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LEGAL BRIEF

Breaking the barrier

The ultimate legal defence for financial planners is informed clients able to make and take responsibility for their own decisions. But it's easier said than done.

"The first thing we do, let's kill all the lawyers." So said Dick the Butcher in William Shakespeare's *Henry VI*. But would Jeffrey Lucy echo this proclamation today? Methinks no, otherwise the chairman of the Australian Securities and Investments Commission (ASIC) would condemn half of his executive directors, and he would become lonely.

At times even I must agree; we lawyers are part of the problem. However, we are also part of the solution. But the bigger problem is how you instruct us, and this has added to the communication mire in the financial services industry today.

Recently, I toured 11 major cities in seven days on behalf of Macquarie Bank. I expect that they didn't know what they had let themselves in for. I was given an open brief to talk tax and financial services. While Macquarie margin lending and geared equities presented product and investor strategies, I lamented the failure of our industry to communicate.

To some, my words sounded like a revelation, but they shouldn't have because they are just common sense and basic law. Let me give you my top tips for achieving clear, concise and effective communication that is legally secure and liability limiting.

Number one: Don't use a lawyer who has never set foot in a planner's office or met a planner's client. It is like asking a priest's advice on the most appropriate sex aid.

Number two: Don't follow ASIC; the only time it sets foot in a planner's office is to inflict harm. But listen carefully to what it says; there is a lot of good in its intent and its practical, useful guides. The example provided by ASIC of a statement of advice was poor, but the style and content achieved what should be the goal of all – it communicated. Learn from it; just do not follow it slavishly.

Number three: This is important. It is not what a client is told; it is what is communicated. This is where the lawyers can get it wrong. And they can also get it right, but you have to be the judge. Otherwise, when you are judged, you will fail.

Let me give you the example that I gave on the Macquarie Bank roadshow. Talking tax, how do you describe borrowing to invest? One way is to say that investment gearing uses built-up equity to enhance a portfolio. While negative gearing is one of the few legitimate ways to reduce tax, margin lending or instalments are a portfolio-enhancement strategy.

Looked at another way, investment gearing is borrowing to buy, negative gearing is losing money tax-effectively and margin lending or instalments is a way to borrow more money than you could otherwise afford. I leave it to you as to which one is communicated.

Number four: Think R-I-S-K – what it is, whose it is, what it can do and how it can be explained. Do this and the risk won't be yours. Dissect the financial product or strategy and look for the risks. Then attach the risks to where they belong. It is important to look to what the risk can do, not just to the investment or strategy – this you must go beyond. In quite a number of the Westpoint statements of advice that I have seen, this has been the failure that could otherwise have exonerated an adviser.

The failure to connect a risk to the client loss is what led to an adviser's downfall in a Financial Industry Complaints Service matter. The adviser knew of the borrowing for a charter boat business, should have known that the business was bound up in the financial future of the client, and that a failure of the business would cause the loan to be called up and the investment strategies to collapse prematurely as a result. The adviser's failure to express this risk was the problem that led to a liability.

Think risk in a consequences manner and you will bridge the communication barrier. Think and express – what if the risk materialises, what may result?

Number five: All disclaimers must contain both positive and negative elements to be effective. A negative "I am not a tax adviser" is not enough. Start with this but add: "It is important to get the tax aspects of the advice confidently correct. After all, obeying the tax laws is your personal obligation and, anyway, it is the after-tax addition to your wealth that will secure your financial objectives. I encourage you to obtain personal tax confirmation of the tax elements of this advice."

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Courts traditionally read down a disclaimer, especially a negative one. What is not understood is that a professional cannot disclaim the very basis of what they are doing. So commenting on issues that include tax (or anything else) and saying you are not responsible for it will not work. But adding that it is important and that the client should take the issues further will work. It is all in the wording.

Number six: Treat all clients as dummies. This doesn't mean that you don't respect them. Just remember that they came to you for advice. In doing this, they are admitting that it is all beyond them; they are dummies in the area of your expertise. The failure to treat the client as dummies is what led the court in Newman v Financial Wisdom to say that "with all due respect to Mr Duncan, his willingness to engage an organisation, which was prepared to put forward these preposterous propositions is indicative of Mr Duncan's

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gullibility and naïveté, in addition to his desperation, and demonstrates the need which he must have had at all times for professional financial and investment advice." If you start with the expectation that clients are dummies, your communication must get better.

Number seven: Drop the jargon. There were chuckles from the room during the roadshow as I described one Westpoint victim's understanding of her investment in mezzanine financing as: "I thought my money was to finance the second storey!"

The 1983 Labor government re-birthed the financial services industry with tax law changes to superannuation and at the same time it created and continued to create a new financial services language. We all know what the jargon means but the clients do not. All industries have it and we do not like it when another speaks their double-Dutch jargon to us. So dumb-down the language not only in the statement of advice but in all communications. And if the client still does not understand, question whether it is appropriate for them.

Number eight: Size does matter. And the answer is not big or small. It is just what is appropriate to communicate (and to satisfy ASIC's tick-box approach to Corporations Act compliance).

ASIC's new discussion paper, *Managing Conflicts of Interest in the Financial Services Industry*, is wrong on the issue of bulky statements of advice (SOA). It is not an impermissible conflict of interest and breach of section 912A(1)(aa) for a dealer "to seek to limit its liability as far as possible", as the paper states. I agree with ASIC that the way hypothetical financial planning firm "Finplannco" went about this was poor, but it is not a conflict breach to seek it.

I can read the ASIC example statement of advice and find five of 12 pages as being all about risk minimisation to the dealer; that is, over 40 per cent of the advice. Size is not relevant – it is how the information is expressed. The ASIC example SOA does this well.

Number nine: Don't hide behind someone else, it won't work. This was the attitude of the 2004 Ontario Superior Court of Justice decision in Andersen v Fortune Financial Corporation when the court said: "I am satisfied, firstly, that the complexity of this document was well beyond the understanding of the plaintiffs and, secondly, that the failure of the plaintiffs to read the document itself reflects the degree of trust placed in Delellis [the financial adviser]." The document referred to by the court was the investment memorandum, the equivalent of our product disclosure statement (PDS). It contained the warnings regarding the speculative nature of the investment, but the complexity of it made these warnings of no use.

Similar views have been expressed by the Australian courts but the above case makes the point clear. The warnings in a financial product PDS are not enough, especially if the PDS itself looks complex. Tailor the warnings for the client in the SOA in a communicative manner.

Number 10: Shift liability to the investor. Curiously, the best way to shift liability to a client is to achieve an informed client who then makes an informed decision based on the material presented and your advice. There is no better defence than being able to show that the client was fully informed in a way that suited them, and then made the decision that is now the issue of complaint.

It is important to understand that clients can lose money as a consequence of following investment recommendations and an adviser can be safe from liability as long as the decision belonged to the client and it was a fully informed decision.

If you look back over the 10 tips, you will see that all are designed to achieve an informed client. Doing this will mean that you are fulfilling your role as an adviser. It will also mean that you will have limited your liability better than any lawyer with a wad of papers but no understanding of financial planning.

Please don't kill the lawyers. Well, not all of them anyway. Asset