Minister to ensure that the number of current members does not fall below four: s 105(4).

Section 105(5) sets out the requirements for appointment of members to the committee. Thus, the Minister must appoint:

- at least one member who works or has worked in the financial adviser industry
- at least one member who is independent of the financial adviser industry, and
- at least one member who is a lawyer with not less than seven years' legal experience.

Code committee

Section 81 of the FA Act provides that the Commissioner must establish a code committee. The functions of the code committee include:

- producing a draft Code for approval by the Commissioner
- recommending changes to the Code as the code committee thinks fit, and
- reviewing the Code from time to time: s 82.

Under s 154(1)(p), the Governor-General may on the recommendation of the Minister make regulations prescribing the procedure of the code committee.

The Commissioner may at any time appoint a new member of the code committee or discharge a member: s 83(1). According to s 83(2), the appointment of a member of the code committee must be for a specified period, but a member may be discharged before the expiry of his or her period of appointment. Section 83(3) specifies that the code committee must have a minimum number of seven members, while the maximum number is limited to 11 members. The Commissioner must ensure that the number of current members does not fall below seven. To be appointed to the code committee, a person must, in the Commissioner's opinion, be qualified for appointment by virtue of his or her knowledge of the financial adviser industry: s 83(4)(b). However, the Commissioner must also appoint one person to the committee with knowledge of, or experience and competency in relation to, consumer affairs: s 83(4)(a).

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Section 87 of the FA Act emphasises that the principal task of the committee is to prepare a draft Code, which must be approved by the Commissioner: s 88. In terms of content, the Code must provide for minimum standards of professional conduct applicable to AFAs, as well as minimum standards of competence, knowledge and skills, ethical behaviour and client care: s 86. These standards were considered in Chapter 5. The Code may provide for different minimum standards for individuals training to be AFAs: s 86(5). According to s 86(4), the Code may limit or modify standards, or provide for separate standards, for the duration of one or more periods of transition.

On 2 September 2010, the Commissioner approved the draft Code and sent it to the Minister of Commerce for approval. It was approved on 20 September 2010.

The Commissioner must give notice in the *Gazette* of the date or dates on which the provisions of the Code come into force: s 94(1).

¶704 General powers of the Commission in relation to all types of financial advisers

In this paragraph, we consider the powers that the Commission may exercise against financial advisers under the FA Act (ie all of the types of financial advisers described in s 16 of the FA Act).

Written directions

Where the Commission has reason to believe that a financial adviser is in breach of a disclosure or conduct obligation, it may give an adviser a notice: s 49 of the FA Act. Section 49(2) requires the Commission to give notice to the financial adviser of his or her alleged breach. The financial adviser must be given a reasonable opportunity to respond to any allegations of misconduct. If the Commission concludes, after considering the financial adviser's response, that the financial adviser is in breach, it may give the adviser a written direction.

The direction may instruct the financial adviser to comply with the relevant conduct obligation. It may also stipulate steps that the financial adviser must take in order to comply with the obligation. The adviser is usually expected to report to the Commission within 28 days of the date of the direction, stating how the direction will be implemented. It is an offence to fail to comply with the requirements of s 49: s 135 of the FA Act.

Commission may exercise powers under Securities Act

Section 147 of the FA Act provides that the Commission may exercise any of its powers under the Securities Act 1978 in performing its functions under the Act. Part 3 of the Securities Act contains extensive general investigative and enforcement powers.

¶705 Powers of the Commission in relation to registered individuals

Banning

Section 59A of the Financial Service Providers (Pre-Implementation Adjustments) Bill empowered the Commission to ban individuals who are registered but not authorised. The section stated as follows:

> (1) This section applies if the Commission is satisfied that an individual (the **affected individual**)—
>
> (a) is a financial adviser, other than a QFE adviser, who is registered but not authorised; and
>
> (b) has persistently breached his or her conduct obligations.
>
> (2) The Commission may, after following the procedure set out in section 60, order that the affected individual not provide any financial adviser services or not provide 1 or more specified classes of financial adviser service for a specified period that does not exceed 5 years.

This provision was abandoned in the Financial Advisers Amendment Act 2010. Provision for banning orders now appears in ss 137C–137E as discussed in ¶712.

¶706 Powers of the Commission in relation to AFAs

Authorisation

AFAs must apply to the Commission for authorisation: s 52 of the FA Act. The Commission will be required to authorise the person if the applicant is eligible: s 55(1). Section 55 states as follows:

> **55 Commission must approve or decline application for authorisation**
>
> (1) If an applicant for authorisation is eligible, the Commission must authorise that person in respect of 1 or more of the following for a specified period:
>
> (a) providing any financial adviser service, or specified kinds of financial adviser services, in relation to any category 1 product, specified category 1 products, or specified classes of category 1 product:

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(b) providing a discretionary investment management service on behalf of clients, generally or in specified cases, in relation to any category 1 product, specified category 1 products, or specified classes of category 1 product:

(c) providing investment planning services generally or in specified cases:

(d) providing, in any case that is specified in the regulations for the purposes of this paragraph, services of the kind referred to in paragraph (a) or (b) or both, but in relation to any category 2 product, specified category 2 products, or specified classes of category 2 products.

(2) The authorisation may be subject to terms and conditions relating to financial adviser services or broking services or to both.

(3) If the Commission approves the application, the Commission must notify the applicant in writing of—

(a) the authorisation; and

(b) the terms and conditions (if any); and

(c) the period of authorisation.

(4) The Commission may incorporate, with any modifications it considers appropriate, the standard conditions.

If an applicant is not eligible, the Commission must decline the application and notify the applicant in writing of its decision and the reasons for it: s 55(5). It must also inform the applicant of the right of appeal against the decision: s 55(5).

Determining eligibility for authorisation

The Commission must determine whether a person meets the criteria for authorisation listed in s 54 of the FA Act. The applicant must show that he or she:

- is registered or complies with s 13(a) and (b) of the Financial Service Providers (Registration and Dispute Resolution) Act 2008 (FSP Act)
- is a person of good character
- meets the levels of competency, knowledge and skills specified in the Code for an AFA, and
- is not debarred from applying for authorisation.

Additionally, the Commission may make any inquiries it considers appropriate to determine whether the person has been convicted by a court in New Zealand or elsewhere of an offence punishable by imprisonment for a

term of six months or more: s 54(b)(i). A person may be eligible to be authorised regardless of any prior convictions if the Commission is satisfied that the offence does not reflect adversely on the person's fitness to act as an AFA: s 53(b)(ii).

Terms and conditions

Under s 55(2), the Commission has the power, by giving written notice to the applicant, to impose terms and conditions relating to financial adviser services or broking services or both.

Commission's power to vary, suspend and cancel the authorisation

The FA Act confers various powers upon the Commission to vary, suspend or cancel an AFA's authorisation. The Commission can resort to such measures where the adviser fails to adhere to the requirements of the Act.

Variations to terms and conditions

Pursuant to s 55A(3) of the FA Act, the Commission may propose a variation of the terms and conditions of an adviser's authorisation or the period of the adviser's authorisation, or both, on the basis that:

- the business of the adviser poses a material risk to consumers, or
- the adviser has been involved in market practices that are, in material respects, inconsistent with the purpose of the FA Act.

The adviser must be given a reasonable period in the notice to respond in writing to the Commission's proposal: s 55(4). Under s 55(5) the Commission may vary the terms of the adviser's authorisation after considering any response received within the period stipulated in the notice.

Section 55(6) permits the Commission to vary terms and conditions on a provisional basis. But if the Commission does so, it must give notice to the AFA and review the variations by a date specified in the notice. The purpose of the review is to determine whether the provisional variations should be confirmed or cancelled or whether further terms and conditions ought to be proposed.

AFAs may also apply to the Commission for a variation of the terms and conditions of their authorisation: s 55A(1). However, the Commission may grant or decline such applications: s 55A(2).

Termination

AFAs may request a termination of their authorisation. According to s 57(1)(b) the Commission may cancel an AFA's authorisation where the adviser requests the Commission to do so.

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Default

Section 59 of the FA Act lists the powers available to the Commission where an AFA is in default. The section applies if the Commission is satisfied that an AFA has:

- ceased to be eligible for authorisation, or
- has breached or is in breach of the FA Act (excluding s 37) or the regulations, or
- has breached or is in breach of a term or condition of his or her authorisation, or
- is the subject of a recommendation by the disciplinary committee under s 101(3)(a), (b) or (c), or
- has failed to pay a fee or levy as required by the Act or the regulations.

In any of the above scenarios, s 59(2) states that the Commission may:

- cancel the authorisation, or
- cancel the authorisation and debar the AFA for a specified period from re-applying for authorisation, or
- suspend the authorisation for a specified period or until the AFA does any thing that the Commission may specify, or
- amend the terms and conditions of the authorisation, or
- make no order.

Section 59(3) limits the Commission to taking only one of the actions specified above. Suspension or cancellation under s 59(2) is effective when a written notice of the suspension or cancellation is sent to the AFA by the Commission: s 62(2).

The adviser's authorisation is immediately revived at the end of the suspension period, unless the Commission takes steps to:

- further suspend, or
- cancel the authorisation: s 62(1).

The Commission must follow the procedures set out in s 60 of the FA Act when cancelling, suspending or varying an adviser's authorisation. This section provides that the Commission must give the person a reasonable opportunity to make written submissions and be heard. It must also inform the person of any proposed action in writing.

Renewing authorisation

Applications for renewal of authorisation are assessed by the Commission. The Commission must have regard to the criteria laid down in s 54. Moreover, the Commission must consider whether the adviser has complied with the minimum professional standards prescribed by the Code: s 58(4)(a). If the applicant failed to comply with any of those standards, the Commission must be satisfied that this failure is not sufficiently serious or recent to preclude the applicant from renewing his or her authorisation: s 58(4)(b).

Notification of the Registrar

The Commission must notify the Registrar in writing of its decision to authorise an applicant: s 56. Further, the Commission must provide details of the name and business address of the applicant, any terms and conditions of the authorisation and the period of authorisation.

The Commission must also notify the Registrar if an AFA's authorisation has been terminated pursuant to s 57 of the FA Act: s 57(2). Similarly, the Commission must notify the Registrar in writing of any cancellation or suspension: s 59(4).

Commission's power to give AFA direction

Section 61 of the FA Act applies if the Commission has reason to believe an AFA is in breach of the terms and conditions of his or her authorisation. Section 61(2) grants the Commission the power to give the financial adviser notice of his or her alleged breach. The financial adviser must be given a reasonable opportunity to respond. If the Commission concludes, after considering the response, that the financial adviser is in breach, the Commission may give the financial adviser a written direction to do specified things. Under s 61(4)(c) the Commission may require the financial adviser to report to the Commission within 28 days of the date of the direction, stating how and by when the Commission's direction will be implemented. If the AFA fails to comply with the direction, the Commission may exercise any of its powers under the Act against AFAs. An AFA who fails to comply with a direction given by the Commission commits an offence under s 127 of the FA Act.

Complaints about AFAs

If the Commission has, under s 97, investigated a complaint about an AFA, it must refer the complaint to the disciplinary committee provided the Commission has determined that the conduct complained of amounts to a breach of the code: s 98 of the FA Act. The disciplinary committee must inform the AFA who is subject to the complaint in writing of the nature of the complaint: s 99.

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Section 99 of the FA Act states:

> **99 Disciplinary committee must give notice of complaint to financial adviser concerned**
>
> If the Commission refers a complaint about an authorised financial adviser to the disciplinary committee, and the disciplinary committee considers that a hearing is necessary to deal with the complaint, the disciplinary committee must serve a written notice of the complaint on the financial adviser.

Pursuant to s 100, the disciplinary committee's notice of complaint to the financial adviser concerned (A) must:

- state that there is reason to believe that A may have breached the code
- clearly inform A of the nature of the contravention, and
- specify a date, which must not be sooner than 20 working days after the date of service of the notice, on which the disciplinary committee intends to hear the matter.

Powers of the disciplinary committee in relation to AFAs

Section 101 permits the disciplinary committee to discipline AFAs for breach of the Code. Where satisfied that an AFA (A) has breached the Code, the disciplinary committee may:

(a) recommend that the Commission cancels A's authorisation:

(b) recommend that the Commission—

(i) cancels A's authorisation; and

(ii) debars A for a specified period from applying to be re-authorised:

(c) recommend that the Commission suspends A's authorisation for a period of no more than 12 months or until A meets specified conditions relating to the authorisation (but, in any case, not for a period of more than 12 months):

(d) censure A:

(e) order that A may, for a period not exceeding 3 years, perform a financial adviser service only subject to any conditions as to employment, supervision, or otherwise that the disciplinary committee may specify in the order:

(f) order that A undertake training specified in the order:

(g) order that A must pay a fine not exceeding $10,000:

(h) take no action.

The disciplinary committee may order that the affected AFA pay costs and expenses of, and incidental to, the investigation by the Commission and the disciplinary committee's proceeding: s 101(5).

The disciplinary committee must not take any of the above actions unless it has first (s 102):

(a) informed the person concerned in writing as to why it may take any of those actions; and

(b) given that person or his or her representative a reasonable opportunity to make written submissions and be heard on the question.

¶707 Powers of the Commission in respect of QFEs

Applications for QFE status

Entities may apply to the Commission for grant of QFE status. Section 64 of the FA Act states:

> An application may be made to the Commission by—
>
> (a) a single entity for QFE status; or
>
> (b) 2 or more related bodies corporate for joint QFE status.

Determining entities' eligibility for QFE status

To be eligible for QFE status, an applicant must ensure:

- each entity is registered or entitled to be registered (under the FSP Act), and
- no entity is debarred from applying for QFE status: s 66(1).

Further, once granted QFE status, the QFE or the partner entities that will be the QFE together must show they have the capacity to, and will:

- discharge the QFE's or their obligations under the FA Act or the regulations
- comply with the terms and conditions (if any) of the grant of QFE status, and
- maintain procedures to ensure that retail clients of the QFE receive adequate consumer protection: s 66(1)(c).

The Commission must be satisfied that the applicant fulfils the above criteria. Significantly, the Commission must consider whether retail clients will be adequately protected when obtaining "personalised financial adviser services" that relate to category 1 products. QFE advisers must be able to

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comply with a standard similar to that provided by advisers who are subject to the Code: s 66(2)(a). The Commission must take into account the scope of category 1 products in respect of which QFE advisers may provide financial adviser services: s 66(2)(b).

Duty to notify

If an applicant meets the criteria enumerated in s 64, the Commission must approve the application and grant the entity QFE status: s 67(1). The Commission must give notice to the QFE entity or entities in writing of:

- the grant of the QFE status
- the terms and conditions
- the period for which the QFE status has been granted: s 68(1).

However, if the applicant is not eligible for QFE status, the Commission must decline the application and notify the relevant entity or entities of its decision, the reasons for it, as well as the right to appeal under s 64(a): s 68(2). Applicants may jointly appeal against the decision under s 64(b) of the FA Act.

Duty to notify the Registrar

The Commission is required to notify the Registrar of the grant of QFE status: s 70(1). It must provide the Registrar in writing with the following information:

- the name of the entity, or the names of the partner entities, granted QFE status
- the period for which QFE status has been granted
- if a QFE group has been formed, the name of the group, or
- if associated entities of the QFE have been approved, the names of those entities.

Terms and conditions

The Commission may impose terms and conditions when granting QFE status: s 67(2). Further, the Commission may incorporate standard conditions, subject to any modifications the Commission sees fit: s 67(3). "Standard conditions" means standard terms and conditions for the time being approved by the Commission under s 147A or 147C and in force under s 147D.

Variation of terms and conditions

A QFE may apply to the Commission for a variation of the terms and conditions of the grant of QFE status: s 75(1). The Commission may grant or decline the application: s 75(2).

The Commission may propose a variation of the terms and conditions of the QFE's grant of QFE status, or the period of the grant on the grounds that:

- the business of the QFE or of the QFE group has changed in a way that poses a material risk to consumers
- the QFE or any member of the QFE group has been involved in market practices that are, in material respects, inconsistent with the purpose of the FA Act: s 75(3).

The Commission must give a notice to the QFE of its proposed amendments to the terms and specify in the notice a reasonable period for the QFE to respond: s 75(4). Section 75(5) permits the Commission to vary the terms and conditions or the period of the grant, or both, after considering the QFE's response.

The Commission may vary terms and conditions on a provisional basis. However, it must, in the light of any changes in risk posed by the business or market practices of the QFE or any member of the QFE group, review those terms and conditions by a date stated in the notice: s 75(6).

QFE products beyond scope of QFE advisers

The Commission may have concerns about QFE advisers' provision of personalised services in relation to certain category 1 products. These concerns would normally arise where such products are highly complex. Section 75B(1) of the FA Act allows the Commission to specify such concerns in a notice to the QFE or the partner entity whose QFE advisers provide those services. Under s 75B(4), the Commission may make a determination that the QFE advisers may not provide personalised financial adviser services to retail clients. The Commission may at any time revoke such a determination: s 75B(6).

Renewal of QFE status

A QFE may apply for renewal of QFE status: s 75C(1). An application for renewal of QFE status must be made in the prescribed form (if any) and be accompanied by the prescribed fee (if any): s 75C(2). The renewal of QFE status takes effect from the date of expiry of the previous grant of QFE status: s 75C(5). Section 75C(4) states:

> (4) If an application for renewal of QFE status has been made but not determined before the close of the 60th day after the date on which the period for which QFE status has been granted expires, the QFE status continues until the application is determined.

Commission's power to give directions

Section 75F(1) of the FA Act allows the Commission to give the QFE, and every partner entity of the QFE, notice where the Commission reasonably believes that the QFE is in breach of a conduct or disclosure obligation or any

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obligation under ss 76 or 77. The QFE must be given reasonable opportunity to respond to the Commission's allegations: s 75F(2). If the Commission considers that the QFE is in breach, notwithstanding the QFE's response, the Commission may give a direction to the QFE: s 75F(3). The direction may:

- direct the QFE or any partner entity, or both, to comply with the obligation
- stipulate any steps that the QFE or any partner entity, or both, must take in order to comply with the obligation
- require the QFE to report to the Commission within 28 days of the date of the direction, stating how and by when the Commission's direction will be implemented: s 75F(4).

If the QFE, any partner entity or any associated entity of the QFE fails to comply with a direction by the Commission, the QFE and every partner entity commits an offence under s 132: s 75F(5).

Termination of QFE status

Section 75A sets out the ways in which the QFE status of an entity or of partner entities may terminate. There are four possibilities:

- If the period of a grant of QFE status expires and the QFE fails for 60 clear days after that expiry to apply for renewal of QFE status, the status will be terminated.
- The QFE or a partner entity may request the Commission in writing to cancel the QFE status.
- The entity that forms, or any of the partner entities that jointly form, the QFE, may cease to be registered.
- The Commission cancels the QFE status under s 75D(2): s 75A(1).

Commission's powers in relation to QFE default

A QFE is considered to be in default where:

- the QFE or any partner entity of the QFE has ceased to be eligible for QFE status
- the QFE or any member of the QFE group has breached or is in breach of the FA Act or the regulations
- the QFE or any member of the QFE group is in breach of a term or condition of the grant of QFE status

- the QFE or any partner entity of the QFE has failed to comply with a direction given to it by the Commission under s 75F of the FA Act, or
- the QFE or any partner entity of the QFE has failed to pay a fee or levy as required by the FA Act or the regulations: s 75D(1).

Under s 75D(2), the Commission may take one of the following actions where it is satisfied that the QFE is in default:

(a) cancel the QFE's status; or

(b) cancel the QFE's status and debar, for a specified period, the entity, any partner entity, and any associated entity of the former QFE from re-applying for QFE status; or

(c) suspend the QFE's status for a specified period or until the suspended QFE or any partner entity, or any associated entity of the suspended QFE, does any thing that the Commission requires; or

(d) amend the terms and conditions of the QFE's grant of status; or

(e) order that the QFE pay a fine not exceeding $50,000; or

(f) censure the QFE; or

(g) take no further action.

The Commission is permitted to take only one of the actions specified in s 75D(2): s 75D(3). However, in addition to taking the actions described in s (2)(d) or (f) above, the Commission may require the QFE to pay a fine not exceeding $50,000: s 75D(3). The Commission must not order the QFE to pay a fine in relation to an act or omission that constitutes an offence for which the QFE or any partner entity of the QFE has already been convicted by a court: s 75D(5). Fines imposed by the Commission under s 75D(2)(e) are recoverable in any court as a debt due to the Commission: s 75G(1).

If the Commission suspends a QFE's status as a QFE under s 75D(2)(c), the status will be immediately revived at the end of the period of suspension, unless the Commission further suspends or cancels the status: s 75G(2). Suspension will normally be effective when a written notice of the suspension or cancellation is sent to the QFE by the Commission: s 75G(3).

Section 75D(4) imposes joint and several liability on QFEs and partner entities. It says that all partner entities of a QFE are "jointly and severally liable" for the payment of a fine that the QFE is ordered to pay. "Joint and several liability" means that a partner entity may incur an obligation for which all the other partner entities are jointly responsible. Liability can be enforced individually against one partner entity or against all partner entities jointly.[1]

1 See generally Gordon Walker, Terry Reid, Pamela Hanrahan, Ian Ramsay and Geof Stapledon *Commercial Applications of Company Law in New Zealand* (3rd ed, CCH New Zealand Ltd, Auckland, 2009) at ¶504.

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Reasonable opportunity to be heard

The Commission must send a written notice to the QFE and any partner entities of the QFE before taking any of the actions described in s 75D(2): s 75E. In its notice, it must state the reasons for its decision and give the QFE and any partner entities of the QFE a reasonable opportunity to be heard on the question: s 75E(2).

¶708 Nominated representatives

A QFE or a partner entity may nominate an individual as a "nominated representative". QFEs are under an obligation to keep up-to-date records of their "nominated representatives": s 74(4). The term "nominated representative" means an individual who has been nominated by a QFE or by a partner entity in accordance with s 74 of the FA Act and whose nomination has not been terminated under that section.

Nomination

According to s 74(1)(a), the method for nominations may be prescribed in the terms and conditions of the relevant grant of QFE status. Where the terms and conditions do not prescribe a method, the QFE or a partner entity must record the nomination in a written instrument that:

- nominates the individual as a nominated representative of the QFE or of the partner entity, and
- is dated, and
- if the nomination is to take effect on a later date, specifies that later date: s 74(1)(b).

Section 74(2) imposes a restriction with respect to the recommendation of nominated representatives. It says that an individual may not be the nominated representative of two or more entities, unless the entities are related bodies corporate.

Termination

The nomination of an individual as nominated representative is terminated if the entity that nominated the individual gives notice to the representative concerned and the Commission. Section 74(3) states:

> (3) The nomination of an individual as nominated representative is terminated if the entity that nominated the individual—
>
> (a) gives written notice to the individual concerned and to the Commission to that effect; or
>
> (b) as a result of the termination of QFE status, ceases to be a QFE or part of a QFE.

¶709 QFE groups

Application

Pursuant to s 69(2) of the FA Act, every application for QFE status that would, if approved, result in the formation of a QFE group must include a name for the proposed group. The name must be approved by the Commission, which may ask the applicant or applicants to submit another name: s 69(3).

Certification

The Commission may issue a certificate stating that:

- the named entities are, as at the date of the certificate, a QFE group, or
- the named entities were, during a specified period, a QFE group: s 73(1).

¶710 Associated entities

Approval of associated entities

Section 67(4) states:

> (4) If the application also asks for the approval of 1 or more entities as associated entities of the QFE, the Commission may approve an entity as an associated entity of the QFE if that entity—
>
> (a) is registered or is entitled to be registered; or
>
> (b) is, under the FSP Act, an affiliated entity of one of the applicants; or
>
> (c) is an exempt provider.

But despite being eligible under s 67(4), the Commission may decline to approve an entity for any reason: s 67(5). For example, the entity may lack a direct connection with the QFE or any of its partner entities.

Special terms and conditions

Section 67A states as follows:

> (1) This section applies if—
>
> (a) an application for QFE status asks for the approval of an entity as an associated entity; but
>
> (b) the Commission has concerns about the provision of personalised services in relation to certain category 1 products by individuals who would, following the approval of the entity, be the entity's QFE advisers.

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Further, a contravention includes "aiding, abetting, counselling or procuring the contravention": s 137A(2). If a person acts as an accessory to the commission of an offence under the FA Act, the Court may grant an injunction against this person.

Section 137A(6) states "engaging in conduct" means doing or refusing to do an act, and includes:

- omitting to do an act, or
- making it known that an act will or will not be done.

Interim injunctions

The Court may grant interim injunctions if it considers this desirable: s 137A(3). Generally, interim injunctions would be granted pending the determination of an application for a final injunction under s 137A(1).

Section 137B says:

> (1) If the Commission applies to the High Court for the grant of an interim injunction under section 137A, the Court must not, as a condition of granting an interim injunction, require the Commission to give an undertaking as to damages.
>
> (2) However, in determining the Commission's application for the grant of an interim injunction, the Court must not take into account that the Commission is not required to give an undertaking as to damages.

Banning orders

The purpose of a banning order is to protect the public from financial advisers or brokers who do not conform to the requirements of the FA Act. The Commission may ask the High Court to make a banning order against a person: s 137C of the FA Act. An order of this kind prohibits the person against whom it is made from doing all or any of the following things:

- providing financial adviser services or broking services
- being a director or promoter of, or in any way, whether directly or indirectly, being concerned or taking part in the management of, any incorporated or unincorporated body that provides financial adviser services or broking services (other than an overseas company, or an incorporated or unincorporated body, that does not carry on business in New Zealand)
- contributing, as employee or agent, to the provision of financial adviser services or broking services: s 137D.

Duration of a banning order

The prohibition against engaging in any of the above conduct continues for the period stated in the order. The maximum period, according to s 137D, is 10 years. Thus, the banning order cannot operate permanently.

Grounds for granting a banning order

Before granting a banning order, the Court must be satisfied that the person has been convicted of an offence against any of the following sections:

- s 118 (misleading or deceptive conduct by financial adviser or broker)
- s 119 (misleading, deceptive or confusing advertisement by financial adviser or broker)
- s 134B (receiving client money if offer for subscription illegal), or
- the person has been convicted of an offence against any of ss 58, 59 and 59A of the Securities Act or a pecuniary penalty order has been made against the person under that Act, or
- the person has been convicted of a crime involving dishonesty as defined in s 2(1) of the Crimes Act 1961, or
- the person has persistently contravened the FA Act or the Securities Act, or
- the person has been prohibited in an overseas jurisdiction from carrying on activities that are substantially similar to any of the activities referred to in s 137D: s 137C of the FA Act.

Offence of contravening a banning order

Section 137E of the FA Act states:

> **137E Offence of contravening banning order**
>
> A person who acts in contravention of a banning order commits an offence and is liable on conviction on indictment,—
>
> (a) in the case of an individual, to imprisonment for a term not exceeding 3 years or to a fine not exceeding $100,000, or to both:
>
> (b) in the case of a body corporate, to a fine not exceeding $300,000.

Temporary banning orders

Under s 137M of the FA Act, the Commission may make temporary banning orders against persons. The provision states:

> The Commission may make . . . a temporary banning order against a person in accordance with sections 137N to 137R if the Commission is satisfied that—
>
> (a) the person has persistently contravened this Act or the Securities Act 1978; or
>
> (b) the person has been prohibited in an overseas jurisdiction from carrying on activities that the Commission is satisfied are substantially similar to any of the activities referred to in section 137N.

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