



As published in Asset Magazine March 2003

WHO DO YOU TRUST?

by

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Trust is an important human emotion. In fact the whole of society is built on our yearning to trust others and our willingness to be trusted. The importance of trust in the financial planning relationship cannot be understated. A client needs to trust their advisor and dealer.

A major part of the reforms of FSR is about stripping away all potential veneers of hidden interests and influences so that clients can feel assured that their trust is well placed. But FSR has been accused of being a failure, the industry of being in need of an overhaul.

Despite the Little Chicken “cackling” of self proclaimed consumerists the FSR sky has not fallen in. In fact it is yet to fully commence. And when it does I am confident that it will help to restore consumer confidence through its enhanced disclosures that will leave a client with a more confident ability to assess the value of the trust that they have placed in their advisor and dealer.

Despite the views of some, consumers will enjoy safeguards but what about advisors? Who should the advisors trust?

I hope it does not come as a surprise to you but there is only person an advisor should trust; themselves. The role of an advisor is to advise. The name speaks for itself. Implicit in the concept of advising is the formation of an opinion, a personal opinion and that personal opinion must be based on an advisor’s own enquiries.

This concept may be surprising to some but it is an essential part of financial planning, it is embodied within the “know your client” rule. Post FSR this rule now sits in the “personal advice” requirements of section 945A and 945B of the Corporations Act. Section 945A(1) imposes a requirement for the licensee or representative to have a reasonable basis for the advice and imposes an obligation that the advice must be appropriate to the client. You should get used to this concept of “appropriate to the client”. It is an enhancement of the “know your client” rule.

All of this leads to the view that advisors must form an opinion and to do that they must make their own enquiries and rely on themselves.

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Surely they are not alone? They can't be when you consider that they are only one part of the financial planning process; the client, dealer and fund manager all play a role. So trust in the financial planning process must extend to all of them, and between them.

But not according to ASIC. They appear to argue that advisors must trust no one.

It was a lack of independent enquiries by the advisor that resulted in Roger Charles Gordon of Tea Tree Gully, South Australia, being banned from acting as a representative of a dealer or investment advisor for one year.

It would appear that he wasn't wholly to blame otherwise ASIC would not have permitted him to continue to act as a securities representative of Greater Western Financial Services Limited subject to that dealer complying with the terms of an enforceable undertaking.

ASIC's complaint was that he had made no independent enquiries about the legitimacy of infomercial and music schemes that he had obviously promoted to his clients. Apparently, both were unregistered managed investment schemes that were being offered in contravention of the Corporations Act. As usual there were a few reasons for the banning order. ASIC also found that Mr Gordon had no reasonable basis for making the recommendations to his clients and had not sufficiently disclosed to clients the commission, or the extent of the commission, that he would receive as a result of his recommendations.

But, in what should be viewed with some alarm, ASIC also found that Mr Gordon had made no independent enquiries about the legitimacy of the schemes. According to ASIC, he had relied solely on assurances from his principal.

Does this mean that ASIC expects you to not trust your principal? Fortunately for us ASIC has run this line of argument before, and it has been tested on appeal to the Administrative Appeals Tribunal. In the 1999 decision of *Foster v ASIC* the Tribunal agreed that it was no defence for a financial planner to rely solely upon information imparted to him by a scheme promoter. The Tribunal was of the view that the planner had a legal duty to make his own enquiries and conduct his own investigations of the investment scheme that was the subject of his recommendations to clients. The Tribunal agreed with ASIC that placing trust in the scheme promoter was not only an error of judgment on behalf of the planner but demonstrated a clear failure to understand the extent of his duties as a representative.

Shouldn't the scheme promoter be responsible, especially if the advisor relied on them? Yes, but all this will achieve is someone who the advisor can blame, the client can still blame the advisor.

ASIC's banning order of Mr Gordon takes the principles in the *Foster's* decision further, perhaps too far. In *Foster* the Tribunal was concerned that the planner relied on information imparted to him by the scheme promoter. In Mr Gordon's circumstances ASIC was concerned that he had relied solely on assurances *from his principal*.

It is simply unacceptable for ASIC to make such broad ranging statements without providing substantial more detail. Every day advisors rely upon the assurances of their principal. The approved product list is the source from which an advisor may create an investment strategy for a client. Implicit within the approved product list is the reasonable assumption of the advisor that their principal has assured them of the "investment grade" of those investments. Surely ASIC does not suggest that every planner should revisit all approved product list

investments and personally reassess those products? Or is ASIC suggesting a licensing standard that exceeds the commercial standard of care that is owed to clients?

When making the decision to ban an advisor, ASIC needs to assess whether the advisor will conduct their affairs *efficiently, honestly and fairly*. The banning order on Mr Gordon suggests that sole reliance on assurances from his principal about legitimacy of schemes is not acting efficiently, honestly and fairly. This approach is at odds with ordinary legal standards, at law it is very reasonable for a representative to act on the assurances of their principal.

There is no loss of consumer protection where the advisor relies on the assurances of their principal, especially under the post FSR regime. Section 917E makes clear that the licensee is liable to a client for any loss or damage they suffer as a result of a representative's conduct. The client's remedy is with the dealer. It is reasonable to argue that where the representative relied on the assurances of their principal as to the investment grade of the financial products recommended, it is appropriate that the client enjoy remedies against the dealer. But ASIC would appear to be identifying a breach of a standard by the representative to the client which may open up liability to the advisor where one would not otherwise exist.

Has ASIC gone too far with Mr Gordon? I don't know because ASIC's press release is too short on reasons.

ASIC found that during the period 1997 to 1999, a number of Mr Gordon's clients entered into financial schemes, known as the Infomercial and music schemes. The schemes were promoted by Infomercial Management Group Pty Ltd and IP Product Management Group Pty Ltd. In earlier Victorian Supreme Court proceedings, Mr Justice Byrne had ruled that these schemes did not comply with the statutory requirements. It is the following ASIC statement that concerns me: *"ASIC found that Mr Gordon had made no independent enquiries about the legitimacy of the schemes and relied solely on assurances from his principal."*

I am sorry ASIC, but much more is needed. Was it plain and obvious that there was a problem with the investment schemes? Was it so blatant that Mr Gordon should have recognised that the investment schemes did not comply with statutory requirements? If ASIC's concern was Mr Gordon's reliance on his principal when "Blind Freddy" would have seen otherwise, I can understand the direction taken by them. But they need to say so in their press release.

If it was not obvious that the investment schemes did not comply with statutory requirements then what was the problem with Mr Gordon relying on the assurances of his principal? Is it not implicit in the approved product list that the principal has undertaken relevant reviews and investigations and is thereby assuring the investment grade of those products? If we are to accept that an advisor must not trust their principal and make their own enquiries, how far should they go? What questions do they ask? Do they need to duplicate the same criteria that allowed the investment scheme onto their principal's approved product list?

To adopt the language of a former member of the Senate, ASIC.... please explain!