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Beware bad apples

The financial services industry can regulate itself if everyone tells the truth

Where is the best place to find a financial services litigation lawyer?

Answer 1: In a grave six feet under, because deep down they are good people. Answer 2: Why look for one, when you can find two and get three different answers? Answer 3: Don't bother looking. Simply mention multi-million-dollar claim and they will find you.

People are looking for someone to blame for the current crisis of uncertainty in the financial services industry. It is the lawyers' fault, some say. They are the prophets (and profits) of doom on which the industry is faltering.

I am sorry if you believe this, but no doubt the lawyers are partly at fault. After all, it was the Treasury lawyers who handed Financial Services Reform (FSR) to the ASIC lawyers, who wrote the policy statements that were confronted by the bevy of industry lawyers, who conflicted with both of them.

But did you know that the most common source of litigation in the financial services industry is not what the lawyer finds? It is what the lawyer is given, by you.

As I approach 18 years of legal practice for the financial services industry, I cannot remember one case of an individual complaint against an adviser that was not first promoted by the client's most recent financial planner. So who is the greatest risk in the industry? It is you! But fear not, you are also the solution.

Don't worry about the lawyers, worry about the next adviser. Every disgruntled former client is litigation waiting to happen. My experience is that the more professional the next financial planner, the more intent they are in searching for rotten apples.

This gives me a risk-management idea: send a client-satisfaction survey to every person who leaves your business. The results will be alarming — you will be surveying only those who are leaving — but the information may allow you to capture and satisfactorily manage a litigation issue that would otherwise spawn a life of its own in the hands of the next financial service provider.

Just now, a great deal of legal over-engineering of the financial services law is giving rise to confusion. This is odd because the lawyers who are judges ruling upon the issues mostly adopt a simple approach. Often the core values of the judges' approach are so simple that you could almost replace the whole of FSR with the simple trilogy: common sense, respect and courtesy. This is the overwhelming core-value statement in the Victorian Supreme Court

judgment of *Newman v Financial Wisdom*. Make no mistake about it, there was technical legal argument upon which Financial Wisdom was made liable (which it is appealing) when it was not the dealer, but the vast majority of the 242-page judgment was about common sense, respect and courtesy in the financial planning process — or the promise but lack of it.

Ten years ago, Dale Newman became a client of the Sentinel Group, a licensed dealer in securities. He spoke with Colin Frederick Quarrell, who assured him of a secure investment future and quality financial planning. He then received a series of recommendations to invest in tax-advantaged schemes.

The claims of Sentinel, the primary dealer, were that clients would enjoy professional advice from a total financial management perspective with an uncompromised level of technical skill, knowledge and creative application, all provided with integrity, outstanding effort and loyalty. Sentinel would create wealth by maximising disposable income with salary packaging and tax planning and with informed investment advice and solid financial planning. The investment philosophy was focused on unbiased assessment of all available opportunities in the marketplace at any one time, and would advocate quality income-producing investments that would compensate for periods of slow capital growth.

What did the clients get? Financial planning that was a far cry from the corporate philosophy stated in the Sentinel brochures. The lifetime of preparation that the clients of Sentinel had made for their retirement was uniformly decimated, if not destroyed.

It may seem obvious, but let's state it anyway: you are liable to live up to your promises.

So here is another risk-management tip: take an honest and stark look at the promises you make. Are they fair dinkum? Do you really do it, can you live up to it? If not, you wield your own sword that one day will be used against you. Be truthful in your financial services promises; the truth is much easier to remember.

Does your organisation have a culture that recognises common sense, respect and courtesy for the client (and your business)? If it is not already evident, sound risk-management starts with the organisation's culture.

There is little doubt that court-ordered compensation was the last thing on Dale Newman's mind. He was in financial trouble and needed help. He went back to the industry that burned him for a professional recommendation. He was told that he was wronged, that he should sue.

Equipped with a recommendation to sue, Newman then needed a lawyer. But how was he to pay the legal fees? At one stage he was nearly bankrupted. IMF Limited, an ASX-listed company, came

to the rescue. The philosophy of IMF is simple: it provides funding for litigation claims that would otherwise fail through lack of funding, often because it is the lost finances that they are fighting over.

A common tactic in large litigation cases such as *Newman v Financial Wisdom* is to seek a court order that the claimants pay money into court as security for costs if they lose. This tactic was used and John Walker, director and principal founder of IMF, responded to the claim. "We just put it up. We always do. I mean, that's part of our risk. We assume that risk."

John Walker is enthusiastic about the IMF role. "The focus of consumerism in society has meant that, if you feel you've been hardly done by, then it's likely that either the regulator or someone like IMF will test it. But a lot of compliance issues haven't been addressed because consumer-focused self-protection has been insufficient. It is up to businesses like IMF to make sure that if there has been a wrong or, if a victim's been created, then the victim can be compensated. The crooked and incompetent have been protected by the very financial devastation that they cause. The lawyers that we work with bring us the cases that should go to court. We then assess these for the ones that will make a good investment".

Walker is pragmatic about the business: "Whilst our business model is built on an expectation of not always funding winning cases, we only take on cases that we expect to win."

What about the role of ASIC? Stephen Mayne, of www.crikey.com.au, asks: "Is ASIC an effective corporate cop?" Crikey's web site lists 213 people sent to jail since ASIC was set up in January 1991, including Colin Frederick Quarrell, and argues that "there are not enough big fish, but ASIC will hopefully improve its record as HIH charts its natural course".

ASIC is certainly moving to stem the tide. Recently it reported on its 353 randomly conducted verification visits, and Pamela McAlister, deputy executive director of financial services regulation, said: "Most of the AFS licensees visited by ASIC demonstrated that appropriate procedures are in place and working well in practice. Where ASIC identified deficiencies, these issues were generally straightforward and easily addressed by the licensee."

The bad apples project is another ASIC initiative. "Reliable, candid references play an important role in reducing the potential for 'bad apples' [poor-quality or dishonest advisers] to either



PHOTO: PENNY STEPHENS

move within or remain in the financial services industry," says Greg Tanzer, ASIC's executive director of consumer protection and international relations.

My concern is that we will end up with yet more regulations requiring reliable, candid references. More regulations seem to be the answer to what appears to be difficult issues. But it is not needed. The problem with the bad-apples concept has been the fear of defamation.

Let's make this point clear: industry-wide risk-management is available if we all tell the truth. Don't be afraid of defamation. It cannot succeed if the statement is not motivated by malice, is truthful, is only disseminated by you to the persons to whom it is addressed for the purpose for which it was created, and it is in the public interest.

You do not have to wait for ASIC. You can adopt your own bad-apples project now and not be afraid of defamation. Sure, the threat will be made, and the greater the rogue, the louder the threat. But the public interest will also be greater, and this will afford you more protection.

In fact, each AFSL that terminates a representative for bad conduct has an obligation to make clear to clients that the representative was terminated for bad conduct. A simple "separation letter" is not enough. To simply let a client go, knowing that they are following the rogue to the new dealer, is a breach of the fiduciary duty an AFSL owes its clients.

Worried by the lawyers? Don't be, they are not your problem. The next financial planner is your problem. As they should be in any professional industry.

Asset

Peter Bobbin holds equity in IMF of less than 0.2%

