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Reasonable grounds for financial advice about financial products

Purpose

This guidance explains our approach to applying and enforcing Code Standard 3 of the [Code of Professional Conduct for Financial Advice Services](#) (the Code), in relation to financial advice about financial products purchased for investment purposes. It is particularly relevant to situations where it is difficult or impractical to access information to support reasonable grounds for financial advice on an investment product.

Code Standard 3 (see Schedule) requires that “[a] person who gives financial advice must ensure that the financial advice is suitable for the client, having regard to the nature and scope of the financial advice.”

The commentary to the standard explains that:

“Ensuring that the financial advice is suitable for the client should include having reasonable grounds for the financial advice. Reasonable grounds for the financial advice means those grounds that a prudent person engaged in the occupation of giving financial advice would consider to be appropriate in the same circumstances, such as those in relation to:

- any strategy supporting the financial advice
- any assumptions underlying the financial advice
- any financial advice product covered by the financial advice
- the client’s circumstances that are relevant to the financial advice, such as their financial situation, needs, goals, and risk tolerance.”

Consequently, whether financial advice is suitable for the client is context-dependent, based on the nature and scope of the financial advice and the circumstances.

This guidance notes the challenges financial advisers may face when giving financial advice about high-risk, complex or novel financial products where it can be difficult to access information to support reasonable grounds. For instance, those giving financial advice about IPOs or smaller market capitalisation stocks may not always have access to ‘expert research’¹.

¹ By ‘expert research’ we mean research published by individuals or teams with the necessary knowledge, experience, and relationships to understand and model the risks, drivers, management and other critical aspects of IPOs and listed equity securities. This research is often, but not exclusively, produced by institutions for their clients (‘sell-side’ research) and for their own investment teams (‘buy-side’ research).

We do not intend to discourage those giving financial advice from giving opinions or recommendations not backed by expert research, as this could result in New Zealanders having less access to financial advice they may otherwise benefit from. It may also result in lower levels of interest – and liquidity – in some products². However, the requirement for reasonable grounds must be met for all financial advice – although what is reasonable will depend in each case on the nature and scope of the advice and the relevant circumstances.

This guidance does not constitute legal advice and is not binding on the Courts or third parties. We encourage you to seek your own professional advice to find out how the Code and legislation discussed, and any other applicable laws, apply to you. It is your responsibility to determine your obligations.

In this guidance, the terms “adviser”, “you” and “your” refer to any person who gives financial advice, including financial advice providers, financial advisers and nominated representatives.

Key principles

Meet your professional responsibilities to your client

Advisers are held to professional standards under the Financial Markets Conduct Act 2013 (FMC Act) and the Code. As such, you are responsible for ensuring your advice is suitable for your client, considering the nature and scope of that advice. This includes ensuring there are reasonable grounds for your financial advice in the relevant circumstances.

Give financial advice that’s within scope of your professional services and competence

You must not give regulated financial advice to a retail client unless you meet the standards of competence, knowledge, and skill (including any continuing professional development requirements) provided in the Code for giving the advice. Some advisers may not have time, capacity, or resources to provide financial advice on more complex or novel types of financial products. In this situation, we would expect an adviser to make it clear to any client seeking advice that the scope of their services does not cover those products.

Exercise professional judgement

You need to apply cogent reason – not irrational or uninformed factors – to the formulation of your financial advice. Exercise your professional judgement based on your competence, knowledge, and skill. You should be able to explain your reasoning and the factors you took into consideration, and why the grounds for the financial advice you give are reasonable in the circumstances. Research is one input that may support reasonable grounds. If you rely on someone else’s assessment of a financial advice product or strategy, you should be able to demonstrate that it is reasonable to rely on their assessment. This also requires the exercise of professional judgement.

² Capital Markets 2029 report, [Growing New Zealand’s Capital Markets 2029](#), at page 41-42

Consider relevant, material, and sufficient information

You will need to apply your professional judgement to determine what information is relevant, material, and sufficient to inform your financial advice and support having reasonable grounds, considering the nature and scope of your advice and the relevant circumstances. We discuss what information may be required for advice about IPOs and listed equity securities later in this guidance note.

Consider your client's relevant circumstances

To give financial advice that is suitable (including being based on reasonable grounds) you need to consider your client's circumstances that are relevant to the financial advice, such as their financial situation (including, for example, any existing portfolio of investments), needs, goals and risk tolerance.

You need to decide if a detailed analysis is required or if it is reasonable to make assumptions about the client's circumstances based on their particular characteristics. The nature and scope of the financial advice you are giving will determine the extent of the analysis of the client's circumstances that is required.

We consider that particular attention should be given to your client's risk tolerance when giving financial advice. For example, advising a client to buy shares in a small or start-up company requires a good understanding of your client's risk tolerance for such financial products and the place these might have in their portfolio. Recommending a portfolio of several smaller market capitalisation companies as a client's sole investment has different risk (and suitability) considerations than recommending the companies as an addition to an already-diversified portfolio.

If your financial advice is based on an investment strategy, this may help support the suitability of the advice. Asset allocation and diversification are important principles of wealth management advice.

Communicate clearly with your client

You must take reasonable steps to ensure your client understands the nature and scope of your advice, including any limitations on the nature and scope of your advice.³ Limitations might include, for example, that:

- you had limited time to prepare your advice
- limited information about the financial product was available
- you relied on another person's assessment
- your advice is limited to a specific financial product.

Keep adequate records

Financial advice providers must create and maintain adequate records in relation to their financial advice service, as a condition of their licence. These records should clearly demonstrate how their advice met Code Standard 3. For example, the records should generally:

³ Section 431J FMC Act

- record the nature and scope of the advice and the relevant circumstances
- explain why you are satisfied that the advice is suitable for your client (including that there are reasonable grounds for the advice).⁴

Good records are particularly important if you have relied on limited information to give your advice, so you can demonstrate why there were reasonable grounds for your advice in the circumstances.

Good records also provide a useful reference for your communications with your client. The FMA has released an [information sheet on record keeping](#).

Financial advice about IPOs and listed equity securities

IPOs and listed equity securities (particularly smaller market capitalisation stocks) can have distinctive risks which often require time to identify and assess, to gain an adequate grasp of what the company does, what drives its value, and its capability to manage the risks it faces.

When giving financial advice about IPOs and listed equity securities we would generally expect you, or if relevant another person on whose assessment you rely, to consider certain fundamental information that is publicly available:

Initial public offerings (IPOs)

- The product disclosure statement or PDS (or equivalent overseas disclosure information)
- Information on the register entry (or equivalent overseas disclosure information)

Listed equity securities

- Material information publicly released by the issuer (such as information released as part of the issuer's continuous disclosure obligations)
- Information about the issuer or the equity securities on NZX or other financial product market on which the securities are listed

We would not expect you or the other person to verify the fundamental information.

You will need to use your professional judgement to decide what, if any, additional information or evaluation is required to have support for reasonable grounds. This includes whether you need to access (or undertake) research and, if so, the nature and extent of that research. Any information (including research) that you rely on to inform your advice should be fit for purpose given the nature and scope of the advice, and the relevant circumstances.

If you do not have access to expert research on a company – more common with smaller market capitalisation companies which may not appeal to many investment firms with expert research functions – you can carry out any research yourself that you determine is required to support reasonable grounds, where this is within your competence, knowledge and skill, and you have sufficient time to do so.

Research on IPOs and listed equity securities will generally:

- describe the company's activities – why it exists and how it generates cashflow (or intends to do so)

⁴ See the [Standard Conditions for full FAP licences](#), and our information sheet [Record keeping for financial advice providers](#)

- encompass, quantitatively and qualitatively, the relevant financial and operational aspects of the company, its risks, its value drivers, its outlook, and the quality of its management.

If you are relying on research or an assessment of a financial product by another person, then you should be able to demonstrate that it is reasonable to do so⁵. The person relied on may be a person within your financial advice business or a person who is external to that business. In both cases the assessment will need to be made by someone with appropriate experience and capability⁶.

Research will not always be required, but is more likely to be needed to support reasonable grounds for financial advice about more complex or novel financial products, including those that are higher risk. However, what is reasonable will depend on the nature and scope of the financial advice and the relevant circumstances. You will need to exercise your professional judgement and experience to determine what information and evaluation is required in the relevant circumstances. We expect your focus to be on ensuring good customer outcomes, including that your advice is suitable for the client.

Examples

We have included some worked examples below to provide guidance on what information may be relevant, material and sufficient to inform advice and support reasonable grounds in specific circumstances. These are fact-specific and do not speak to other situations.

Example one – Preventing high-risk investment of life savings

A client asks an adviser whether to put all their house sale proceeds into an urgent opportunity to invest in 'micro-cap stock x'. In this situation, the adviser would have reasonable grounds to advise the client **not** to invest after assessing their circumstances, even without research. Investment would clearly be unwise. The adviser saying they cannot provide advice as they do not have access to relevant research is unlikely to lead to a good client outcome in this situation, as the client may proceed without any advice. However, the adviser would still need to have and be able to evidence reasonable grounds for the advice to not invest, by reference to the other factors discussed in this guidance (such as professional judgement, based on knowledge of the client's circumstances).

Example two – Preventing dilution of existing investment

A client asks an adviser whether they should take up a discounted rights issue. Even if the issue structure is complex, the client is an existing holder, their holding is small, the price is substantially discounted and taking up their rights will avoid the client's holding being diluted. Without access to research on the company offering the rights issue, the adviser is likely to have reasonable grounds for advising the client whether to take up their rights based on the disclosures provided by the issuer and an assessment of the client's circumstances. Having to get research before giving the advice would not be warranted in the circumstances. However, the adviser would still need to have and be able to evidence reasonable grounds for the advice by reference to the other factors discussed in this guidance.

⁵ Commentary to Code Standard 3.

⁶ You will also need to consider other relevant matters when deciding whether it is reasonable to rely on the assessment, including whether the person making the assessment has any conflict of interest.

Example three – Small component of diverse portfolio for existing client

An adviser advises several existing clients on their whole investment portfolio. The adviser considers various shares that are not independently researched for possible inclusion in clients' portfolios. Shares are chosen by the adviser based on various themes the adviser knows interest some clients. The adviser undertakes research on the options based on publicly available information. This includes an assessment of basic ratios, and peer and sector performance. The assessment includes the adviser's views on how speculative each investment is and what might be an appropriate limit for inclusion in portfolios with different risk characteristics. In these circumstances, the adviser is likely to have reasonable grounds for recommending the various investments to clients as a small component in an otherwise diversified portfolio, considering each client's particular circumstances. The adviser tells each client that the advice is based on the adviser's own assessment of publicly available information and the shares have not been independently researched.

Example four – Client just wants to have a punt

A new client asks an adviser for recommendations on technology start-up investments. The adviser establishes that the client's existing portfolio is well-diversified. The adviser asks about the client's circumstances and discovers that the client has a high-risk profile, given their overall appetite for risk, financial position, goals and investment timeframe. The client confirms they "want to have a punt with a small amount", and that they are keen on supporting the New Zealand technology industry. The adviser considers several technology start-ups that are not independently researched for possible inclusion in the client's portfolio. The adviser does some research based on publicly available information. This includes an assessment of basic ratios, and peer and sector performance. The assessment includes the adviser's views on how speculative each technology company is, and what might be an appropriate limit for inclusion in the client's portfolio. In this situation, the adviser is likely to have reasonable grounds for recommending some technology start-ups to the client as a small component of their portfolio, considering the client's circumstances. The adviser informs the client that the investment is high risk, that the advice is based on the adviser's own assessment of publicly available information, and the shares have not been independently researched.

Example five – Advice based on Google search

An adviser gets a phone call from an existing client asking for advice about buying shares in a company that the adviser is unfamiliar with, and for which no independent research is available. While on the call, the adviser googles the company and looks at information about the company on the NZX website, and makes a recommendation to the client on the spot. At this stage, the adviser is unlikely to have reasonable grounds to make a recommendation about buying shares in the company.

Example six – Employer-approved research

An adviser gets a phone call from an existing client asking for advice on buying shares in a company. The proposed purchase is of a quantity that would not materially alter the risk of the client's portfolio. The

adviser has read a recent research report about these shares. The adviser's employer is a licensed financial advice provider which has approved the use of research reports from that research provider after reasonable enquiries into the provider and the quality of their reports. The adviser has no reason to question the report's analysis or conclusions. The adviser is familiar with the client's circumstances but checks that nothing has changed. They are likely to have reasonable grounds to rely on the report in providing financial advice to the client, considering the nature and scope of the advice and an assessment of the client's circumstances.

Further information

If you have questions about this guidance, you can email us at questions@fma.govt.nz. You can find further information on financial advice regulation on our [website](#). Here are links to information on relevant regulatory requirements:

- [Code of Professional Conduct for Financial Advice Services](#)
- [Financial Markets Conduct Act 2013](#)
- [NZX Participant Rules](#) (relevant for NZX participants)

Schedule

CODE STANDARD 3 – GIVE ADVICE THAT IS SUITABLE

A person who gives financial advice must ensure that the financial advice is suitable for the client, having regard to the nature and scope of the financial advice.

COMMENTARY

Ensuring that the financial advice is suitable for the client should include having reasonable grounds for the financial advice. Reasonable grounds for the financial advice means those grounds that a prudent person engaged in the occupation of giving financial advice would consider to be appropriate in the same circumstances, such as those in relation to:

- any strategy supporting the financial advice
- any assumptions underlying the financial advice
- any financial advice product covered by the financial advice
- the client's circumstances that are relevant to the financial advice, such as their financial situation, needs, goals, and risk tolerance.

Depending on the nature and scope of the financial advice, a detailed analysis of the client's circumstances may be required, or it may be reasonable to make assumptions about the client's circumstances based on particular characteristics of the client.

If the financial advice includes a comparison between two or more financial advice products, the financial advice should be based on an assessment of each product.

A person who gives financial advice may rely on another person's assessment of a financial advice product or strategy. The person giving the financial advice should be able to demonstrate that it is reasonable to rely on the other person's assessment.