

Rotten to the core

Advisers can face a dilemma when they need to warn clients about unprofessional behaviour. ASIC is on the case, however, and PETER BOBBIN has some advice on what to do in the meantime.

AS A lawyer, I am battle-hardened against the fact that fraud is an everyday occurrence. Lawyers hear many tragic stories but to be effective we must ignore the human side and look only at the legal remedies. Nevertheless, when I hear about the utter havoc these experiences inflict upon families and how they devastate lives, I'm incredibly saddened.

The Estate Mortgage collapse is a case in point. The people it affected are now living financially shattered lives. I was not an investor but the media kept me aware of the issues. However, it missed the point. It was not about the money lost, but rather the lives that were broken.

Remember Telford, HIH, FAI, the Wattle scheme, Westpoint and the unlisted property trust collapse? There seems to be a major financial disaster every decade, and lots of little ones in between. I remember my investment in the former Australian Stock Exchange-listed Satellite Group. I was given a hot tip and bought shares. While I owned the shares, one of the directors was found guilty of misusing Satellite funds through "sheer self-indulgence and ego" after spending \$220,000 on a fashion show without Satellite board approval. At the age of 43, I lost \$7000. But my financial loss was not the issue.

Do you know the difference between an old man and an old gentleman? It's money.

Financial planners don't just provide investment portfolio advice. They affect their clients' lives. They can make the difference between a satisfying life and one of misery.

We all need to guard against fraud. The starting point is to know that fraud has many facets: it can be innocent, exaggerated truth or a misrepresentation that has gone too far. All too often, it is simple deceit and theft.

For some, fraud is just a cost of business. Something as small as the destruction of client files can be fraud. It was just such an act that brought down a billion-dollar worldwide organisation, Arthur Andersen. Will your business survive a fraud?

I am passionate about anti-fraud issues and I believe the state governments' thirst for gaming revenue has fuelled the misfortunes of many. Fraud has grown as a result of the

states' lust for the gambling dollar. But before you look too kindly upon me for my concern, remember that I am part of the problem: I am a lawyer.

There were many within the financial services profession who knew that Estate Mortgage was going to fail. Some warned clients, but Estate Mortgage used lawyers to threaten defamation against doomsayers, so some did not tell their clients. Those clients now live lesser lives.

Bad apples

State and federal police offer little help. It is only in very recent times that they have begun to develop skills in financial fraud, but their involvement is after the fact.

However, the Australian Securities and Investments Commission has set up an important project, called Bad Apples, that will soon reach maturity and I hope our profession will be mature enough to embrace it. For the first time we will be able to root the problem out systematically, as it begins.

The project is about identifying the bad apples before they spread into a new and unsuspecting group. Bad apples is an appropriate name because everyone knows that one bad apple can destroy the whole barrel.

Again, it is a lawyer-induced problem. Fear of facing a misrepresentation claim or a threat of a defamation suit has led many dealers to refuse to disclose to a new licensee the reason for their separation from the previous adviser. Police and bankruptcy checks are not enough as they don't tell the story of what the person is likely to do, only what they have been caught doing.

ASIC is leading the project. The starting point was to map the minefield of legal hyperbole that we lawyers are good at, and to find a way through the maze. The brief has been to:

- ✦ Improve practices for reference checking within the financial services industry.
- ✦ Identify barriers to the provision of appropriately candid, factually based references.
- ✦ Identify practical measures to enhance the referencing process.

In other words, the object is to design a system to allow the financial services profession to root out unprofessional operators. It is not another regulation or policy statement, but it is a very solid idea.

Easy as pie

Judging from the sneak preview that I have been given, I believe it will go a long way to overcoming threats of misrepresentation and defamation. Financial services professionals will be able to speak more frankly than before. Some guarding of comments will still be needed, but even this is proper as it will ensure that what is communicated about the recently terminated financial planner or employee will be carefully and honestly presented.

But that is not all that is needed.

Australian financial services licensees have a fiduciary duty to clients that is based on centuries of common law. Sadly, I have heard of licensees who have rooted out a bad apple only to find that they pop up somewhere else. Their satisfaction in getting rid of them soon turns into a lament that they have emerged relatively unscathed elsewhere, ready to do damage again. I always ask the licensee what they told their clients when he or she left so suddenly. I ask whether they warned those who elected to move their business with the bad apple.

Sometimes the response is: "Are you kidding? I was lucky enough just to get rid of them."

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But their jaw usually drops when I explain that responsibility for the problem they thought they had moved on still rests with them – but has now become completely uncontrollable. It is easily argued that the nature of the fiduciary duty of the licensee to the client is such that they must alert the client to the reason for the recent termination of their relationship with their financial planner.

A client who follows a bad apple and, soon after, financially suffers from that adviser's actions can argue that their former licensee owed them a duty to warn them and that, had they done so, the loss would not have occurred. A share of the loss will then be attributed to the former licensee for failing to fulfil their last fiduciary duty to the client – for failing to care for their future.

I am not saying that licensees must alert clients to the chapter and verse of events that led to the separation, but they should issue a letter to all clients stating that their adviser has been terminated or has agreed to leave after a failed compliance review of their financial planning business activities. Of course, this needs to be true.

ASIC's Bad Apples will soon be upon us.

In the meantime, the courageous among you can continue to speak the truth. Soon you will be able to put it in writing and even the lawyers will agree. ☺

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