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LEGAL BRIEF

Conduct unbecoming

The usual suspects will feature heavily in 2006, refusing to let some old issues die and finding new ones to get stuck into, Peter Bobbin writes.



PHOTO: PHIL GARRICK

Welcome to 2006 and the start of the slide through the second half of the twenty-noughties into the twenty-teens. What has the year got in store for you? What will be the big and little issues for 2006?

The Australian Securities and Investments Commission's attempt to carve an advice-based regulatory system out of a financial product regime will be challenged and lessons learnt on all sides. Claims of conflict of interest, misleading and deceptive conduct, as well as unconscionable conduct, will be the mainstays of ASIC regulatory action this year. However, in the process, ASIC will begin to learn that there is a role that planners play in the financial-planning process that is both valuable and valued. They will begin to understand this process and, who knows, some ASIC staff may even employ the services of a personal financial planner.

Fear of ASIC aggression has dampened superannuation choice expectations. Some find it curious that ASIC's intent has been

focused on its findings in the lead up to super choice. But don't be fooled. ASIC will persist in its super choice endeavours, and will look to prosecute more super choice failures to comply with the law. It will do this even if the clients are happy with their advice and don't intend changing back to earlier super arrangements.

Ethics, and the pursuit of them, will emerge as the new principled approach to financial-services compliance – after some learn how to spell it.

This emphasis on super choice will continue to challenge the industry. In 2006, it will finally realise that it must abandon the "economically challenged clients" (industry jargon for poor people) in favour of those with assets and incomes who can afford financial planning. Centrelink-supported individuals will no longer have access to Centrelink financial planning experts as more of these retire. Centrelink recipients will need to rely on the opinions of Centrelink staff whose role is to reduce the Centrelink burden.

Those earning too much to rely on Centrelink, but not enough to afford financial planning, will also be abandoned. The largest financial institutions may be capable of picking them up but will be too afraid to offer in-house financial products. A main complaint arising out of ASIC's super switching surveillance was that "of the 4900 switching recommendations given by advisers ... 90 per cent recommended a switch to the related fund. This does not mean that this advice was necessarily inappropriate but it does highlight the need for such conflicts to be clearly disclosed and carefully managed." So why take the risk with smaller-value clients? From a compliance cost, it is cheaper to abandon them. This will be realised in 2006.

There will be a continued blurring of the lines between industry and commercial super funds, mostly as industry funds become more commercial. (Industry super schemes are the mutual funds of the 1990s. Their last act in favour of members will be the commercial demutualisation and capital realisation of inherent value by issuing shares to members. This will begin to happen in the twenty-teens.)

More prescriptive regulations and policy statements will be issued and some in the financial planning community will continue to whine about the need for greater ASIC guidance on these. In the closing days of last year, it was announced that amendments to the Financial Services Reform Act would result in advisers no longer being bound to issue a statement of advice (SoA) to existing clients each time they updated a financial plan – so long as there was no significant change to the client's circumstances. Calls for a definition from ASIC of "significant change" were immediately bleated.

The problem will be that ASIC, which itself grapples with the financial-planning process, will respond to the bleating then stand criticised by all and sundry. ASIC is in a no-win situation.

While its attempt at the financial-planning-advice process was poor, quite a number of its suggestions in its example SoA were both practical and appropriate for a limited financial-advice scenario for a new client. Yet most industry gossip/comment focused on the poor financial plan that ASIC created.

ASIC should be excused for its financial-planning advice as this is not its skill. So why ask it the questions that the industry should answer?

Perhaps because the industry is too fractured and has the potential to fracture more this year unless some guiding light emerges. In 2005, CPA Australia and the Institute of Chartered Accountants in Australia were able to get together and release a joint professional standard governing the provision of financial advice by members: statement of financial advisory service standards (APS 12). It will now be up to the Financial Planning Association, the Association of Financial Advisers and the other associations that are filling the gaps to work out how to leapfrog this standard. Instead, they should be all getting together to create a single series of comprehensive standards. It would be good if they could all get together with other stakeholders and form the National Australian Financial Standards Board.

ANYONE WILLING TO VOLUNTEER?

It won't happen. In 2006, the fiend-focus will finally shift away from trailing commissions as it is realised that – until the taxation laws are changed – this approach is usually more tax-efficient for clients and consequently some advisers are obligated to have their services paid in this manner. In any event, the method of payment is not relevant. It is the value perceived and gained by the client that is important. Some diehards will maintain the rage and continue to alert all about the evils of trailing commissions.

If, as many predict, the markets suffers a “correction” (industry jargon for a big and sustained fall) this year, there will be a greater consolidation in the advice area. It is cheaper to buy a financial advisory business in poorer times. However, this year will also see the beginning of the end of the multiple-of-trailing-commission approach to valuing a financial-services business. Common business-valuing methods are already emerging.

The market correction will further squeeze dealer margins. If the sale of the financial advisory business into the consolidator business is not achieved in time, the business will fall into liquidators' hands, with a confusing loss of dealer/adviser/client relationships. There will be dealer failures this year.

The market correction will also affect the mortgage origination market. To cope, mortgage origination businesses will expand into

financial planning. By the way, the federal government will finally see past the phrase “mortgage origination” and realise they are just agents for the moneylenders. This year will see the the introduction of ethics and standards that will, by and large, be ignored. This industry initiative will be necessary. It has to start somewhere; otherwise, the government will introduce the Financing Services Reform Act.

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Changes to the taxation laws will continue along their frenetic pace. But don't worry. This will ensure the existence of the financial advisory business for years to come.

The Australian Taxation Office compliance program for the 2006 financial year will maintain its focus on the financial-services industry. Its stated objectives include investigating financial planners and their compliance with their personal taxation obligations, as well as their involvement in aggressive tax planning for clients. The ATO will use Austrac and other information to ensure that promoters of tax schemes meet their lodgement obligations. Some of these will be referred by the ATO to the Australian Crime Commission, which appears to have become its police investigative arm.

In 2006, the ATO will find the sacrificial financial planner who it will impale on the new 'Tax Promoter; Let's Get 'Em Law'. ASIC will become jealous of the ATO's Tax Promoter; Let's Get 'Em Law and in doing so will realise that it had the power to deal with this all the time but didn't.

The ATO also expects increased abuse of client-tax identities and affairs. It is already aware of cases where tax agents and financial planners have accessed and misused individual identity details to submit fraudulent tax returns.

In 2006, identity fraud will be the most insidious threat of all but will remain hidden. And I should know, it has already happened to me. They did not get away with it thanks to a diligent bank employee, but one dealer client in 2005 was not so lucky – in fact, they were almost \$1 million unlucky. This year will see the beginning of the question: who is to be held responsible for identity fraud? The financial planner who acted on false instructions and who unknowingly handed the money to the fraudster, or the client for not protecting their information? The answer as to how much caution is not enough when dealing with client fund redemptions will be answered soon.

A slide into, or a climb-up, to the twenty-teens begins in 2006. What will your year be like?

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