



PETER BOBBIN

## LEGAL BRIEF

# Stop being so critical

*Do financial services providers deserve being lumped in with used-car salesmen?*

**Y**ou reap what you sow. So who do we blame for the imminent release of an ASIC-designed statement of advice?

I am tired of people whose only role appears to be to label the financial services industry as inherently corrupt. Recently, Peter Kell, chief executive of the Australian Consumers' Association, lamented: "Who can I trust when seeking financial advice on super, shares or my mortgage or insurance? Who will give me advice that is clearly in my interest, rather than in the interest of the adviser, broker or funds manager? ... Conflicts of interest are so deeply embedded in the Australian financial services landscape that consumers may despair of finding genuinely impartial advice."

But the Australian public is smarter than this. It accepts that advisers are representatives and, as such, they act for another when giving advice. And this is what the Government intended! The Corporations Act identifies a financial planner as a representative, authorised or otherwise. Specifically dropped from the pre-Financial Services Reform structure of the dealer-adviser relationship was the capacity for this to be "by arrangement with". Representatives act on behalf of licensees, and they must take into account the interests of their licensee when fulfilling their advisory function.

The public understands that, in dealing with an adviser, that adviser is acting on behalf of another to whom they have a representative duty. Kathryn Greiner presented this well when, on behalf of the Financial Planning Association, she said that this is what public investors are told in the Financial Services Guide: they are told who their adviser is, who they act on behalf of, which financial services can be given in connection with what financial products, and how and what the adviser and their licensee will earn.

So, Mr Kell, the truth is that advisers cannot give you advice that is clearly in your interest rather than in the interest of whom they represent! Of course they can, and they will give you appropriate advice that, in the context of a fiduciary relationship, will be in your interest. But it will be limited by the fact that your adviser is a representative of another and will have told you of their limitation to financial services among a list of financial products.

Financial commentator Michael Pascoe joins Peter Kell when he claims that the industry is structurally corrupt since it is based on commissions that will, in some instances, lead advisers to make inappropriate recommendations.

Commissions are a common form of remuneration, but are these any more structurally corrupt than another form of payment? In the legal industry, where hourly fee for service is common, there are many who claim it to be structurally corrupt and rewarding of inefficiency.

It is in the interest of most financial services clients that they are charged on a commission basis, because it is more income-tax-efficient that the costs of their financial plan are taken over time out of their gross pre-tax earnings. I am certain that if Pascoe and Kell had a choice between a commission or a fee-for-service adviser, both of whom give the same advice within disclosed relevant limitations and at the same disclosed dollar cost, both would choose the income-tax-efficient commissions method of payment.

Instead of bleating about inherently corrupt commissions, why don't they take the more effective road of lobbying Government to address the inherent taxation bias towards commissions-based financial services charges? The tax office has many misgivings about the tax-deductibility of financial planning fees, some expressed as long as 10 years ago in Taxation Determination 95/60. So let's deal



with the structural corruption created by a government that allows commissions to be tax-preferred over other forms of payment, or else financial commentators may attack the industry for charging non-tax-deductible fees when tax-efficient commissions are available.

So much negative sentiment affects the way the industry views its role and responsibilities. Does a financial service need to be impartial? No, it most certainly does not! Is it shocking that Asic has learned that, of switching data provided by licensees with a related-party conflict, there was a very strong tendency towards switching into a related superannuation fund? Of 4900 switching recommendations given by advisers in this circumstance, Asic found that 90% recommended a switch to the related fund.

What else could the advisers do? They are representatives who owe a duty to the people they act for. And Asic knows this.

In Asic's own words, "... unless all commissions are rebated in full to their clients ... it is an offence for a person carrying on a financial services business or providing a financial service to assume or use a "restricted word or expression" in relation to that business or service". Restricted words or expressions include the words "independent", "impartial" or "unbiased". (See s923A(5)(a)(i) of the Corporations Act 2001, and Asic QFS38, November 25, 2003.)

This is the legal background against which the licensee and adviser roles should be considered in a super-switching, or otherwise, context. It is with the benefit of this background that the specific requirements of the "know your client" and product-switching rules of sections 945A and 947D of the Corporations Act must be viewed.

Following Asic's *Super-Switching Advice: Questions and Answers* without the above context will not be in the client's interest. Financial services compliance is important, but don't let it get in the way of achieving quality of advice within the representative relationship of the adviser to their licensee.

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The procedural aspect of compliance with the law is not to be understated, it is just that these procedural requirements must be considered in the context of the relationships that the Government has created and within the expectations of the clients and the advisory business model adopted. It is important to respect the limitations of Asic's super-switching guide and accept that there are times when the adviser's duty to the client must take precedence over the apparent directions given by the guide.

It is also OK to assist a client to make a dumb decision; it is the client's prerogative to do so. A client determined to "switch" their super after being told that it may not be appropriate, can do as they wish. The adviser's duty to the client requires that the client's instructions be followed. Any loss that results from the failure to act will be grounds for a law suit. It is also acceptable to give general product information about a super fund without a recommendation to switch, even if the adviser is aware of personal information about the client. Even Asic accepts this in QFS158.

I often hear that in financial services we are in interesting times. What is interesting is the over-interpretation of the law in the absence of actual client situations and the lack of industry leadership.

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