

ARGYLE ADVOCATE



Client ownership: dealer vs planner

The importance of a dealer representative agreement cannot be underestimated when a planning practice decides to move on. **PETER SARDELIC** explains why.

For planners who have entered into a dealer representative relationship on the understanding that the planner owns the client, the moment of truth arrives when the representative arrangement ends.

The planner wants to be sure that they are able to transfer their clients in an orderly and trouble-free manner, whether to a new dealer group, where they obtain their own licence, or in cases where they sell their business to an adviser who belongs to a different dealer group.

Client transfers

In the post-privacy and financial services reform world, a lot

more procedure has been introduced in terms of client transfers. One common practice is for dealers to require that a client of the planner provide formal consent before the client's affairs are transferred out of the dealer group. Often the dealer will claim this is necessary for legal reasons to enable the transfer of client information and the redirection of trail commissions and other servicing commissions.

Other conditions that have become common include comprehensive 'transfer agreements', which place obligations on new Australian Financial Services Licence (AFSL) holders to review the financial plans of all clients

within a minimum period of time and indemnify the current dealer against client claims for advice given after the clients are transferred.

It is possible for an adviser to send clients pro forma letters to obtain their consent before their affairs are transferred to the new dealer. Depending on how the letters are used, this practice can potentially harm a planner by preventing the transfer of clients. Planners need to be vigilant to ensure this does not occur.

If the basis of the planner/dealer relationship is that clients move with the planner, and do not stay with the dealer, then



representative in respect to client ownership and equally ensure that what lawyers describe as 'mechanical provisions', such as client letters, do not operate to deprive the planner of their client base.

Moving dealerships

Consider the following situation. Alan and Ben operate, in partnership, a small financial planning business as authorised representatives of XYZ dealer group. XYZ markets itself as a dealer group that respects the fact that clients belong to planners and they will fully assist planners in transferring their client base out of XYZ should the relationship end.

Alan and Ben have built their business from scratch and have sourced all their clients themselves, or through their referral base.

client letters should be used in a way that is consistent with the understanding on client ownership.

Planners need to help themselves. They need to carefully review dealer representative agreements to ensure they properly encapsulate the understanding between the dealer and the

ARGYLE ADVOCATE

After eight years with XYZ, Alan and Ben decide to transfer their business to a different dealer group. They have been concerned for some time about XYZ's direction. Recently, there have been management changes at XYZ that convinced Alan and Ben that they would do better at a different dealer group.

Alan and Ben inform XYZ of their decision. XYZ's senior management meets with them to try and convince them to reconsider. They do not change their minds and they give XYZ three months notice as required under the XYZ Dealer Representative Agreement.

Letters of consent

Six weeks before Alan and Ben are due to leave, XYZ informs them that their clients need to provide written consent before their affairs are transferred to the new dealer group. XYZ requires that a 'joint letter', signed by both the dealer and the representative, be sent to all clients advising them of the developments and requesting their consent to the transfer.

Alan and Ben protest. They say this is not necessary. They say all their clients are fully informed about the transfer to the new dealer group. XYZ replies that though this may be the case, their legal adviser says the joint letter must be sent and each client must provide written consent to the transfer.

XYZ says this is necessary under privacy laws and to comply with their licence obligations under the Corporations Act. Besides, XYZ points out: "You should read your dealer representative agreement. It clearly states that client letters and consent are prerequisites to client information being sent and commissions being redirected to the new dealer group."

Default financial advice

Alan and Ben are not happy with the wording of the letter prepared by XYZ. The letter requires the client to make a decision. The client may decide to remain with XYZ or move to Alan and Ben's new dealer group. If the client does not respond, XYZ informs the client that they

will take this to mean that they wish to stay with XYZ, in which case XYZ will appoint a new representative to handle their affairs.

Alan and Ben protest. They say the letter does not reflect their understanding of client ownership. They say if the letter has to be sent, then it should be worded so that the message urges clients to stay with Alan and Ben, and if they do not respond, then it is assumed that they wish to stay with Alan and Ben.

XYZ's response is they will not change the letter. This is their standard letter that has been approved by their lawyers. They are not prepared to make Alan and Ben a special case.

The letter is sent. Most clients respond, indicating that they wish to move to Alan and Ben's new dealer group. However, some clients are confused by the letter and mistakenly elect to remain with XYZ. Some clients do not respond. In relation to those clients, XYZ will not allow the transfer to occur and they refuse to redirect commission entitlements to the new dealer.

Apart from the provision dealing with client letters, the XYZ dealer representative agreement is silent on what happens to Alan and Ben's clients when Alan and Ben's arrangements with XYZ end.

Dealer agreement

Could this happen? Yes. Does this happen? Yes. Should this happen? No. Look after yourself; make sure the dealer representative agreement is right.

Alan and Ben's problems arose because the dealer representative agreement did not align with the dealer's marketing. The clients belonged to Alan and Ben, yet the legal agreement between the parties did not give clear rights to Alan and Ben and did not protect them at the vital time when they wished to terminate the relationship with their dealer.

There are three basic principles that are important to understand.

Firstly, neither the dealer nor the planner 'owns' the client. The client makes their own decision as to whom they wish to engage. Nevertheless, unless there is a clearly defined relationship supported by legal documentation between the planner and the dealer, then the position 'at law' is that the dealer is the one that has the relationship with the client.

The second principle is that the planner can still be protected if the legal documentation between the representative and the dealer squarely and fully addresses the right to client issue in favour of the planner.

The third principle is that mechanical and procedural requirements, such as client letters, should not be inconsistent with the broad position reached on clients. If the clients belong to the planner then they should not operate to prevent the transfer. These procedures are just procedures and the tail should not wag the dog.

Corporations Act rules

Under the Corporations Act, post-financial services reform (FSR), planners who wish to conduct their own businesses are only permitted to do so if they act on behalf of the holder of an Australian Financial Services Licence, and they are expressly authorised by the licence holder to do so.

The Corporations Act, in effect, introduces a relationship of principal and agent between the dealer and the representative. It is for this reason (the first principle) that if the dealer representative agreement is silent on the client issue (in other words, it does not squarely address the issue of client ownership), then the dealer is the one that has ownership of the client.

It could be said that the representative is merely the dealer's agent in terms of the Corporations Act and has no rights, as a separate independent party, to the client.

The second principle of ensuring the legal documentation is correct and comprehensive is therefore vitally important.

The Corporations Act does not prohibit the adviser from also having an interest in clients and does not prohibit the dealer and the planner coming to an agreement between them as to what will happen in terms of the client relationship upon termination of the dealer representative arrangement.

Restraint of trade

A case in point is restraint of trade provisions. Non-solicitation restraint provisions operate to prohibit a person from attempting to solicit the business of a client. Typically, they are used in employment contracts where employees are, for a defined period, prohibited from attempting to win the business of their employer's clients.

These provisions can, and often do, operate in the dealer representative context. For a defined period after termination, the dealer is prohibited from approaching the planner's clients to win their business.

If Alan and Ben had their time again, how should they approach the client letter requirement? Alternative arrangements could have been presented to the dealer. Why does the client need to provide written consent? Why isn't 'negative' consent acceptable? In other words, why wasn't the client given the opportunity to provide his or her consent by way of no action? That is, unless the client actually responded saying it did not wish to remain with XYZ, it is taken to have consented.

For representatives with a large number of clients, this is a much simpler process to operate and it also minimises the risk of error by clients misunderstanding precisely what they are required to do. These and other options were all available to Alan and Ben.

A considerable amount of new documentation and methodology has been introduced into the financial services industry as a result of FSR. In some cases, there has been a great deal of misinformation as to what the law requires in terms of the retail client relationship.

Add to this the fact that individual financial planners are often disadvantaged in terms of bargaining and negotiating power in contractual arrangements with their dealer.

So, it is not easy for a planner to obtain a dealer representative agreement that properly protects them. However, getting it wrong is not an option.

Peter Sardelic is a partner with The Argyle Partnership Lawyers.

“ It is not easy for a planner to obtain a dealer representative agreement that properly protects them. However, getting it wrong is not an option. ”

Need to add to the brain power

Without increasing the head count?

The Financial Planning Guide is a complete reference tool that sources its information from industry experts.

It's easy to use and updated as developments unfold.

Facts, figures, technical information.

Available via CD, online or through your corporate intranet.

Let us do the legwork for you.

Financial Planning Guide

Formerly Integratext

WHY WAIT? SUBSCRIBE TODAY
VISIT www.financialplanningguide.com.au
CALL 1300 662 203
EMAIL adviserguides@tribeca.com.au

Proud providers of the SMSF guide:
www.smsfguide.com.au

TRIBECA