The Statutory Duty of Care, Diligence and Skill Owed by Financial Advisers

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I AN INTRODUCTION TO THE HISTORICAL PROBLEMS OF THE FINANCIAL ADVISER INDUSTRY

In the 4 years between 2006 and 2010 over 60 finance companies collapsed in New Zealand.[1] The investors in these companies suffered significant losses, in some cases as much as 90 per cent of the funds invested.[2] To a certain extent, these losses can be attributed to the poor lending practices adopted by finance companies.[3] However, it must be remembered that these companies were set up to facilitate high-risk lending. There is a legitimate market for such lending. It is merely a matter of which investors should provide the funding for this market.

The investors who are best suited to funding finance companies are those who have the capacity to absorb the potential losses. Given this criterion, it is clear that many investors were ill-suited to such high-risk investments: for example, retirees with few other investments. For these investors, investing in the finance companies was a poor investment decision even before any losses were incurred. This poor decision-making can be partially explained by the careless attitude of investors chasing the highest possible return with little regard for the risk involved. However, much of the responsibility lies with the financial advisers who directed these investors towards the finance companies. After all, many investors had only a rudimentary understanding of their investment options and relied on the guidance provided by their financial advisers.[4]

The frequency of this type of poor investment advice was a consequence of an industry plagued by poorly trained financial advisers giving advice based on pre-set sales strategies rather than the actual

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1 Jamie Gray "More finance companies set to fail — S&P" *The National Business Review* (New Zealand, 17 September 2010) at 6.

2 See Colin McCloy "Receivers' Seventh Report on the State of Affairs of Bridgecorp Limited (In Receivership and In Liquidation)" (2010) PwC New Zealand at 5 <www.pwc.com>.

3 John Horsley "The buck stops here" *NZLawyer Magazine* (New Zealand, 17 September 2010) at 18.

4 Financial Intermediaries Task Force *Confidence, Change and Opportunity Final Report of the Task Force on Financial Intermediaries* (prepared for the Ministry of Economic Development 2005) at 18–19.

investment needs of the clients.[5] These low industry standards were obviously harmful to the investors who made poor investment decisions based on poor quality advice. However, perhaps less obvious is the harm that low industry standards caused by discouraging investors from seeking financial advice. This discouraging effect resulted from an inability to distinguish between good and bad financial advisers.[6] This meant that the reputation of good financial advisers suffered as a result of the bad financial advisers who brought the whole industry into disrepute.[7] Moreover, the discouraged investors potentially made poor investment decisions by investing without obtaining advice from good financial advisers.[8]

Parliament resolved that these industry-wide problems should be addressed by raising industry standards through regulation. The idea of reforming the industry had been around for decades. In the years leading up to the finance company collapses, significant progress had been made in this regard.[9] The collapses further highlighted the importance of industry regulation and provided the political motivation to pass the reforming legislation. For this reason, the Financial Advisers Act 2008 (the Act) was enacted with almost universal support.[10] It introduced a raft of different conduct and disclosure obligations and also provided for the creation of a Code of Professional Conduct. In particular, s 33 of the Act imposes a statutory duty of care on financial advisers:

> **33 Financial adviser must exercise care, diligence, and skill**
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> (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.
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> (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):
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> (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

5 Ibid, at 20–22 and 29–30. Financial intermediaries commonly received some form of commission from a product generator (finance companies are one type of product generator) for advising a client to invest in its product. Thus, there has historically been a blurred line between the roles of the financial adviser and the product marketer.

6 Ibid, at 20.

7 Ibid, at 35.

8 Ibid.

9 Cabinet Economic Development Committee "Regulation of Financial Intermediaries" (prepared for the Ministry of Economic Development 2005) at [10]. A task force review (Financial Intermediaries Task Force, above n 4) was completed in 2005 following problems highlighted by the International Monetary Fund report *New Zealand: Financial Sector Assessment Program — Detailed Assessments of Observance of Standards and Codes — International Organization of Securities Commission (IOSCO) — Objectives and Principles of Securities Regulation* IMF Country Report No 04/417 (2004).

10 (23 September 2008) 650 NZPD 18994: 118 ayes versus 2 noes.

(b) the nature of the service provided and the circumstances in which the service is provided; and

(c) the type of financial adviser.

The Act expressly anticipates that the s 33 obligation will be one of the primary means of achieving, and indeed justifying, its objectives of "[promoting] the sound and efficient delivery of financial adviser and broking services" and "[encouraging] public confidence in the professionalism and integrity of financial advisers".[11] In other words, the statutory duty of care is likely to play a key role as a regulatory tool in the future of the financial adviser industry. For this reason, this article considers various aspects of the new obligation, including the appropriateness of imposing a statutory duty of care on financial advisers; the jurisdictional application of the obligation; and the nature and requirements of the standard created by the obligation. It is hoped that this examination will provide guidance to market participants who are uncertain of their rights or obligations that arise by virtue of s 33.

II THE APPROPRIATENESS OF IMPOSING A STATUTORY DUTY OF CARE ON FINANCIAL ADVISERS

Before delving into the substance of the new s 33 obligation, it is useful to consider why it is appropriate to impose a statutory duty of care on financial advisers. Care-based obligations have broad applicability: they can regulate conduct generally, whereas prohibitive obligations can only be used to prohibit specific conduct.[12] Thus, a statutory duty of care performs a unique regulatory role. It ensures that financial advisers are always subject to a minimum standard of conduct.

The appropriateness of imposing some form of care-based obligation on financial advisers is self-evident. Perhaps a more pertinent question to ask is why the many pre-existing care-based obligations were insufficient. These include the guarantee of care for services provided to consumers under s 28 of the Consumer Guarantees Act 1993, the equitable duty of care owed by fiduciaries,[13] the duty of care owed pursuant to the tort of

11 Financial Advisers Act 2008, s 3(1).

12 The other obligations imposed on financial advisers (i.e. loyalty, disclosure and prohibitory obligations) also play an important role in industry regulation. However, consideration of these obligations is outside the scope of this article.

13 *Laws of New Zealand* Equity (online ed) at [238]: this is only applicable where there is a fiduciary relationship.

negligence,[14] and the contractual duty of care that has historically been implied into financial adviser–client contracts.[15]

These obligations were insufficient because the financial adviser could exclude their application. The implied duty of care could easily be avoided by including an express term in the contract preventing such an implication. Similarly, the tortious duty of care could be excluded through including a carefully drafted exclusion clause in the contract. Further, the guarantee of care in the Consumer Guarantees Act 1993 only applies to services supplied to a "consumer" and can be excluded where the service is acquired for business purposes.[16] Thus, there were many scenarios where a financial adviser could provide a financial adviser service without having a care-based obligation apply.

Furthermore, even if one of these obligations happened to apply in the particular circumstances, enforcement mechanisms were insufficient to ensure compliance. In particular, the prohibitive cost of court action meant that many retail investors were unable to obtain a remedy in the event of a breach. To remedy this deficiency, the Financial Service Providers (Registration and Dispute Resolution) Act 2008 has introduced compulsory dispute resolution schemes to give retail clients an alternative, readily available, method of enforcing the new statutory duty of care.[17] In addition, the Act gives the Financial Markets Authority (the FMA) a variety of enforcement powers to help ensure compliance with the new duty of care.[18]

III THE JURISDICTIONAL ENTRY POINTS FOR THE S 33 OBLIGATION

The appropriateness, and indeed importance, of imposing a care-based obligation on financial advisers has been illustrated. Given its importance, it is essential to ensure that the new obligation is implemented properly. In this regard, the obligation needs to have appropriate jurisdictional entry points to ensure that it is targeted towards the financial adviser industry. If the obligation is overly broad, it will have an undesirable collateral impact on related industries.[19] Conversely, if it is too narrow, the reforming powering of the obligation will be diminished.

14 *Armitage v Church* [2010] NZCCLR 28 (HC) at [30]: "... the imposition of a duty of care between financial adviser and client is not a novel concept".

15 See *Breeze v VPFS Financial Planners Ltd* HC Napier CIV-2008-441-566, 11 September 2009 at [2] for an example of a successful claim for breach of an "implied term to use reasonable care and skill in advising".

16 Consumer Guarantees Act 1993, ss 2, 28 and 43.

17 Financial Service Providers (Registration and Dispute Resolution) Act 2008, ss 47, 48, 63(e), 63(f) and 63(l) [FSP Act 2008].

18 Financial Advisers Act 2008, ss 49(2)–(3), 59(2), 60, 75D and 137A.

19 See Cabinet Economic Development Committee "Financial Advisers Bill: Amendments to Policy Design" (prepared for the Ministry of Economic Development 2008) at [25]–[29] ["Amendments to Policy Design"], where it was recommended that specific professions be excluded from the Act's application.

The new statutory duty of care, diligence and skill only applies to a "financial adviser, when providing a financial adviser service".[20] In other words, the jurisdictional entry points are the two phrases "financial adviser" and "when providing a financial adviser service".[21] These phrases are statutorily defined and serve as markers that point to the detailed jurisdictional rules.

Who Is a Financial Adviser?

A financial adviser is simply a "person who provides a financial adviser service".[22] Thus, the s 33 obligation is owed by a person who provides a financial adviser service, when providing a financial adviser service. This transitory definition of a financial adviser means that the jurisdictional scope of s 33 hinges squarely on the concept of a financial adviser service.

While the definition of a financial adviser at a holistic level is merely transitory, there is a more meaningful division of the financial adviser concept into several different types of financial adviser.[23] However, for jurisdictional purposes, the s 33 obligation does not discriminate between these different types of financial advisers: the obligation clearly applies to every adviser.[24]

When Does a Financial Adviser Provide a Financial Adviser Service?

A person provides a financial adviser service when, in the ordinary course of business,[25] that person provides one of three specified services to a client.[26] These are giving financial advice, providing an investment planning service and providing a discretionary investment management service.[27] The Act contains detailed rules stipulating what is required to provide each of the three services. These rules form the backbone of s 33's jurisdictional application.

1 What Is Financial Advice?

The broadest specified service is the giving of financial advice. A person gives financial advice when that person "makes a recommendation or gives an opinion in relation to acquiring or disposing of (including refraining from acquiring or disposing of) a financial product".[28] The reference to a

20 Financial Advisers Act 2008, s 33(1).
21 Ibid, s 33(1). Section 157 imposes a territorial scope restriction.
22 Ibid, s 8(1).
23 Ibid, s 16.
24 Ibid, s 32(2).
25 Ibid, s 9(1). Alternatively, a person may provide a financial adviser service "in the course of business of a financial service provider registered under the [FSP Act 2008]" (s 9(2)).
26 Ibid, s 9(1).
27 Ibid, s 9(3).
28 Ibid, s 10(1).

financial product means one of the financial products identified in the Act.[29] The products covered include securities, land investment products, bank term deposits and contracts of insurance.[30]

The breadth of the above definition, without further qualification, would likely capture some services that are commonly provided in relation to financial products but that are not the desired target of the reforming legislation. The Act anticipates this problem by stating explicitly that a person does not give financial advice merely by:[31]

> (a) providing information (for example, the cost or terms and conditions of a financial product); or
> (b) making a recommendation or giving an opinion relating to a class of financial products; or
> (c) making a recommendation or giving an opinion about the procedure for acquiring or disposing of a financial product; or
> (d) transmitting the financial advice of another person (unless A gives A's own financial advice in doing so or holds out the transmitted financial advice as A's own financial advice); or
> (e) recommending that a person consult a financial adviser.

These exceptions give rise to substantial jurisdictional uncertainty because the distinctions drawn do not have definitive boundaries.[32] For example, at what point does providing information change into providing advice?[33] Furthermore, some financial advisers may try to structure their advice to fall within an exception.[34] For example, the financial adviser might only provide information about a few products and thereby imply that the client should invest in those products. However, such efforts are likely to fail because s 10(2) of the Act contains a type of substance-over-form provision.

Needless to say, this is an area of the Act that will have a high incidence of litigation. Further amendments may be required to clarify uncertainties associated with unintended uses of the exceptions.

2 What Is an Investment Planning Service?

The second service within the jurisdiction of s 33 is an investment planning service. This service involves the financial adviser designing a plan for an

29 Ibid, s 5. Financial products can be further categorised into category 1 products and category 2 products.

30 Ibid.

31 Ibid, s 10(3).

32 Financial Intermediaries Task Force, above n 4, at 30.

33 See generally Regulatory and Competition Policy Branch "Financial Intermediaries Discussion Document" (prepared for the Ministry of Economic Development 2006) at [72]–[120] for guidance regarding the intended targets of the exceptions in s 10(3)(a) and (c). See also Cabinet Economic Development Committee "Amendments to Policy Design", above n 19, at [31(a)] for guidance regarding the exception in s 10(3)(b), which was introduced to preserve "general market commentary".

34 See Regulatory and Competition Policy Branch, above n 33, at [76] where product marketers were rejected as a service warranting an exception. Thus, these marketers might try to construct their activities to fall within one of the exceptions.

individual that is based upon the individual's financial situation and goals, including "recommendations or opinions on how to realise those goals".[35]

The range of services that fall within this description is narrower than the range of services within the description of financial advice.[36] In fact, it is difficult to conceive of a situation where the jurisdiction of s 33 is established solely on the grounds of the provision of an investment planning service and not also on the grounds of the provision of financial advice.

3 What Is a Discretionary Investment Management Service?

The third specified service deals with a different kind of situation from the previous two categories. A person provides a discretionary investment management service when, in accordance with the client's authority, that person "decides which financial products to acquire or dispose of on behalf of the client".[37] Thus, a discretionary investment management service involves the adviser actually acquiring or disposing of financial products, not just making recommendations or providing opinions.

The Other Jurisdictional Requirements

If the service provided in a given scenario is one of the services specified above, the core jurisdictional requirement of s 33 will be satisfied. However, it cannot be said that a financial adviser service is provided unless one of these specified services is provided to a "client" and "in the ordinary course of business" or "in the course of business of a financial service provider registered under the [Financial Service Providers (Registration and Dispute Resolution) Act 2008]".[38]

1 Who Is a Client?

A client is simply "a person who receives a service".[39] It is irrelevant whether the person has to pay for the service.[40] For the purposes of this jurisdictional requirement, the Act makes it clear that "person" is a broad concept and thus provides little limitation on the Act's application. The definition of person includes a "person carrying on the business, a controlling owner, a director, an agent, or any other person".[41]

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35 Financial Advisers Act 2008, s 11(1).

36 See generally Securities Commission "Guidance Note: Distinguishing the boundary between a financial planning service and advice" (press release, 29 March 2010) for guidance as to when an adviser provides an investment planning service rather than just financial advice.

37 Financial Advisers Act 2008, s 12.

38 Ibid, s 9.

39 Ibid, s 5A.

40 Ibid.

41 Ibid, s 5A(2).

The limiting power of this jurisdictional requirement comes from an exception that exists for situations where a service is provided between different arms of the same business;[42] for example, an employee advising a director for the purposes of the business. In such situations the person receiving the service is not considered a client.[43]

2 When Is a Service Provided in the Ordinary Course of Business?

Section 9(1) of the Act requires that the service be provided "in the ordinary course of business". This requirement is critical because it ensures that advice given in a private context is not captured by the Act: for example, between a husband and wife.[44] Furthermore, it could be said that the service is not provided "in the ordinary course of business" if the service is provided only incidentally to the main business, which does not involve the provision of that service.[45]

This jurisdictional requirement can alternatively be met by providing a service "in the course of business of a financial service provider registered under the FSP Act".[46] This removes the possibility of arguing that the service is provided only incidentally to the main business when the provider of that service is a registered financial service provider.[47]

Exemptions

If the foregoing jurisdictional requirements are satisfied, the s 33 obligation prima facie applies. However, there are numerous exemptions, which deem that the service provided is not a financial adviser service in particular scenarios.[48] These exemptions can be found in ss 13, 14 and 148 of the Act and also the associated regulations.[49]

42 The word "receives" in Financial Advisers Act 2008, s 5A could be interpreted narrowly to create another limiting power in this jurisdictional requirement. For example, one might say no one receives advice if it is provided to the world at large over the Internet.

43 Ibid, s 5A(1).

44 Cabinet Economic Development Committee "Review of Financial Intermediaries: Financial Advisers — A New Regulatory Framework" (prepared for the Ministry of Economic Development 2007) at [28].

45 Cabinet Economic Development Committee "Amendments to Policy Design", above n 19, at [20]: this jurisdictional requirement does not exclude part-time advisers.

46 Financial Advisers Act 2008, s 9(2).

47 Financial Service Providers (Pre-Implementation Adjustments) Bill 2009 (109—2) (select committee report) at 3–4.

48 Financial Advisers Act 2008, s 9(4).

49 Ibid.

1 The Exemption for Incidental Service

The Act's general exemption provides that:[50]

> A service is not a financial adviser service for the purposes of this Act if the service is provided only as an *incidental* part of another business that is not otherwise a financial service or does not have, as its principal activity, the provision of another financial service.

This exemption removes the need to rely on the phrase "in the ordinary course of business" to exclude services that are provided incidentally to the main business.[51] The true importance of that phrase is its ability to exclude services provided in a private context. Thus, the specific provision dealing with incidental services separates the two distinct jurisdictional limitations and thereby adds clarity.

2 Other Exemptions

Section 14 contains a raft of other exemptions for services that are not the intended target of the Act but are at risk of being caught by the legislation if not exempted specifically. The exemptions cover a variety of occupations: for example, lawyers, chartered accountants, lecturers and Members of Parliament.[52] There are also exemptions for several scenarios in which another regulatory regime is applicable: for example, takeovers and the offer of securities to the public.[53]

3 Section 148 and the Associated Regulations

The FMA has the power to grant exemptions from compliance with any obligation imposed by the Act.[54] However, this power may only be exercised if the costs of complying with the obligation would be "unreasonable" and would not be "justified by the benefit of compliance".[55] It is unlikely that the costs of complying with the s 33 obligation alone would give the FMA sufficient justification to invoke this power. The Governor-General, on the recommendation of the relevant Minister, has a similar power to make exempting regulations.[56] This power is as unlikely to be exercised as that of the FMA.

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50 Ibid, s 13(1) (emphasis added).

51 Ibid, s 9(1).

52 Ibid, s 14(1)(a)–(d): although, the exemptions all have qualifying words to the effect of "in the ordinary course of business of that kind".

53 Ibid, s 14(1)(i)–(n).

54 Ibid, s 148.

55 Ibid, s 148(2).

56 Ibid, s 154(1)(a) and (5).

IV THE NATURE OF THE STANDARD OF CARE, DILIGENCE AND SKILL

If all of the preceding jurisdictional requirements are satisfied, and none of the exemptions apply, then the s 33 obligation applies and the inquiry shifts to considering the nature and requirements of the standard of care, diligence and skill. The standard imposed on financial advisers by s 33 is the standard of "care, diligence and skill that a reasonable financial adviser would exercise in the same circumstances". At the date of publication, no cases have considered the requirements of this standard because the Act only came into force on 1 December 2010.[57] Therefore, when determining the nature and requirements of this standard it is useful to consider how the duty of care, diligence and skill has been interpreted in other contexts. In particular, it is useful to consider the statutory duty of care, diligence and skill imposed on directors by s 137 of the Companies Act 1993.[58]

The Standard (or Standards) of Care, Diligence and Skill

One aberration in the interpretation of the statutory duty of care, diligence and skill owed by directors is the question of whether the duty creates a single composite standard of "care, diligence and skill" or multiple discrete standards of "care", "diligence" and "skill".[59] The word aberration is used because case law seems to indicate that the courts will adopt whichever approach is the most convenient for dealing with the case at hand.

Most cases simply analyse the facts as if there is a single composite standard.[60] This is presumably because the facts of the case engage all elements of the duty of care, diligence and skill and the factual scenario is not complex enough to warrant an individual analysis of each separate standard. However, the courts have not universally viewed the standard as a composite. The approach of separately dealing with three distinct standards has been favoured where the facts tend to engage one element of the duty over the other elements.[61] This approach enables the court to focus its inquiry on the relevant standard that most closely aligns with the facts.

1 What Do the Words Care, Diligence and Skill Mean?

It seems likely that the statutory duty of care, diligence and skill creates three distinct standards. When courts analyse cases on the basis of a

57 Financial Advisers Act Commencement Order 2010, cl 3.

58 See Companies Act 1993, s 137.

59 Peter Watts *Directors' Powers and Duties* (LexisNexis, Wellington, 2009) at 237 where reference is made to the directors' duties of care, diligence and skill, not the duty of care, diligence and skill.

60 See *Vercauteren v B-Guided Media Ltd* [2011] NZCCLR 9 (HC) at [56]–[58] for an example of this approach.

61 See generally Watts, above n 59, at 255–257 where the author discusses what each separate standard requires according to *Daniels v Anderson* (1995) 37 NSWLR 438 (CA).

composite standard they do so merely because there would be no benefit in focusing the inquiry on a particular standard. This benefit only arises if one particular standard most closely aligns with the facts. However, this raises the question of what the three standards actually mean independently of the facts: stating that a particular factual scenario aligns most closely with one standard presupposes an understanding of what the words care, diligence and skill mean in the abstract.

It could be argued that the words care, diligence and skill are so simple that any attempt further to break down their meaning is likely to alienate some other aspect of that meaning.[62] On this view, any judicial elaboration of the meaning of these three words should be treated with caution outside the particular facts of the case.[63] There is certainly value in adopting this approach. It recognises the multitude of different factual scenarios in which the duty of care, diligence and skill might arise and prevents previously formed legal constructs from clouding judgement in the case at hand.[64] However, for present purposes it is useful to consider the meaning of these three words while recognising that the ground covered will probably not exhaust the full scope of three concepts.

The word "care" is largely synonymous with the word caution.[65] Thus, the standard of care requires the financial adviser to exercise a certain degree of caution in any action undertaken as part of providing a financial adviser service. Further guidance on the meaning of the word "care" can be found by contrasting it with the words "diligence" and "skill".

The word "diligence" is perhaps best contrasted with the word "care" by the fact that the former requires the financial adviser to take active steps and checks.[66] The standard of care, at least in its narrow sense, is more passive because it requires caution when an action is undertaken but does not require an action be taken in the first place.[67] For this reason,

62 See generally *Red Eagle Corp Ltd v Ellis* [2010] NZSC 20, [2010] 2 NZLR 492 at [26] where the Supreme Court adopted this view in respect of the meaning of the words "misleading or deceptive".

63 Ibid.

64 Ibid, at [26].

65 See the definition of "care" in *The New Zealand Oxford Dictionary*: the word "care" has multiple meanings, but its use to convey the need for caution seems to be the intended meaning in this context.

66 See the definition of "diligence" in *The New Zealand Oxford Dictionary*: the word "diligence" conveys the notion of making an active effort and also incorporates the idea of taking care while making that effort. See also Julie Cassidy "An Evaluation of Section 232(4) of the Corporations Law and the Directors' Duty of Due Care, Skill and Diligence" (1995) 23(3) ABLR 184 at 191–193.

67 But the extent to which the standard of diligence requires a financial adviser to take action in the first place will depend upon the circumstances. To this end, guidance can be taken from what is required by the directors' duty of diligence: see *Daniels v Anderson*, above n 61, at 501. See also Watts, above n 59, at 255: the office of a director is held for a period of time; it is not a one-off responsibility. This understanding of the director's role has led to much discussion regarding the continuing requirements of the standard of diligence: for example, to what extent is a director required to consider the company's affairs between directors' meetings, and how frequently are the directors required to hold meetings? In *Daniels v Anderson*, above n 61, at 501, it was stated that directors' meetings should be held as often as necessary and not solely at predetermined intervals. In relation to the requirements of the standard of diligence, it is possible to draw an analogy between the office of a director and those scenarios in which there is a continuous adviser–client relationship: that is, the standard of diligence requires an adviser in such circumstances to meet the client as often as necessary and not solely at predetermined intervals. However, this analogy cannot be drawn in scenarios where the adviser–client relationship is one-off or intermittent.

in cases where there is an omission to act, it is easier to frame the factual analysis in terms of the required standard of diligence.[68]

The word "skill" is used in reference to the adviser's personal ability: for example, the adviser's expertise and knowledge.[69] Thus, the standard of skill requires the financial adviser to have the necessary ability to advise the client properly in the circumstances. The distinction with the standard of care is best illustrated through an example. Consider a scenario in which the financial adviser has limited knowledge in relation to a particular investment product. This adviser might provide advice in respect of that product with a great deal of caution but still provide a substandard service through a lack of ability. In this scenario, the caution that the financial adviser exercised would satisfy the requirements of the standard of care, at least on a narrow interpretation of that standard's requirements. However, the financial adviser has not exercised the requisite degree of skill. Therefore, cases that relate to the financial adviser's lack of ability are most closely associated with the standard of skill.

Is the Standard of Care, Diligence and Skill Objective or Subjective?

The above consideration of the words "care, diligence and skill" has provided some guidance as to the likely requirements of a standard of care, diligence and skill. However, it must also be considered whether the standard is objective or subjective. In this regard, the standard's requirements are determined by an assessment of what the "reasonable financial adviser would [do] in the same circumstances".[70] At first glance this definition appears to suggest that the standard is objective because it requires an assessment of what a "reasonable" financial adviser would do.[71] However, the standard still has some scope for subjectivity due to the words "in the same circumstances".[72]

The circumstances of the case potentially include facts that are quite specific to the particular financial adviser in question: for instance, the financial adviser's qualifications and experience. The extent to which the circumstances of the case should be allowed to erode the objectivity of the standard has been considered extensively in the context of the directors' statutory duty of care, diligence and skill.[73] In that context, the courts have reached the point of denying the relevance of a director's personal knowledge and experience but recognising that the director's position in the company and responsibilities add a tint of subjectivity to the standard.[74] This is because the director's position in the company and

68 *Brookers Company Law* (online looseleaf ed, Thomson Reuters) at [CA137.01(4)].

69 See the definition of "skill" in *The New Zealand Oxford Dictionary*.

70 Financial Advisers Act 2008, s 33(1).

71 *Laws of New Zealand* Companies (online ed) at [196].

72 Ibid.

73 See generally *Brookers Company Law*, above n 68, at [CA137.01].

74 *Vercauteren v B-Guided Media Ltd*, above n 60, at [57].

responsibilities are circumstances that are identified specifically as being relevant in the Companies Act 1993.[75] Thus, it appears that the words "in the same circumstances" will not allow the introduction of subjectivity to the standard unless the subjective circumstance is identified specifically in the Act.

The fact that the standard is objective does not mean that there is only one correct method of meeting that standard. To this end, useful guidance can be found in the "business judgement rule" that has developed in the context of the equivalent directors' duty.[76] The essence of this rule is that the courts recognise that a director has to make decisions that balance the risk of harm to the company against the possibility of obtaining a benefit for the company.[77] In such situations, the director will not be liable for any losses incurred as a result of the decision unless no person exercising a reasonable degree of prudence would have come to the same decision.[78] Hence, two reasonable financial advisers could both satisfy the requirements of the objective standard of care, diligence and skill even if those advisers gave different advice in the same circumstances. In other words, a standard of care, diligence and skill does not guarantee that the advice given will be the best possible advice in hindsight.

V THE REQUIREMENTS OF THE STANDARD OF CARE, DILIGENCE AND SKILL

The nature of the standard of care, diligence and skill imposed on financial advisers has now been traversed in some detail. There still remains the question of what is actually required by a standard of this nature. Stated concisely, the standard requires financial advisers to "exercise the care, diligence, and skill that a reasonable financial adviser would exercise *in the same circumstances*".[79] The requirements of this standard cannot be fully understood without knowing the circumstances of the case. However, when those circumstances are known, the requirements can be ascertained fully by answering two sequential questions. The first is: what is the degree of care, diligence and skill that a reasonable financial adviser would exercise in those same circumstances? The second is: what is factually required of a financial adviser to meet that particular degree of care, diligence and skill?

It should be noted that these questions are only guides to help answer the overarching question of what the s 33 duty demands of financial advisers. This overarching question may not always be broken down into

75 Companies Act 1993, s 137(c).

76 Watts, above n 59, at 244.

77 Ibid, at 245 quoting from *Vrisakis v Australian Securities Commission* (1993) 9 WAR 395 (SC) at 449–450.

78 Watts, above n 59, at 246.

79 Financial Advisers Act 2008, s 33(1) (emphasis added).

sequential questions.[80] Instead, a single question may be used to determine the standard's requirements: that is, what is factually required of a financial adviser exercising the care, diligence and skill that a reasonable financial adviser would exercise in the same circumstances?

There is some merit in determining the standard's requirements through answering a single question as opposed to two sequential questions. This is because the answers to both questions must be ascertained through an assessment of the circumstances of the case. Thus, it could be said that it is pointless to separate the inquiry and carry out two assessments of the same circumstances. However, the sequential questions approach will be looked at in this article because it more clearly identifies the issues for analysis and is favoured by the wording of s 33.

The Wording of s 33 and the Sequential Questions Approach

The requirements of the statutory duty of care, diligence and skill imposed on directors are usually determined through a single assessment of the circumstances of the case.[81] This approach is favoured by the wording of s 137 of the Companies Act 1993. Therefore, the similarities between the statutory duty of care imposed on directors and the equivalent duty imposed on financial advisers would seem to support adopting the single question approach in the present context. However, there is a minor difference between the wording of s 137 of the Companies Act 1993 and s 33 of the Act, which favours adopting the sequential questions approach:[82]

> **137 Director's duty of care**
> A director of a company, when exercising powers or performing duties as a 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.
>
> **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.

80 See *Vercauteren v B-Guided Media Ltd*, above n 60, at [58].
81 Ibid.
82 Companies Act 1993, s 137; Financial Advisers Act 2008, s 33 (emphasis added).

> (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.

The difference in format should be immediately apparent: the s 33 obligation is split into two subsections. This different format is accompanied by the specific inclusion of the words "in determining the degree of care, diligence and skill".[83] Therefore, the specifically mentioned circumstances in s 33(2) must be considered when ascertaining the degree of care, diligence and skill that is owed by the financial adviser. However, the section does not mandate that those specifically mentioned circumstances be considered when determining what is factually required for the financial adviser to meet that particular degree of care, diligence and skill.[84] This can be contrasted with the situation under s 137 of the Companies Act 1993 where the specifically mentioned circumstances must be considered in assessing the requirements of the duty but no further guidance as to their relevance is stipulated.

The upshot of this addition to s 33(2) is that the consideration of the circumstances should be carried out in light of two sequential questions: first, what is the degree of care, diligence and skill required; and then, what is required to meet that degree of care, diligence and skill. The separation of the analysis into two sequential questions does not have any impact on the substantive requirements of the standard of care, diligence and skill. Rather, adopting the sequential questions approach merely enables a more focused assessment of how the circumstances of the case affect the requirements of the standard of care, diligence and skill.

VI THE DEGREE OF CARE, DILIGENCE AND SKILL REQUIRED IN THE CIRCUMSTANCES

Consider the first question to be answered in the sequential questions approach: what is the degree of care, diligence and skill that a reasonable

83 See generally Supplementary Order Paper 2010 (146) Financial Service Providers (Pre-Implementation Adjustments) Bill 2009 (109—2), at cl 11A: this different format and the inclusion of the word "degree" are changes that were introduced to s 33 via a last minute Supplementary Order Paper to the amending Bill. These changes were never considered by a select committee.

84 Ibid, (explanatory note) at 24: the changes to s 33 were not specifically mentioned in the explanatory note and it is doubtful whether they were intended to have any effect besides adding clarity.

financial adviser would exercise in the same circumstances?[85] The question is principally concerned with the concept of relativity as conveyed by the word "degree".[86] This question contributes to the overarching inquiry of what is required by the standard by determining whether the standard's requirements are relatively higher or lower due to the particular circumstances of the case. Making this determination is somewhat complicated by the fact that any given case will have a variety of different circumstances to weigh.

In particular, the degree of care, diligence and skill depends on an overall consideration of the circumstances that are identified specifically in s 33 and any other unidentified relevant circumstances.[87] The cumulative effect that these circumstances will have on the requisite degree of care, diligence and skill can be determined by weighing the circumstances according to their relative importance. The importance of each circumstance is relative and depends on all of the other circumstances. But it is likely that the specifically identified circumstances will be the weightiest considerations.

The Specifically Identified Relevant Circumstances

As mentioned above, s 33(2) identifies three circumstances specifically that must be considered to determine the degree of care, diligence and skill that a reasonable financial adviser would exercise.

1 The Nature and Requirements of the Financial Adviser's Client

The first specifically identified circumstance is "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".[88] A useful indication of a particular client's nature and requirements is whether the Act classifies him or her as a retail or wholesale client. The nature and requirements of the client is a broader concept than any statutory classification of the client; for example, the nature of the client would include the client's financial literacy and the requirements of the client would include the client's risk profile.

The statutory classification of clients is perhaps the most important factor indicating the nature and requirements of the client. The client must fit within one of the categories in s 5C of the Act to be classified as a wholesale client; any other client is considered a retail client.[89] The common characteristic across these categories is the expectation that wholesale

85 In answering this question interpretative guidance should be taken from the Act's objectives: see Interpretation Act 1999, s 5(1) and Financial Advisers (Code of Professional Conduct for Authorised Financial Advisers) Notice 2010 at 4.

86 See the definition of "degree" in *The New Zealand Oxford Dictionary*.

87 Financial Advisers Act 2008, s 33(2).

88 Ibid.

89 Ibid, s 5B.

clients have a good understanding of financial matters. For example, an "eligible investor" is considered to be a wholesale client and becoming an eligible investor requires the client to certify that "the client has sufficient knowledge, skills, or experience in financial matters to assess the value and risks of financial products and the merits of the service or services to be provided".[90] Thus, the degree of care, skill and diligence that a reasonable financial adviser would exercise for wholesale clients is lower than that which would be exercised for retail clients.

The distinction drawn between wholesale clients and retail clients demonstrates a more general factor regarding the "nature" of the client: the client's financial literacy. An experienced, financially competent business person would be expected to exercise some personal judgement and not completely rely on the financial adviser's recommendations.[91] Conversely, a financially illiterate person would be unlikely to question the financial adviser's recommendations. Thus, the degree of care, diligence and skill that a reasonable financial adviser would exercise is proportional to the client's financial literacy.

The degree of care, diligence and skill that a reasonable financial adviser would exercise will also be affected by the client's requirements. The client's requirements would include any requirements specifically made known to the financial adviser but could also include those requirements that are implied given the circumstances. For example, it is generally considered that people approaching retirement have a lower tolerance for risk than other investors and thus impliedly require a low-risk investment portfolio.[92] A financial adviser who is exercising the appropriate degree of care, diligence and skill would advise the client in a manner consistent with this low risk profile. However, this is not to say that a person with a low risk profile is owed a higher degree of care, diligence and skill than a person with a high risk profile. Rather, the advice that the standard requires for a client with a high risk profile will merely be different from the advice that is required for a client with a low risk profile (a matter to be considered in answering the second sequential question).[93]

The client's "advice requirements" is another factor that may affect the requisite degree of care, diligence and skill.[94] For example, if a client requires complex advice, then a reasonable financial adviser would

90 Ibid, s 5D. One method by which a financial adviser can reduce the degree of care, skill and diligence required by the standard is to obtain this certification from the client.

91 See generally *Hedley Byrne & Co Ltd v Heller & Partners Ltd* [1964] AC 465 (HL): the skill differential between the two parties has been a relevant factor since the inception of negligent misstatement as a potential cause of action.

92 See *Breeze v VPFS Financial Planners Ltd*, above n 15, at [7].

93 It is odd that the requirements of the client must be considered in determining the degree of care because the word "requirements", in this context, is most commonly associated with the client's risk profile and income needs. These factors patently should not affect the degree of care owed. Thus, in terms of altering the degree of care, it is not clear what the word "requirements" adds that is not already covered by the word "nature". In the author's view, the presence of the word "requirements" indicates that the change in meaning that came about through the introduction of the word "degree" was not intended: see section V above.

94 See generally Securities Commission, above n 36, at [11]–[18].

exercise a higher degree of care, diligence and skill than if the client only required basic advice.[95] But care must be taken not to double count the same factor because the client's advice requirements will be manifested in the nature of the service provided: a financial adviser should provide a more comprehensive service when the client has complex advice requirements.[96] A better approach would be to consider the client's advice requirements only in assessing the type of service that the financial adviser is factually required to provide in the circumstances.[97] The requisite degree of care, diligence and skill can then be determined by the nature of the service provided without any risk of double counting.

2 The Nature of the Service Provided and the Circumstances in which the Service Is Provided

The second expressly stated circumstance that must be considered is "the nature of the service provided and the circumstances in which the service is provided".[98] The Act identifies three different types of financial adviser services and also distinguishes between personalised and class services. The classification into these statutorily defined categories will certainly be important in determining the requisite degree of care, diligence and skill. But the "nature of the service provided and the circumstances in which the service is provided" is a broader concept than the statutory classification of the service.

To begin with, consider the three types of financial adviser service that exist under the Act: giving financial advice; providing an investment planning service; and providing a discretionary investment management service.[99] Giving financial advice could be viewed as the base service that requires a base standard of care, diligence and skill: it entails giving a recommendation or an opinion "in relation to acquiring or disposing of ... a financial product".[100] This base service can be compared with the provision of an investment planning service, which entails not only the giving of a recommendation or opinion but also requires a plan that considers the client's goals and financial situation.[101] These additional requirements when providing an investment planning service suggest that a reasonable financial adviser would exercise a higher degree of care, diligence and skill when providing that service.

Both of these services can be contrasted with the provision of a discretionary investment management service. This discretionary service

95 Ibid, at [11].

96 Ibid, at [16]–[17].

97 Ibid, at [17]–[18]: other factors will also affect the type of service that the financial adviser is factually required to provide: for example, "the nature of the service being offered or that the client can reasonably expect".

98 Financial Advisers Act 2008, s 33(2)(b).

99 Ibid, s 9(3).

100 Ibid, s 10.

101 Ibid, s 11.

involves the actual acquisition or disposal of financial products rather than merely giving a recommendation or providing an opinion.[102] Thus, a discretionary investment management service warrants imposing an even higher degree of care, diligence and skill on the financial adviser because the client's ability to intervene is substantially reduced. In a situation involving financial advice or an investment planning service the client can simply choose not to follow the financial adviser's recommendation or opinion. This opportunity may not arise in the context of a discretionary investment management service.

The Act contains a further distinction relevant to the nature of the service provided: that is, the classification of the service as either a personalised service or a class service. A personalised service exists if a financial adviser service is given to a named or otherwise readily identifiable client and the financial adviser has taken into account that client's particular financial situation or goals in providing the service;[103] otherwise the service is a class service.[104] The fact that the personalised service requires consideration of the client's particular financial situation and goals would in most cases warrant a higher degree of care, diligence and skill than would exist for a class service. However, the class service could require the consideration of the financial situation and goals of the client's class in general.[105] This kind of class service would warrant a similar degree of care, diligence and skill as that required for a personalised service.

The foregoing statutory classifications indicate a more general factor regarding the nature of the service provided: the complexity of the service.[106] There are numerous factors that influence the complexity of the service provided, including: the extent to which the service requires tailored consideration of the client's needs; the variety of different financial products that must be considered; and the complexity of the financial product(s) considered.[107] The degree of care, diligence and skill that a reasonable financial adviser would exercise is proportional to the complexity of the service provided.

The nature of the service provided is also affected by the type of recommendation that the financial adviser gives:[108] for instance, a hold recommendation as opposed to a buy or sell recommendation. The former recommendation is passive, whereas the latter two recommendations would require the client to take a positive action. Thus, it is arguable that

102 Ibid, s 12.

103 Ibid, s 15(1): or "a client would, in the circumstances in which the service is provided, reasonably expect the financial adviser to take into account the client's particular financial situation or goals (or any 1 or more of them)".

104 Ibid, s 15(3).

105 Ibid, ss 11(2) and 15(2).

106 See generally Securities Commission, above n 36, at [11]–[12].

107 Ibid.

108 However, this would be stretching the words "nature of the service provided". A better view would be to distinguish between the nature of the advice given and the nature of the service provided.

a reasonable financial adviser would exercise a higher degree of care, diligence and skill before giving a buy or sell recommendation. But such reasoning would be flawed as it is not possible to draw a distinction in the nature of the service provided until after the financial adviser has provided a recommendation. Furthermore, drawing the distinction subsequently would distort the advice that is given to the client: a hold recommendation would be favoured over a buy or sell recommendation.

It is not merely the nature of the service provided that is relevant in determining the requisite degree of care, diligence and skill: the "circumstances in which [that] service is provided" must also be considered.[109] There are many potential background circumstances to consider: for example, the time frame within which the service must be provided; the setting in which the service is provided; and the contractual background. Consider, for example, a scenario where a client requests a service within a much shorter time frame than is usually required: the degree of care, diligence and skill that a reasonable financial adviser would exercise is likely to be lower due to this time pressure.

3 The Type of Financial Adviser

The third expressly stated circumstance that must be considered in determining the degree of care, diligence and skill required by the standard is the "type of financial adviser".[110] It is notable that the word "type" is used and not the word "nature", which has been used for the previous two circumstances. The "type" of financial adviser is a narrower concept than "nature" and is only present in the Act. This narrower meaning of "type" can be contrasted with the "nature" of the financial adviser, a broader concept that would incorporate subjective considerations (for example, the experience and knowledge of the financial adviser). The word "type" should be construed in this narrow way because a broad interpretation would involve a serious erosion of the objectivity of the "reasonable financial adviser" test.[111]

The Act identifies five different types of financial adviser:[112]

(a) an authorised financial adviser:
(b) an individual who is registered but not authorised:
(c) a QFE adviser:
(d) a QFE or any other entity that is registered but does not have QFE status:
(e) any other person (whether an individual or an entity) who is an exempt provider.

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109 Financial Advisers Act 2008, s 33(2).
110 Ibid, s 33(2).
111 See Part IV above.
112 Financial Advisers Act 2008, s 16. QFE is defined in s 5 to mean "qualifying financial entity".

The most important distinction is that between an authorised financial adviser and a registered financial adviser. The substance of this distinction relates to the competency and character requirements that must be satisfied in order to become an authorised financial adviser, and also the resulting fact that only an authorised financial adviser is permitted to provide certain financial adviser services: for example, personalised services to retail clients.[113] Clearly, an aim of the legislation is to establish authorised financial advisers as respected professionals, while maintaining the registered financial adviser as a method of facilitating the delivery of simple financial products.[114] A reasonable financial adviser, who is an authorised financial adviser, should exercise a higher degree of care, diligence and skill than a reasonable financial adviser who is merely a registered financial adviser.

It is logical to consider the type of financial adviser when determining the degree of care, diligence and skill that a reasonable financial adviser would exercise: that is, it is a reasonable financial adviser of a particular type. It would be completely illogical for a reasonable financial adviser to be a reasonable "registered but not authorised" financial adviser if the particular service provided required an authorised financial adviser.[115] The degree of care, skill and diligence required should reflect these restrictions on the type of financial adviser that can provide the service.

However, the circumstance that must be taken into account is simply stated as the "type of financial adviser", not as the restriction on the type of financial adviser that can provide the particular service in question. To explain this distinction, consider the following situation: an authorised financial adviser provides a financial adviser service that can also be provided by a merely registered financial adviser.[116] In this situation there is a strong argument that the reasonable financial adviser should be the reasonable registered financial adviser, not the reasonable authorised financial adviser. However, it is somewhat stretching the words of the statute to adopt this interpretation.[117]

The more natural interpretation of the phrase "type of financial adviser" is the actual type of financial adviser in the particular case, not the restriction on the type of financial adviser that can provide the service.[118] This interpretation is preferred as a client may have higher expectations of a financial adviser who exceeds the requirements necessary to provide the service. This expectation is reinforced by the fact that the authorised financial adviser (AFA) label will probably become recognised and trusted

113 Ibid, ss 18(1) and 54.

114 Cabinet Economic Development Committee "Amendments to Policy Design", above n 19, at [38]–[39].

115 This is because there are greater restrictions on who can become an authorised financial adviser.

116 Financial Advisers Act 2008, s 51: an authorised financial adviser is a financial adviser who is both registered and authorised.

117 An argument would have to be made that a financial adviser, when providing a financial adviser service, is acting only in the capacity necessary to provide that service.

118 This interpretation adds a tint of subjectivity to the assessment of the required degree of care, diligence and skill.

by investors.[119] But this interpretation could also be seen as unfair as it creates a double standard for different financial advisers giving the same advice. This section of the Act would benefit from either an amendment or judicial guidance clarifying the meaning of the phrase: "type of financial adviser".

Further Relevant Circumstances

The three specifically identified circumstances are only those circumstances that must be taken into account in determining the degree of care, diligence and skill that is required by the standard. There is still the possibility of further unidentified circumstances affecting the requisite degree of care, diligence and skill.[120] Beyond the subjectivity limitation that has been discussed, the Act does not purport to place any limitation on the kind of other circumstances that might be relevant. Two such circumstances include the content of the adviser–client contract[121] and the minimum standards in the Code of Professional Conduct for Authorised Financial Advisers (the Code).

1 The Content of the Adviser–Client Contract

It is not possible for a financial adviser to contract out of the Act.[122] However, it is possible to alter the scope of the s 33 obligation by contract. In other words, the content of the adviser–client contract is a circumstance that can change the degree of care, diligence and skill that a reasonable financial adviser would exercise. For example, if an unusually high price has been paid for the advice, then the reasonable financial adviser would be expected to exercise a very high degree of care, diligence and skill in providing that advice.[123]

2 Minimum Standards in the Code

The Code stipulates a series of minimum standards for client care.[124] The degree of care, diligence and skill required by the standard should reflect these minimum standards in the Code. This is because a reasonable authorised financial adviser would exercise a degree of care, diligence and skill that at least meets the minimum standards in the Code.

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119 See Financial Intermediaries Task Force, above n 4, at 30.

120 Financial Advisers Act 2008, s 33(2).

121 It is possible to argue that this factor comes within the "circumstances in which the service is provided" and is therefore actually a specifically identified circumstance that must be considered.

122 Financial Advisers Act 2008, s 156.

123 It is possible to alter the extent of this mandatory statutory obligation without crossing the line into contracting out of that obligation, through the use of disclaimers in the contract. This possibility has been recognised by the courts in other contexts: for example, the use of disclaimers and the obligation contained in the Fair Trading Act 1986 (*David v TFAC Ltd* [2009] NZCA 44, [2009] 3 NZLR 239 at [65]–[67]).

124 Financial Advisers (Code of Professional Conduct for Authorised Financial Advisers) Notice 2010 at 8–14.

VII THE FACTUAL REQUIREMENTS OF THE DEGREE OF CARE, DILIGENCE AND SKILL

The first part of the assessment as to the scope of a financial adviser's duty of care indicates whether a relatively higher or lower degree of care, diligence and skill is required in the particular circumstances. The logical next step in the assessment is to determine what this abstract degree of care, diligence or skill requires in terms of concrete actions. Hence the second question to be answered in the sequential questions approach is: what is factually required of a financial adviser to meet the particular degree of care, diligence and skill? The answer to this second question provides a complete answer to the overarching question of what the standard of care, diligence and skill requires in the circumstances.

How the Factual Requirements Change with the Circumstances of the Case

The factual requirements of a particular degree of care, diligence and skill can be ascertained by answering the following question: what would the reasonable financial adviser, exercising the particular degree of care, diligence and skill, do in the same circumstances? The factual requirements will obviously change with any changes in the degree of care, diligence and skill as determined by the first question in the sequential questions approach. But even when the requisite degree of care, diligence and skill remains constant, the factual requirements of the standard can still be altered by changes in the circumstances of the case. The two different ways in which the factual requirements can be altered are best illustrated through examples.

First, the way in which the circumstances of the case alter the factual requirements without affecting the requisite degree of care, diligence and skill will be examined. Consider, for example, a financial adviser who has been asked by a client to give advice on a particular high-risk investment. Imagine that the client's risk profile is the variable circumstance whose impact on the factual requirements is under examination. If the client has a low risk profile (the circumstance), then a reasonable financial adviser exercising a particular degree of care, diligence and skill would advise the client against making the high-risk investment because it is inconsistent with the client's risk profile (the factual requirement). Conversely, if the client has a high risk profile (the circumstance), then a reasonable financial adviser exercising that same degree of care, diligence and skill would advise the client to make the high-risk investment because it is consistent with the client's risk profile (the factual requirement). The end result is that the financial adviser exercises the same degree of care, diligence and skill in both cases but is required to give different advice due to a change in circumstances.

Secondly, the factual requirements can be altered by changes in the

degree of care, diligence and skill as determined by the first question under the sequential questions approach. Consider, for instance, that a financial adviser has advised the client against an investment but the client still intends to make the investment anyway. Further, consider that the client's financial literacy is the variable circumstance that alters the degree of care, diligence, and skill owed by the financial adviser. If the client is financially illiterate and required a high degree of care, diligence and skill from his or her financial adviser, then a reasonable financial adviser exercising that heightened degree of care, diligence and skill would take extra steps to warn the client against the bad investment (the factual requirement).[125] Conversely, if the client is a financially competent investor and required a relatively low degree of care, diligence and skill from his or her financial adviser, then a reasonable financial adviser exercising that relatively low degree of care, diligence and skill would not necessarily bother to take the extra steps to warn the client against the bad investment (the absence of the previous factual requirement). In fact, it could be construed as patronising to reiterate the advice to a financially competent investor who most likely understood the advice the first time it was given.

These are of course simplified examples. In reality, many different circumstances will affect the factual requirements of the standard of care, diligence and skill.[126] It is much more difficult to make a precise assessment of the impact that a circumstance should have on the factual requirements when that circumstance is some shade of grey. For instance, a client may have a moderate risk profile or some degree of financial knowledge. Making an assessment of the impact that these intermediate circumstances should have on the factual requirements is essentially a matter of judgement. Thus, the ability to make this assessment is best obtained through an examination of how the courts have previously dealt with similar circumstances. However, a body of case law dealing with the new statutory duty of care, diligence and skill has not yet developed. Therefore, guidance on what is factually required by the s 33 duty must be sought from elsewhere: for example, cases that deal with the requirements of the pre-existing duties of care; experienced industry participants; and, in particular, the new Standards in the Code.

Taking Guidance from the Code

The Code establishes a series of minimum professional standards applicable to authorised financial advisers. The prescribed standards relate to various

125 See *Armitage v Church*, above n 14, at [80]–[81], [88] and [183] for likely requirements where the client has a low level of financial literacy. A financial adviser is required to assess the client's needs and not rely on self-assessments; check the client's financial knowledge; and, if insufficient, educate the client so as to enable the client to make an informed investment decision. However, the financial adviser is only required to advise and cannot compel a certain decision.

126 Furthermore, certain factual requirements will exist in almost every situation due to the circumstances as a whole. See for example *Armitage v Church*, above n 14, at [203]: a reasonable financial adviser must not recommend an "imprudent concentration" of investments and must advise the client of any relevant alternative investments.

issues, including ethical behaviour, client care, the required level of competence, knowledge and skills, and continuing professional training.[127] The minimum standards relating to client care deal with conceptually similar problems to the duty of care, diligence and skill.[128] As a result of this conceptual similarity, a reasonable financial adviser exercising the appropriate degree of care, diligence and skill would almost certainly adhere to the factual requirements of the minimum standards of client care. Thus, the factual requirements of the Code Standards are effectively also factual requirements of the duty of care, diligence and skill. An example of a Code Standard that will be looked at for illustrative purposes is Code Standard 6:[129]

> **An *Authorised Financial Adviser* must behave professionally in all dealings with a *client*, and communicate clearly, concisely, and effectively.**
> When providing *financial adviser services* to a *client*, an *AFA* must:
> (a) provide only services that the *AFA* has the competence, knowledge, and skill to provide; and
> (b) provide the *services* and perform the *AFA's* obligations in a timely way; and
> (c) transparently manage any conflicts of interest that may arise in providing the services; and
> (d) make recommendations only in relation to *financial products* that have been analysed by the *AFA* to a level that provides a reasonable basis for any such recommendation, or analysed by another *person* upon whose analysis it is reasonable, in all the circumstances, for the *AFA* to rely.

The Code Standard itself (the bold text) is an overarching principle that authorised financial advisers must uphold.[130] The overarching principle is usually relatively general and thus gives a useful impression of what will be factually required given a particular circumstance. Additional provisions supplement the Code Standard. These contain more detailed information regarding the application of the overarching principle while not limiting its potential application.[131] The additional provisions are useful in that they set out quite specific factual requirements. Cumulatively, the Code Standards and the additional provisions provide extensive guidance as to what will be factually required given a certain set of circumstances. However, the Code is by no means an exhaustive list of what the s 33 obligation requires of an authorised financial adviser. Furthermore, it must be remembered that the Code only sets out minimum standards of client care. Thus, the factual

127 Financial Advisers (Code of Professional Conduct for Authorised Financial Advisers) Notice 2010 at 5–17.

128 See generally Consumer NZ "Submission to the Code Committee on the Proposed Minimum Standards of Ethical Behaviour and Client Care for Authorised Financial Advisers 17 November 2009" at 5.

129 Financial Advisers (Code of Professional Conduct for Authorised Financial Advisers) Notice 2010 at 8 (emphasis in the original).

130 Ibid, at 4.

131 Ibid.

requirements of the s 33 obligation will be more onerous than those in the Code if the financial adviser is required to exercise a heightened degree of care, diligence and skill.

VIII THE FUTURE OF THE FINANCIAL ADVISER INDUSTRY

The examination of the factual requirements of the statutory duty of care, diligence and skill has rounded out this review of s 33 of the Act. The author hopes that this article has provided some useful guidance as to the likely operation of s 33 and its importance for the future of the financial adviser industry. In particular, the s 33 obligation, alongside the other new regulations, will undoubtedly help to ensure that the financial adviser industry is, in the future, characterised by high standards reflecting the principles of "professionalism" and "integrity".[132]

The new statutory duty of care, diligence and skill is likely to be effective in achieving these high standards because it is mandatory in nature and supported by proper enforcement mechanisms. Furthermore, should any unforeseen problems arise hindering the effectiveness of the statutory obligation, the problems can be dealt with before the motivation to reform subsides because the relevant Ministry is required to carry out a review of the operation of the Act and recommend desirable amendments prior to 1 July 2016.[133] This will ensure that the s 33 obligation continues to be an effective regulatory tool into the future.

Perhaps the most important factor that will influence the effectiveness of the new industry regulations is not a matter that can be dealt with through regulation: the attitude of the investors who use financial adviser services.[134] These investors must recognise the value in receiving quality financial advice before making an investment decision and seek out the advice of an authorised financial adviser. At the same time, investors must be wary of making an investment decision based upon the advice of a product marketer and not be so easily tempted by offers of high returns. This change in the attitude of investors, in conjunction with the new obligations imposed on financial advisers, would see a dramatic increase in the quality of investors' investment decisions and largely solve the problems that have long plagued the financial adviser industry.

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132 Financial Advisers Act 2008, s 3(1).

133 See Financial Advisers Act 2008, s 161; Financial Advisers Act Commencement Order 2010, cl 4. Examples of areas that might be amended following this review include the unforeseen use of jurisdictional exceptions; the use of the word "degree" in s 33; and the failure to state specifically to whom the duty is owed.

134 See Financial Intermediaries Task Force, above n 4, at 19.