FINANCIAL PLANNING ASSOCIATION

CONDUCT REVIEW COMMISSION

DETERMINATION AND REASONS FOR DECISION

The Principal Member (name withheld)

PANEL MEMBERS: ***Professor Dimity Kingsford Smith (Chair)***
Mr Michael Perkins
Mr James Cotis

DATE OF HEARING: **13 February 2009**

DATE OF FINAL DETERMINATION: **21 September 2009**

PARTIES' REPRESENTATIVES: ***Mr Ivan Middleton (FPA)***
Mr Paul Ahearne (LG)

DETERMINATION
AND REASONS FOR DECISION

I. SUMMARY OF DETERMINATION AND REASONS

The Conduct Review Commission finds breaches by Mr. N and EC Pty Ltd for which the Principal Member (LG) is vicariously liable. These are in relation to misleading statements, integrity, fairness and reasonableness and bringing discredit on the financial planning profession. There are also breaches of disclosure requirements. The FPA did not bring evidence of negligence. The CRC found that LG had a reasonably effective system of supervision of its external authorized representative at the level which applied when the facts took place in late 2005, and found no breach of supervision requirements. The details of the determination are set out at the end of these reasons in part VIII and the sanctions the CRC has directed, in part IX.

II. THE COMPLAINT

2.1 This is a complaint by the Financial Planning Association (FPA) in its disciplinary capacity under its Constitution and Disciplinary Regulations. The complaint is referred to the Conduct Review Commission (CRC) on the motion of the FPA's Investigations Officer, as a result of a complaint received by him from a client of Mr. N an authorized representative of LG. LG, but not Mr. N, is a principal member of the FPA and the holder of an Australian Financial Services License. The complainant is Mr. B.

2.2 After investigation and correspondence between the FPA and LG it was alleged that LG had a case to answer under the FPA's Code of Ethics and Rules of Conduct (FPA Ethics and Rules). It was also alleged that LG by the conduct of its representative Mr. N, had breached the FPA's Ethics and Rules. The case to answer alleged breaches of the Ethics and Rules as follows:

A. By Mr. N for Which LG is Vicariously Liable:

2.3 **1.** In breach of FPA Ethics and Rules 101 Mr. N, in the course of recommending that Mr. B invest in the discounted promissory notes ('Metro Notes') issued by Metro Stadium Global Capital Limited ('Metro') made a misleading, deceptive or dishonest statements to Mr. B.

Particulars: On or about 28 November 2005 at Mr. N's offices, Mr. N said to Mr. B, 'This investment is so safe I'll guarantee it myself. You can make 15% in 30 days. At the end of the 30 days the investment plus the 15 percent will be returned to you.'

2. In breach of FPA Ethics and Rules 1 (Honesty and Integrity), 4 (Fairness and Reasonableness) and 6 (Professionalism) Mr. N took advantage of the failure of Metro to repay Mr. B after 30 days as promised, to persuade Mr. B to assign his interest in the Metro Notes to Mr. N's associated company EC Pty Ltd, which was a breach of the duty of loyalty Mr. N owed to Mr. B as his client.

Particulars: In a letter dated 31 July 2007 from Mr. N to LG, Mr. N describes EC Pty Ltd as 'a separate company of mine.' There is no evidence that Mr. N fully and frankly disclosed to Mr. B the nature and effect of his ownership of EC Pty Ltd and the material benefits of the assignment of the Metro Notes that would accrue to him through EC Pty Ltd. Further, when causing EC Pty Ltd to loan the amount of $150,000 to Mr. B on or about 29 November 2005, Mr. N did not disclose to Mr. B the material benefits to him of that transaction either.

3. In breach of FPA Ethics and Rules 5 Mr. N failed to act with due skill, care and diligence in making the recommendation that Mr. B invest in the Metro Notes.

Particulars: Mr. N did not conduct, or have access to, research on financial strategies and products suitable to Mr. B. Mr. N did not develop a suitable financial strategy or plan for the client that included the Metro Notes or investments of the same class as the Metro Notes. There was no reasonable basis on which Mr. N could have recommended the acquisition of the Metro Notes to Mr. B.

4. In breach of FPA Ethics and Rules 111 Mr. N failed to provide an explanation of investment risks involved in the acquisition by Mr. B of the Metro Notes in terms Mr. B could understand.

Particulars: Mr. N did not provide an explanation of investment risks involved in the acquisition by Mr. B of the Metro Notes in terms Mr. B could understand or at all.

5. In breach of FPA Ethics and Rules 102(e), 106(a), (b), (c), 107 and 117 Mr. N failed to inform Mr. B orally or in writing of the fees, commissions and other benefits capable of influencing Mr. N in making the recommendation that Mr. B invest in the Metro Notes.

Particulars: Mr. N did not disclose his association with EC Pty Ltd as particularized in paragraph 2 above. In the letter of 31 July 2007 from Mr. N to LG Mr. N states that EC Pty Ltd 'was offered the opportunity to purchase a high-yielding Discounted Promissory Note from' Metro. At no time did Mr. N tell Mr. B that EC Pty Ltd was dealing with him for its own account and that it would benefit from selling the Metro Notes to Mr. B, as well as lending him $150,000 to purchase part of the parcel.

6. In breach of FPA Ethics and Rules 112 Mr. N failed to ensure that the recommendation to Mr. B to invest in the Metro Notes was in writing.

Particulars: Mr. N did not give Mr. B a written recommendation to invest in the Metro Notes, either as soon as practicable after the oral recommendation, or at all.

and by force of FPA Ethics and Rules 132 the conduct of its representative Mr. N shall be treated as the conduct of LG.

B. By LG Directly as Principal Member

7. In breach of FPA Ethics and Rules 135 LG has failed to maintain an effective system of supervision of the activities of its representative Mr. N and the recommendations made to clients.

Particulars: LG failed to supervise Mr. N so that his conduct complied with the FPA Ethics and Rules that the FPA alleges in paragraphs 1-6 above, have been breached.

2.4 A hearing of the complaint was heard on 13 February 2009. A transcript of those proceedings was created, and is referred to as such in this determination. The FPA presented documentary evidence in a folder with numbered tabs available to all parties before the hearing. That evidence is referred to in this determination as FPA Exhibit and the relevant tab number. LG presented evidence in bundles under cover of letters dated 8 September 2008, 3 December 2008 and 12 February 2009. Evidence from this source is referred to as LG Exhibit and then the date of the covering letter and a description of the document in question.

At the hearing it became evident that Mr. B had further emails and email attachments that were contemporaneous with the Metro Notes investment and relevant corroborating evidence. This was provided to the Panel by email on 16 February 2009 and is referred to in this determination as Mr. B Exhibit and

the date and description of the document in question. The evidence comprised in Mr. B Exhibits was provided to LG on 1 April 2009. LG has been extended an opportunity to respond to the Mr. B Exhibits in writing before the finalisation of this determination. No response has been received by the CRC.

III. BACKGROUND TO THE COMPLAINT

The Relationship Between LG and Mr. N

3.1 LG operates an accountancy, financial planning and mortgage broking practice. LG has been a Principal Member of the FPA since 30 November 2005. LH Pty Ltd was controlled by Mr. N an authorised representative of LG from 21 April 2004 to 24 April 2007. It was through LH Pty Ltd that Mr. N conducted financial planning business. Mr. N is not a member of the FPA. Mr. N also ran a mortgage broking business, which he operated through the company EC Pty Ltd. In these reasons we refer to Mr. N and LH Pty Ltd interchangeably, when referring to Mr. N acting as the authorised representative of LG.

Initiating the Advisory Relationship Between Mr. B and Mr. N

3.2 Mr. B is the Chief Executive Officer of ABC Pty Ltd, a removalist business. In early February 2005, Mr. B was referred to Mr. N and sought a full financial planning service. On about 8 February 2005, Mr. B met Mr. N at his offices in Chifley Towers, Sydney. Mr. N provided Mr. B with a business card that stated that he was an Authorised Representative of LG. Mr. N informed Mr. B that he provided a financial planning service whereby he would take the financial position of Mr. B, assess Mr. B's objectives, analyse Mr. B's risk profile and draft a feasibility study that would set out the investment goals and investment recommendations in achieving those goals.

3.3 Mr. N said that he charged $480 per hour for the service of providing a detailed financial report. There would be further fees for implementation and establishment of the financial plan, and a management fee of 1.5% of funds under management for ongoing review and portfolio assessment. Mr. B agreed and Mr. N asked him to complete a 1-page risk questionnaire. Mr. B completed the questionnaire and at the conclusion of this meeting both Mr. B and Mr. N agreed Mr. B should invest in growth assets but was not an aggressive investor. At some point in the interview, Mr. N provided Mr. B with a Financial Services Guide of LG.

On about 18 February 2005, Mr. B received a letter from Mr. N outlining his fees for:

a. The preparation of a feasibility study;

b. Establishment of the financial plan; and

c. Implementation of the financial plan.

On 23 February 2005, Mr. B considered the above fees letter and agreed to pay the following:

d. Financial Strategy Report fee LH Pty Ltd Group Pty Ltd- $8,976 (GST inclusive)

e. Implementation fees LH Pty Ltd Group Pty Ltd - $15,709 (GST inclusive)

f. Financial establishment fee payable to Investfin Pty Ltd - $36,069 (GST inclusive)

On 23 February 2005, Mr. N provided Mr. B with his bank account details and requested payment of the fees. On that date Mr. B paid the fee.

3.4 On 2 March 2008, Mr. B met with Mr. N at his Chifley square offices. Mr. N provided Mr. B with his feasibility study and outlined the details of the plan. Throughout March to June 2005, Mr. B had a number of conversations with Mr. N in which he expressed his displeasure with the feasibility study. Mr. B believed the financial plan was too complex and requested Mr. N to simplify the recommendations.

One of the recommendations was to borrow funds to invest $874,390 in an agricultural plantation investment scheme offered by Gunns Plantation Ltd (Gunns). Mr. B believed this to be excessive but decided to invest $177,320 into the Gunns scheme. Mr. B instructed Mr. N to implement this recommendation and to arrange the funding. This was done on 16 June 2005.

On 18 July 2005, Mr. N emailed to Mr. B a revised feasibility study. On 3 August 2008, Mr. B reviewed the plan and again believed the plan to be too complex. Mr. B emailed his concerns to Mr. N. On 17 August 2005, Mr. N replied to Mr. B. Between August and November 2005, Mr. B did not have any significant contact with Mr. N.

Introduction to Metro and the Metro Notes Investment

3.5 In early November 2005, Mr. B was to receive a $100,000 taxation refund as a result of the Gunns investment.

On or about 23 November 2008, Mr. N telephoned Mr. B. The FPA asserts Mr. N said words to the effect,

"I have an investment for you, it has a high level of return. This is a great investment, I know other guys that have invested. We all know each other. You can make 15% in 30 days"

Mr. N and Mr. B decided to meet personally and discuss the investment proposal.

3.6 On 28 November 2005, Mr. B met Mr. N at his Chifley Square offices. During the meeting Mr. N provided Mr. B with a product information document and an application for promissory notes in Metro.

The FPA asserts Mr. N explained the investment to Mr. B in words to the following effect:

"The investment is called Metro Stadiums Global Capital. They are raising funds by issuing discounted promissory notes."

"Metro needs to raise funds by the end of the November."

"They need short-term funding to get them through some cash-flow issues they have."

"This investment is so safe I'll guarantee it myself. You can make 15% in 30 days"

"At the end of the 30 days the investment plus the 15 percent will be returned to you."

3.7 After discussing the Metro Notes, the FPA asserts Mr. B and Mr. N said words to the following effect:

Mr. B said, "*I'm prepared to put in my $100,000 tax refund into the Metro investment".*

Mr. N said, *"That is not enough to seriously put into it. I can arrange for you to borrow $150,000 in addition to your $100,000."*

Mr. B agreed to invest $250,000 into the Metro Notes.

On 30 November 2005, Mr. B received an email from Mr. N, requesting Mr. B sign an application for the Metro Notes and the loan application. Mr. B completed the application forms on that day and returned them to Mr. N.

On or about 5 December 2005, Mr. N requested Mr. B transfer $100,000 to a bank account operated by 'United Legal', being the solicitors assisting with the issue of the Metro Notes. On that day, Mr. B completed the bank transfer to the United Legal bank account.

3.8 The FPA asserts that at no time did Mr. N inform Mr. B that the Metro Notes were outside the financial advisory relationship that he was providing to Mr. B. Nor did Mr. N inform Mr. B that he should seek his own financial advice before accepting the offer. Both these assertions are expressly refuted by LG. It is not contested that Mr. N failed to provide a written recommendation to Mr. B for the Metro Notes. Nor that Mr. N also failed to explain the risks associated with the Metro Notes. Mr. B believed the offering of the Metro Notes by Mr. N was part of the financial advice that he had been seeking from Mr. N since early February 2005.

Seeking Return of Funds on Maturity of the Metro Notes.

3.9 On 6 January 2006, Mr. B emailed Mr. N and requested the proceeds of the Metro Notes be directed to his bank account. Mr. N replied and stated that he was receiving an update on the Metro Notes later in the day.

Over the following few weeks, the FPA asserts Mr. N and Mr. B had conversations regarding the Metro Notes whereby Mr. N said words to the effect:

"There is a delay in the settlement of the Metro Notes. It's due to a court action against Metro."

3.10 On 20 February 2006, Mr. B received an email from Mr. N which forwarded an email from someone apparently acting on behalf of the issuer of the Metro Notes. The email confirmed the delay in the maturity for the Metro Notes. Over the following 6 months, Mr. N and Mr. B had numerous discussions regarding the repayment of the Metro Notes.

About July 2006, Mr. N approached Mr. B and proposed that he could arrange for repayment of Mr. B's loan ($150,000) if Mr. B handed over the rights to the Metro Notes to him. Mr. B agreed and signed an agreement to this effect. Since that time Mr. B has been unable to recover that part of the investment in the Metro Notes that he provided himself – namely $100,000.

Mr. B's only contact with the issuer of the Metro Notes was through Mr. N. Emails that Mr. B received from Mr. N, including those that related to the Metro Notes, stated that LH Pty Ltd was an Authorised Representative of LG.

Making the Complaint

3.11 On 26 July 2007 Mr. B made a written compliant to LG. On 31 July 2007, LG replied to the complaint, and informed him that the Metro Notes investment was not on LG's authorised list of investments and Mr. N was not authorised to recommend the Metro Notes to Mr. B.

3.12 On 10 October 2007, the FPA received a written complaint from Mr. B. On 7 January 2008, the FPA made initial contact with LG in order to clarify whether they had a case to answer. On 3 March 2008, LG responded informing the FPA that Mr. N was not acting in his capacity as a proper authority holder of LG when he arranged the loan and arranged the Metro Notes for Mr. B. Also that the Metro Notes was not on LG's approved product list, LG had no knowledge of the Metro Notes, or the transaction involving Mr. B.

LG have provided a statement from Mr. N, signed on 31 July 2007, in which Mr. N states in paragraph 7 that he informed persons he introduced to the Metro Notes that the offering was outside of his activities as a proper authority holder of LG.

On 20 March 2008, the FPA emailed LG and requested further information. On 8 September 2008, LG responded to the letter. On 12th November 2008, the FPA issued LG with a FPA Breach Notice. On 3rd December 2008, LG responded to the Breach Notice. On 23rd December 2008, the FPA wrote to LG and informed them that the matter would proceed to a FPA Conduct Review Commission Hearing on 13th February 2009.

3.13 Of particular relevance to this complaint are the following questions:

1. Whether Mr. N made a 'recommendation' to Mr. B to acquire the Metro Notes on the terms alleged by Mr. B, and whether that recommendation (if any) was misleading, deceptive or dishonest;

2. Whether Mr. N failed to act with due skill, care and diligence in making the recommendation (if any) that Mr. B invest in the Metro Notes;

3. Whether Mr. N took advantage of the failure of Metro to repay Mr. B as promised, to persuade Mr. B to assign his interest in the Metro Notes to Mr. N's associated company EC Pty Ltd in breach of the duty of loyalty Mr. N owed to Mr. B as his client;

4. Whether Mr. N failed to make the disclosures required by the FPA Ethics and Rules as alleged in the breach notice including explanations of the investment risk in terms that Mr. B could understand;

5. Whether LG maintained an effective system of supervision of all Mr. N's activities.

IV. THE FPA's POSITION

A. In Relation to Mr. N for Which LG is Vicariously Liable

4.1 The FPA makes four main allegations:

1. That Mr. N made statements to Mr. B in relation to the investment in the Metro Notes that were misleading. The FPA did not bring evidence that the statements by Mr. N were deceptive, dishonest or fraudulent. The FPA alleges that the statements made by Mr. N were in the course of an ongoing advisory relationship and were relied on by Mr. B.

2. That Mr. N was in breach of his duty not to act with a conflict of interest between his own benefit in purchasing the Metro Notes through his company EC Pty Ltd, and his duty of loyalty to his client Mr. B.

3. That Mr. N was negligent in advising Mr. B to enter the investment in the Metro Notes because he did not have a reasonable basis on which to make the recommendation, having no securities research and no suitable financial

strategy developed for Mr. B, to support the recommendation to invest in the Metro Notes.

4. That Mr. N failed to make to Mr. B a number of disclosures required under the FPA Ethics and Rules required when an investment recommendation is made to a client.

It says further, that because of FPA Ethics and Rules 132 that LG is vicariously liable for any breaches of the FPA Ethics & Rules in his relationship with Mr. B.

That Mr. N Made Misleading Statements to Mr. B in Relation to the Investment in the Metro Notes in the Course of an Ongoing Advisory Relationship.

4.2 As recounted in paragraphs 3.5-3.6 above, the FPA's position is that in November 2005 Mr. N said to Mr. B words to the effect:

"The investment is called Metro Stadiums Global Capital. They are raising funds by issuing discounted promissory notes."

"Metro needs to raise funds by the end of the November."

"They need short-term funding to get them through some cash-flow issues they have."

"This investment is so safe I'll guarantee it myself. You can make 15% in 30 days"

"At the end of the 30 days the investment plus the 15 percent will be returned to you."

This evidence was confirmed by Mr. B personally at the CRC hearing (Transcript p8).

4.3 The FPA relies on this evidence of conversations between Mr. B and Mr. N for the investment terms that were represented to Mr. B. LG did not lead any evidence to refute the fact and substance of these conversations between Mr. N and Mr. B: for example Mr. N was not present as a witness. The Panel was careful to question Mr. B about his account of the conversations (Transcript p 7-17) and to seek corroborating evidence of the conversations and their terms. This is because of their importance in establishing the FPA's allegations of misleading conduct.

In particular the Panel was concerned about the obvious difference between the terms of investment. There were those set out in a letter from the issuer and information memorandum given by Mr. N to Mr. B (FPA Exhibit 10) and in the terms of the Metro Notes actually issued to Mr. B (FPA Exhibit 11). Then there were those Mr. B asserted had been represented to him orally as set out above. The Panel was also concerned that evidence that came to light after the hearing (Mr. B Exhibits 'Invitation to Treat' dated 23 January 2005 (we assume 2006 was intended)), suggested that the investment was not concluded in November 2005 as Mr. B's oral evidence asserted.

4.4 Of particular importance were representations as to the rate of return, the duration of the investment and whether it was guaranteed. To begin with the covering letter and information memorandum in FPA Exhibit 10 were both dated 18 September 2005, and expressed the offer of the Metro Notes to be open for only 14 days from that date. Mr. B gave evidence that his conversations with Mr. N about the Metro Notes took place in late November 2005. Mr. B explained this gap in the dates as due to (Transcript p16) the issuer requiring finance to bridge a period until settlement of the sale of the real estate development being funded by the Metro Note issue. The offer by the issuer had therefore been extended.

4.5 Not only extended but while the rate of return (15% pa) remained as offered in the information memorandum, as did the guarantee made by the issuer's parent company, to raise the bridging funds the duration of the investment was greatly reduced – from 30 months to 30 days. In summary, Mr. B gave evidence that Mr. N offered him the Metro Notes on the same terms as the written documents, except for the investment term. There is no direct documentary evidence that the issuer accepted the investment, though post-term negotiations documented below were conducted on the basis that the investment had been accepted.

4.6 Although Mr. B actually signed a promissory note (FPA Exhibit 11) which provided for the 30 month investment period, there is evidence to corroborate his account of being offered the greatly reduced investment period. First, a number of other investors were offered the same reduced investment term by Mr. N (Transcript p 8-17). The names of the other investors, as relevant to LG are set out in LG's complaints register reproduced as Annexure 2 to FPA Exhibit 21. Most of these other investors were known to Mr. B either personally or professionally (Transcript p 17). All of these investors also lost the portion of their investment where the capital was supplied by them, rather than borrowed from EC Pty Ltd.

4.7 Second, after the Metro Notes were not repaid on the expiry of 30 days in January 2006 there were a number of meetings between Mr. N and the group

of investors which Mr. B attended. These meetings punctuated a period of negotiations which extended from January 2006 to about August 2006 to obtain repayment of the Metro Notes. Salient events during that period which corroborate Mr. B's evidence, particularly as to the terms originally offered were these:

1. An email dated 20 February 2006 (FPA Exhibit) from Mr. N to Mr. B (and to other members of the group of investors) in which Mr. N passes on the news from the issuer that the rate of return has been increased to 20% in consideration of the delay in repayment of the Metro Notes. This suggests that Mr. B's evidence that the term agreed was 30 days is correct, since by February 2006 compensation is being offered for delay. Also an interest rate higher than 15% is being offered.

2. An email dated 5 March 2006 from Mr. N to Mr. B (and the other investors) in which the increased 20% rate of return is confirmed. (Mr. B Exhibits email 5 March 2006).

3. A further email dated 22 March 2006 from Mr. N to Mr. B in which the fact that the rate of return has been lifted to 20% is again mentioned. (Mr. B Exhibits email 22 March 2006).

4. Email from Mr. N to Chris at Sterlington & Booth (acting for the issuer of the Metro Notes) dated 22 March 2006 in which Mr. N is objecting to Chris's suggestion that the investors introduced by Mr. N be put off by relying on the investment periods set out in the Metro Notes documentation. The relevant portions of the email written by Mr. N read: 'telling these investors it's a 30 month investments doesn't fly when they com back with 'Chris told us on the Queensland trip that this was going to be completed by end of December 2005.' Also 'The point is we can't hide behind the 'timeframes in the note', when these have been verbally.'(sic) The increase in the rate of return is again referred to in the email. (Mr. B Exhibits email 22 March 2006 Mr. N to Chris).

4.8 The period of negotiations ended in August 2006 with the investors including Mr. B, agreeing to enter an assignment of their Metro Notes to EC Pty Ltd. This was in consideration of EC Pty Ltd making no further claims for return of the funds loaned to the investors, and making no further claims for legal and consultancy fees owed to LH Pty Ltd (FPA Exhibit 16).

4.9 The FPA also asserts that the relationship between Mr. N and Mr. B was one of financial advisor and client. This relationship is not disputed by LG (Transcript p7). What is disputed is whether Mr. N had effectively excluded

the transaction over the Metro Notes from the relationship (Transcript 6-7). The FPA argues that facts set out in Part III of this determination show the inception of a financial advisory relationship in early 2005. This led to Mr. N recommending to Mr. B that he enter the Gunns investment, which he subsequently did, and making other investment recommendations to him (Transcript p 18). This is further reiterated by Mr. B in response to questioning from the Panel when he said 'He was an investment adviser. That's what I saw – he was a financial advisor so whether that be tax matters or matters in relation to investments made or tax effective investing or whatever, I saw him providing that advice.' (Transcript p 18) Further when asked by the Panel 'What did you understand Mr. N's advice to be in relation to the Metro Notes offer?' he replied 'This is a good investment, its 30 days, guaranteed, get 15% at the end.' (Transcript p18-19).

4.10 The FPA's case is that Mr. N took no steps to end, limit or exclude the Metro Notes investment from the advisory relationship with Mr. B. It is clear that Mr. B knew from the start that Mr. N was investing in the Metro Notes for his own account (Transcript p20). Mr. B's evidence was equivocal when asked if Mr. N told him to get independent financial advice, he said: 'No, I don't recall him saying that, no. I can't say he didn't but I just don't recall.' (Transcript p 20).

4.11 The documentary record however, is much less equivocal. Under FPA Exhibits tab 26 there is a bundle of emails furnished by LG which purports to show that the transaction on the Metro Notes was done by EC Pty Ltd not by LH Pty Ltd. But they start after the completion not only of the transaction in November 2005, but well after the term of investment. Even as late as 22 March 2006, Mr. N was still using the LH Pty Ltd address line. The more relevant emails are in FPA Exhibit tab 12 such as the email of Mr. N to Mr. B on 30 November 2005 at the time the investment was being arranged. This asks for the completion of the 'application for the Promissory note, and the attached loan document by close of business today' and uses LH Pty Ltd address lines. Similarly an email of 20 February 2006 in which Mr. N announces to the investor group that a higher rate of interest has been negotiated to compensate for delay, also uses the LH Pty Ltd address line

4.12 The crux of the difficulty is captured in an email (under FPA Exhibits tab 26 dated 17 August 2006) from Mr. N to Mr. B. There Mr. N states 'EC Pty Ltd will pay fees for current LH Pty Ltd Group fee paying clients.' The irresistible fact of the matter was that the investors in Metro Notes were LH Pty Ltd advisory clients, and in taking an assignment of their investments EC Pty Ltd agreed to pay amounts that in the absence of the assignment would have been paid by 'LH Pty Ltd Group fee paying clients'. That is, LH Pty Ltd advisory clients, clients for which LG has responsibility

4.13 It is clear from the evidence as a whole that Mr. B was approached at the eleventh hour to enter the investment, and that the amount required and the time-frame for deciding (Transcript p17), in conjunction with the unfamiliar nature of the investment put pressure on Mr. B (Transcript p 19). There is no documentary evidence that Mr. N ended, limited or excluded Metro Note investment from the advisory relationship at or before offering the advice. As already canvassed there is ample evidence that Mr. B continued to be advised by Mr. N in efforts to recover the investment.

4.14 The FPA also asserts that Mr. B relied on the advice from Mr. N in entering the Metro Notes investment. It is clear that Mr. B had conversations with others he knew in the group of investors about taking the Metro Notes (Transcript p 17-18). It is clear that Mr. B had some investing experience, and was not afraid to ask questions of investment advisors, and decide not to act on some recommendations. The facts of the early part of his relationship with Mr. N (querying the feasibility studies) demonstrate that he was capable of this level of independent mindedness.

4.15 But it is one thing to query and draw back from acting, and another thing to decide affirmatively to invest. Did Mr. B rely on Mr. N, or the others in the group or act on his own, in making the Metro Notes decision? The FPA asserts that Mr. B relied on Mr. N. In this the FPA points to the clear existence of a financial advisory relationship from late 2005, the acceptance of advice to enter into the Gunns investment, the fact that Mr. N bought the Metro Notes investment opportunity to Mr. B after a long period of no contact (Transcript p16-19) and that Mr. B described his relationship with Mr. N

'He was an investment advisor. That's what I saw – he was a financial advisor …I saw him as providing that advice.' (Transcript p18).

As we have noted above, the advisory relationship continued after the 30 day investment term, with Mr. N negotiating new terms to compensate for the delay, and working to get repayment of the invested funds.

That Mr. N was in Breach of FPA Rules and Ethics Requiring Integrity, Fairness and Professionalism Because he Breached His 'No Conflict' Duty to Mr. B and Failed to Disclose Benefits by the Purchase of the Metro Note by EC Pty Ltd.

4.16 As we have said already, it is the FPA's contention that the relationship between Mr. B and Mr. N was advisory. In these circumstances the FPA Ethics and Rules require a high level of disclosure when ever it is contemplated that the advisor might take a benefit from the client.

The FPA argues that in virtually no situation that is it possible to imagine, would the likelihood of conflict be greater and the duty to disclose benefits be higher, than when the advisor is buying investments from his client or causing an entity he controls to do so (EC Pty Ltd). Especially in circumstances such as this, where the advisor controls the lender of investment funds and has been the sole conduit for communication with the issuer of the investment.

4.17 The virtually uncontradicted evidence of Mr. N's transaction with Mr. B is set out in the transcript of proceedings, see initially Transcript p 7. There the FPA alleges that in July 2006 Mr. N proposed to Mr. B that he could arrange a repayment of Mr. B's loan from EC Pty Ltd (which was $150,000 of the total $375,000 investment), if Mr. B assigned to him the rights in the Metro Notes. In short the agreement was that EC Pty Ltd would take the Metro Notes with a face value of $375,000 from Mr. B for $150,000. The documentation of this offer which Mr. B accepted was a letter (undated) from Mr. N to Mr. B on EC Pty Ltd letterhead (FPA Exhibits tab 16). It seems this letter was sent in July or early August 2006. A salient paragraph in that letter which bears on the question discussed above of whether an advisory relationship existed between Mr. N and Mr. B reads:

'these arrangements have been extended to the private clients of LH Pty Ltd Group Pty Ltd and these terms and conditions are only applicable to those clients whose management fees are fully paid. We formally confirm payment of your management fees to 14 March 2007, and further confirm your private client status is fully paid up to this date.'

4.18 The FPA argues that Mr. N had a persisting advisory relationship with Mr. B, as a representative of LG when this offer was made and accepted. The FPA argues that in taking the assignment of the Metro Notes from Mr. B Mr. N should have disclosed his own interest in the Metro Notes and the benefits (e.g. fees and commission, ability to redeem the Metro Notes from Mr. B at a value higher than $150,000) that he would receive, at least in relation to those notes he purchased from Mr. B.

The FPA alleges that Mr. N made no such disclosure to Mr. B. It alleges that failure to disclose was a breach of the FPA Ethics requiring conduct that observes a high standard of honesty and integrity (Ethic 1), fairness and reasonableness (Ethic 4) and professionalism (Ethic 6). The standard of conduct set by these Ethics is discussed in Part VI of these reasons.

Subsequent to the hearing and the first version of this determination, Mr Ahearne in a letter of 11 September 2009, pointed out that we had overlooked a deed of assignment that was entered by Mr. B and Great Western Long Term

Investments Limited on 17 May 2006. This document, in unsigned form, was part of the FPA Exhibits at Tab 26 at the hearing but neither party drew the document to the CRC's attention as relevant to its arguments.

The CRC questioned Mr. B about this document in September 2009. He agrees that he did sign the deed of assignment. However, he says that it was never performed. Great Western Long Term Investments Limited did not pay any of the $150,000 that is provided for in the deed. Mr. B did not endorse over the Metro Notes i.e. no title to them passed to Great Western Long Term Investments Limited. The deed was rescinded by the breach of Great Western Long Term Investments Limited in not paying the $150,000, which Mr. B accepted. That leaves both Mr. B and Mr. N in position where they could enter into the subsequent assignment arrangement of August 2006. We have therefore come to the conclusion that the fact of entry to the deed of assignment of 17 May 2006 makes no difference to the reasoning in this determination on the question of whether Mr. N should have made full and frank disclosure to Mr. B before entering the subsequent assignment agreement in August 2006.

That Mr. N was Negligent in Advising Mr. B to Enter the Investment in the Metro Notes Without Securities Research and a Suitable Financial Strategy

The FPA offered no evidence in support of this breach.

That Mr. N Failed to Make a Number of Other Disclosures to Mr. B.

4.19 The FPA alleged that Mr. N failed to make other disclosures to Mr. B which the FPA alleges were required under the FPA rules, as a result of there being an advisory relationship between Mr. N and Mr. B. While the existence of an advisory relationship in relation to the Metro Notes was strongly contested, that Mr. N had failed to make the required disclosures, was not contested.

B. In Relation to LG Directly as Principal Member

4.20 The FPA makes two main allegations against LG:

1. That under Rule 132 LG is responsible for the conduct of Mr. N as its representative. The significance of this is that in determining whether the principal member has complied with the FPA Ethics and Rules, the conduct of the representative shall be treated as if it were that of the principal member.

2. That LG has failed to maintain an effective system of supervision of Mr. N's activities as required by Rule 135.

4.21 The FPA argues that on the words of Rule 132, LG is responsible for the conduct of Mr. N. Its position is that Mr. N was authorised by LG to conduct financial planning business as a representative under LG's Australian Financial Services Licence, and under the authorised representative agreement entered by both parties.

4.22 The FPA accepts the evidence that LG had no knowledge of the offer to Mr. B of the Metro Notes, investments not on LG's authorised products list. It also accepts that LG received no direct financial advantage, such as commission, from that transaction involving LH Pty Ltd and Mr. B. It nevertheless maintains that Mr. N through LH Pty Ltd gave financial planning advice to Mr. B which related to the conduct of LG's financial planning business and that under the FPA Ethics and Rules the acts of Mr. N should be vicariously attributed to LG.

4.23 In relation to Rule 135 the FPA alleges that there were deficiencies in the supervision of Mr. N's activities by LG. The allegation is that there were significant breaches of the FPA Ethics and Rules by Mr. N, and that these occurred because of the failure of LG to maintain an effective system of supervision of LH Pty Ltd. In particular there were deficiencies in the system of supervision of authorised representatives that had more than one professional designation – financial planner as well mortgage broker and factor for structured finance products – and that because of FPA Ethics and Rules 135 and especially since the recent decision in *Newman v Financial Wisdom* [2005] VSCA 110; [2004] VSC 216 discussed below, LG should have been more alive to providing effective supervision in this area.

V. THE MEMBER'S POSITION

A. In Relation to Mr. N for Which LG Denies Vicarious Liability

Denial that in the Course of an Ongoing Advisory Relationship Mr. N Made Misleading Statements to Mr. B in Relation to the Investment in the Metro Notes.

(i) Was There an Ongoing Advisory Relationship?

5.1 The crucial question which we address next, is whether there was in fact an advisory relationship in relation to the Metro Notes between Mr. B and Mr. N, (and hence liability in LG) at the time the statements were made and the advice given by Mr. N.

LG does not deny that generally there was an advisory relationship between Mr. N and LH Pty Ltd and Mr. B from May 2005 until well into 2006 (Transcript p33-34). Further LG accepted that in November 2005 there was a persisting financial advisory relationship between Mr. B and Mr. N that came under the LG proper authority (Transcript p33-34). They had received commission from the advisory relationship between Mr. N and Mr. B following Mr. B's entry to the Gunns investment earlier in the year (Transcript p 36).

5.2 What LG does dispute is that the advisory relationship between Mr. B and Mr. N was such that it included the recommendation to Mr. B that he invest in the Metro Notes. Both Mr Ahearne for LG and Mr. B described the investment in the Metro Notes as 'self standing' to capture this idea. This was put in a number of ways.

5.3 First Mr Ahearne pointed to an argument set up by a letter dated 13 February 2009 from Mr. N to him (Transcript p38-9). That argument is that the Metro Notes were not a 'financial product' under the definition of that term in the Corporations Act. In the letter Mr. N asserts that he dealt with Mr. B on the basis that he was not entitled to the protection of Chapter 7 of the Corporations Act because the Metro Notes were offered by an unregistered scheme under section 601ED(1) of the Corporations Act. If that were the case the argument seems to go, Mr. B is not entitled to the quality of customer disclosure and other requirements that Chapter 7 of the Corporations Act mandates for retail investors. This takes Mr. B outside the advisory relationship that LG acknowledged existed more generally.

5.4 Second Mr Ahearne gave evidence that Mr. N had excluded the Metro Notes from the advisory relationship with Mr. B by informing Mr. B that the issue of the Metro Notes was a wholesale offering. He relied on a letter addressed to LG on 31 July 2007 from Mr. N (LG Exhibit bundle under letter dated 8 September 2008), in which Mr. N says of the Metro Notes 'this was a wholesale offering and was outside of my activities as a Proper Authority holder of LG Securities Pty Ltd' (Transcript p 28-30).

5.5 He drew to the Panel's attention a letter on 'EC Pty Ltd Group' letterhead, in which Mr. B signs in agreement that he is being offered the Metro Notes under one of the categories of s761G(7) of the Corporations Act – the category that allows 20 offers to be made in 12 months, without a full prospectus having to accompany the offer (FPA Exhibit Tab 21 last document in the bundle). The letter is not dated by the authors, but seems to have been sent to Mr. B and is endorsed at the top as follows: '24/01/2006 13: ABC HEAD OFFICE > 093752251'. This date strongly suggests that it was received by Mr. B nearly two months after the investment in Metro was made. The letter is headed

'Investor Category Wholesale Offering'. Mr Ahearne's submissions relied on the letter to support the argument that Mr. B was a wholesale customer, and did not have to be offered the protections of a retail customer. Or put another way, that his becoming a wholesale customer created a limitation on or exception to the advisory relationship between Mr. B and Mr. N, and hence LG's vicarious liability for Mr. N's acts. We take up this question again in the discussion of legal issues in Part VI of this determination and come to a conclusion in Part VII.

5.6 Thirdly, pursuing further the argument that there was no liability inducing advisory relationship between Mr. B and Mr. N in relation to the Metro Notes, LG also relies on a large bundle of emails from Mr. N to Mr. B and others in the group who invested in the Metro Notes. These all used EC Pty Ltd address lines, not those of LH Pty Ltd. LG argues it was EC Pty Ltd that was the relevant financial intermediary in the advisory relationship with Mr. B on the Metro Notes, not LG's authorised representative Mr. N through LH Pty Ltd.

5.7 A parallel argument made by LG is that Mr. B was one of a group of investors that were co-venturers with Mr. N in entering the investment in the Metro Notes. Mr Ahearne said:

'this was a collaborative group of associated people who were all getting involved in this private investment scheme. They entered into it, it wasn't on our APL, they were co-venturers, they spent time pre-analysing the venture and it wasn't, certainly wasn't anything that we would ever have approved…' (Transcript p35)

Chiming in with this is Mr. B's own statement:

'my understanding was that we were all co-investors in one note including Mr. N.' (Transcript p15)

5.8 The trouble with this argument is that it is contradicted by other facts. First, the documents demonstrate that Mr. N was contracted as a distributor to find investors on commission, but that offers were to be made by investors individually and accepted by the issuer company (FPA Exhibits tab 10). The notes were issued to individual investors for the amount of their invested funds, in Mr. B's case, $375,000. The note contains no terms which suggest that the notes were held jointly or severally, and the note has only one subscriber, Mr. B (FPA Exhibits tab 11).

5.9 Mr. B mentioned a document bought into existence during the phase of negotiations to try to recover the investment, which showed the proportionate amounts for costs and fees, to be borne by each investor introduced by Mr. N. The schedule was sent to all the investors in the group including Mr. B, by Mr. N, attached to an email dated 17 August 2006 (FPA Exhibits tab 26). While this document is capable of suggesting an inference that the group was investing jointly because the legal fees are calculated as a percentage of the pool of funds being put by the Mr. N investors into the notes, there may be other equally rational interpretations. The trouble for LG is that the documentary record clearly shows that the note issued to Mr. B was his and his alone. While Mr. N may have treated the investors he introduced to the issuer as a 'job lot' in terms of getting them legal services etc., there is no other contemporaneous evidence to contradict the documentary record that each investor invested separately.

5.10 Finally, Mr Ahearne argued that the terms of Mr. N's Authorised Representative agreement with LG meant he was not authorised to advise Mr. B in relation to investments such as the Metro Notes. Mr Ahearne pointed out that the Metro Notes were not on LG's Authorised Product List (APL), and never would be – one sign of the fact that the agency between LG and Mr. N was limited. Mr Ahearne went on to point out that it must be absurd to contemplate that giving someone agency to do a certain function, bound the principal in relation to all possible functions of that sort. He put this memorably when he said:

'You empower me to go and buy the house next door to you and I come back and say I didn't get it but I bought you a sheep station in the Northern Territory' (Transcript p 28)

That, he argued, involves stepping outside the agency relationship. By analogy here, LG should not be responsible for Mr. N's conduct in relation to Mr. B. He also pointed out that Mr. N had gone to some lengths to 'disconnect and to quarantine his activities under EC Pty Ltd' from LG (Transcript p 28).

(ii) Did Mr. N Make Misleading Statements to Mr. B About the Metro Notes Investment?

5.11 Much of the evidence given by Mr. B is not disputed by LG. Indeed Mr Ahearne at one point in the evidence said: 'It's not my part to seek to defend this investment or this venture because it looks to be pretty dreadful. It wasn't on our approved product list, we would never approve such an investment.' (Transcript p 28).

5.12 Mr Ahearne said (Transcript p44) that that statement attributed to Mr. N 'It's so fantastic, he would guarantee it himself...is inconsistent with the way I've heard him [Mr. N] speak about the financial planning industry.' Otherwise there was no real attempt by LG to deny that statements about the Metro Notes alleged by Mr. B to have been made to him by Mr. N, were in fact made. Unfortunately for LG, much of the documentary record which we have outlined above supports Mr. B's evidence. Further, LG did not resist the FPA's allegations that Mr. B relied on Mr. N's representations about the safety of the Metro Notes as an investment. Indeed Mr. B's oral evidence and other evidence of the circumstances at the time of the making and failure of the investment, do not provide substantial grounds for demonstrating that Mr. B acted independently.

That Mr. N was in Breach of FPA Rules and Ethics Requiring Integrity, Fairness and Professionalism Because he Breached His 'No Conflict' Duty to Mr. B and Failed to Disclose Benefits in the Purchase of the Metro Notes by EC Pty Ltd.

5.13 LG sought to resist this allegation of breach by bringing many arguments evidential and legal to show that the relationship between Mr. N and Mr. B was not advisory in relation to the Metro Notes. If that argument is successful the relationship is then not fiduciary, and the prohibition on not contracting with your client falls away. So does the requirement to disclose benefits that might flow from purchasing investments from your client.

We have already pointed out that the factual record evidencing the client relationship, makes resisting this argument that the relationship was advisory and fiduciary difficult to sustain. We consider the legal aspects of it in Part VI below and conclude in Part VII.

As to whether the negotiations and transactions for Mr. B to assign the Metro Notes to EC Pty Ltd occurred, the evidence leaves very little doubt. Mr Ahearne made no attempt to deny that the assignment from Mr. B to EC Pty Ltd had occurred. He also did not attempt to show that Mr. N had made required disclosures of benefits to Mr. B.

That Mr. N was Negligent in Advising Mr. B to Enter the Investment in the Metro Notes Without Securities Research and a Suitable Financial Strategy

5.14 The FPA offered no evidence in support of this breach. There was therefore no need for LG to respond.

That Mr. N Failed to Make a Number of Other Disclosures to Mr. B.

5.15 It was not contested that Mr. N failed to make other disclosures to Mr. B which the FPA alleges were required under the FPA rules though the fact of an advisory relationship was contested.

B. In Relation to LG Directly as Principal Member

Denial That the Conduct of Mr. N Should be Attributed to LG Under FPA Ethics and Rules 132.

5.16 LG argued on several bases, that the conduct of its representative LH Pty Ltd should not be attributed to it as Principal Member. First it indirectly argued that for the conduct of Mr. N to be attributed to it, it was necessary that the conduct involve a 'financial product' as defined by the Corporations Act. The essence of the argument seems to be that the FPA Ethics and Rules should be read down to the same compass as the Corporations Act, and that LG are not liable for conduct effecting transactions not the subject of 'financial products' so defined. The investment in the Metro Notes it is implied, is not an investment in a 'financial product' and LG is not liable for Mr. N's behaviour in relation to it. This is primarily a legal argument and we deal with it in section VI of these reasons.

5.17 The second and related reason given for resisting attribution of Mr. N's conduct to LG is that the transaction with Mr. B was not one 'which relates to conduct of the Principal member's financial planning business' in FPA Ethics and Rules 132. This too, is primarily a legal argument and we also deal with this further in section VI below. LG argues that the Metro Notes are not an 'interest in a managed investment scheme' that required registration and therefore not a 'financial product'. The argument seems to proceed further that not being an investment in a 'financial product' it is not within LG's Australian Financial Services Licence, and consequentially not one 'which relates to conduct of the Principal member's financial planning business.'

5.18 The third reason LG argue that in principle that they should not be vicariously liable for Mr. N, is that it concerns conduct which they could not supervise despite best practice compliance arrangements nor have any knowledge of or control over. It is not disputed on any side that LG had no actual notice that Mr. N was making recommendations to clients of interests in the Metro Notes. It is also not disputed that LG received no commission for the sale of this investment, nor that the investment would ever have made it onto LG's list of authorised investments. Once again, this point depends mostly on a legal analysis, and we address this question too, in section VI below.

B. Denial That LG Failed to Supervise Mr. N Effectively.

5.19 An important legal argument about the interpretation of FPA Ethics and Rules 135 which also applies to FPA Ethics and Rules 103, has to be considered at the outset of dealing with this issue. This is whether the words of both rules should be interpreted to allow a reasonableness standard or objective standard related to industry practice to apply. The words of FPA Ethics and Rules 135 require a Principal member to 'maintain an effective system of supervision'. Should that be interpreted to require a Principal member to 'maintain a *reasonably* effective system of supervision'? As this is primarily a legal argument, as before we deal with this in section VI below.

5.20 LG brought evidence to demonstrate that it had created, implemented and continuously maintained a system to supervise Mr. N effectively. LG had a number of employee representatives, but its only external authorised representative was Mr. N . LH Pty Ltd had Mr. N as principal using a well appointed serviced office, with no permanent staff and LH Pty Ltd did not hold client funds, not did it advertise (Transcript p 46-48). LG relied on considerable documentary evidence that it had established supervision and compliance arrangements to ISO 9000 Quality Standards. It had Tribeca and later Paragem assist with the establishment of the arrangements. This seems to have been achieved in about November 2004. A year before the transaction between LH Pty Ltd and Mr. B.

Under its supervision system LG conducted internal audits of Mr. N. Although LG's Policy Document '4. Monitoring, Supervision & Training of Representatives & Staff' (LG Exhibits under letter 12 February 2009) provides on page 4 at (b) that Tribeca will monitor LG representatives 'through regular formal compliance reviews' no evidence of this external review ever having been undertaken, was supplied. The internal audits of Mr. N were performed by Mr Ahearne, and they gave Mr. N a result of 'compliant' for each of the years of 2004-2008 (Audit reports in LG Exhibits under letter 12 February 2009). The audit reports show that until Mr. B and his fellow investors complained, there were no complaints against Mr. N. Financial planning files were kept separately from the files of the other affairs of Mr. N, conducted through EC Pty Ltd. Mr Ahearne commented in evidence to the CRC that 'within the work that we authorised Mr. N to operate within he conducts himself very well.' (Transcript p47).

5.21 LH Pty Ltd used a Financial Services Guide (FSG) provided by LG. Mr Ahearne confirmed this when questioned by the CRC (Transcript p31 and 47). The FSG was preceded by a four page document descriptive of the LH Pty Ltd group and the services it offered. Mr Ahearne confirmed (Transcript p 32) that he was aware that Mr. N used the four pages which describe a wide range of services related to financial planning provided by or through referrals from LH Pty Ltd.

5.22 Mr Ahearne told the CRC that he had regular 4-6 weekly conversations with Mr. N about the conduct of business undertaken by Mr. N for LG. Those meetings also ranged as far as discussions about Mr. N's efforts to develop a business in structured finance. The thrust of these discussions was to assure Mr Ahearne that Mr. N's structured finance activities were as he put it 'business to business' (Transcript p51). Also that there was no practical likelihood that they would be offered to the advisory clients Mr. N had through the LG representation (Transcript p53-54).

Because of this, and the fact that it was axiomatic in the running of LG that advisory clients could be offered only those investments on the LG APL (Transcript p62-63) there were no processes or mechanisms in LG's supervisory system to address compliance with this requirement in LG's system of supervision. Mr Ahearne considered the APL requirement so elemental that it had not been thought to include a question on the internal audit regarding whether the representative had complied. To him it was as axiomatic that Mr. N would not offer non-APL investments as it was that Mr. N would not defraud LG's clients. He believed that Mr. N thought the same thing.

VI. RELEVANT LEGAL ISSUES AND RULES

Were There Legal Reasons to Conclude That the Ongoing Advisory Relationship Between Mr. B and LG Did Not Extend to the Metro Notes?

6.1 LG argued on a number of legal grounds that Mr. N created an exception or limitation to his advisory relationship with Mr. B that excluded the Metro Notes. It is now appropriate to turn to the legal arguments that were bought forward to support this position.

(i) Is it necessary to have a 'financial product' before the FPA Rules and Ethics apply?

Although the argument was not put in exactly this way by Mr Ahearne, when he asserted that the scheme offering the Metro Notes was within S601ED(1) of the Corporations Act, he was really arguing that interests not within the definition of 'financial product' under the Act, could not be the basis of an advisory relationship under the FPA Ethics and Rules. By 'financial product' LG must mean that term as defined in sections 762A, 763A and 765A of the Corporations Act.

6.2 By contrast the words of the FPA Ethics and Rules do not restrict their operation by reference to such a term. Instead the FPA Ethics and Rules demonstrate variable scope, depending on their subject matter. So for example, FPA Ethics and Rules 101 contains a wide prohibition on members engaging in misleading, deceptive, dishonest or fraudulent acts 'in the conduct of professional and business activities'. This has an application wider than just financial planning business. Some other rules, for instance some requiring disclosure (e.g. FPA Ethics and Rules 106-08), require there to be a 'recommendation' made or in prospect, before the rule requires members to make disclosure etc. We discuss what we think a 'recommendation' is, in more detail below. It is only FPA Ethics and Rules 132 under which a principal member may become responsible for the conduct of its representative, which limits the principal member's responsibilities by reference to the 'conduct of the Principal member's financial planning business'. Not even the requirement on a Principal member to effectively supervise its representatives in FPA Ethics and Rules 135 contains this limitation – its terms are far wider.

6.3 Having considered this variation in the extent of the FPA Ethics and Rules we consider there is no justification on their terms, to impose an umbrella definition such as that found in 'financial product' in the Corporations Act, to limit the operation of FPA Ethics and Rules. This conclusion is in line with the approach taken by Finkelstein, J. in *Deakin Financial Services v Financial Industry Complaints Service Ltd* (2006) FCA where the interpretation of the rules of a private financial industry dispute resolving body were at issue. If anything the rules of the Financial Industry Complaints Service (FICS) demonstrate a stronger case for being aligned with the meaning of Corporations Act terms, since FICS was drawn into the Corporations Act regulatory regime by acting as the external dispute resolution body for the applicant under section 912A(2) of the Act. The Federal Court however, gave the FICS rules an ordinary (and wider) meaning than those in the Corporations Act. The CRC has adopted this approach in another determination where the requirement of having a 'financial product' was raised, and it sees no reason to depart from the reasoning there, in this case. We conclude that the same approach should be taken with the FPA Ethics and Rules here and that a 'financial product' as defined by the Corporations Act is not required to found an advisory relationship under the Rules.

6.4 Though we have concluded that the FPA Ethics and Rules apply more widely than the definition of 'financial products' in the Corporations Act, it is still necessary to say what we think the relevant boundaries are. For the FPA Ethics and Rules that are germane to this case there are two terms which are defining: first, the term 'recommendation' (FPA Ethics and Rules 106-09) and second what it means to say that the behaviour of an authorized representative 'relates to conduct of the Principal member's financial planning business' (FPA Ethics and Rules 132). We deal with this second question later, and turn

now to whether there was a 'recommendation'. We also consider some other arguments raised in an attempt to demonstrate that the Metro Notes transaction did not fall within a current advisory relationship between Mr. B and Mr. N.

(ii) When is a recommendation made?

6.5 The FPA Ethics and Rules speak of an advisor making a 'recommendation' (e.g. in FPA Ethics and Rules 106-109). Many obligations flow from the making of a recommendation, particularly disclosure obligations. These are in issue in this case. However, the FPA Ethics and Rules do not clarify what a recommendation is, and when it is made.

6.6 Applying Justice Finkelstein's approach in *Deakin Financial Services v Financial Industry Complaints Service Ltd* (2006) FCA we give the meaning of 'recommendation' in the FPA Ethics and Rules its ordinary meaning and not the highly technical meaning provided for in S766B of the Corporations Act. The Oxford Dictionary Online defines the verb 'recommend' is to:

'Put forward [advice] with approval as being suitable for a purpose or role. Advise as a course of action'

The derived noun, 'recommendation', would have a corresponding meaning.

6.7 It seems to us that the FPA Ethics and Rules provide for information seeking about the client, product research and analysis and disclosure upon the making of a 'recommendation' in a fashion consonant with this meaning. For example, FPA Ethics and Rules 108 and 109 require information seeking about the client and research. We think this is so that 'the [advice] put forward with approval' is 'suitable for a purpose or role' identified by the client as their financial planning goal. It also occurs to us that financial planning is far wider in its application then mere recommendations made on financial products. For example, it may include advice and recommendations on estate and business planning, lending, debt management and reduction and numerous other strategies that fall outside the definition of a financial product recommendation within the Corporations Act.

6.8 Therefore we conclude that a 'recommendation' is made under the FPA Ethics and Rules when a financial adviser puts forward advice with approval as being suitable for the client's financial planning purposes. There does not seem to be very much doubt on the facts that Mr. N got in touch with Mr. B and recommended the Metro Notes to him. The questions we tackle below are whether there are any other legal grounds on which the Metro Notes

transaction might fall outside the advisory relationship continued by this recommendation.

(iii) Was the Offer of the Metro Notes to Mr. B a 'Wholesale Transaction' that Makes the Transaction Non-Advisory?

6.9 Mr Ahearne drew our attention to a letter on 'EC Pty Ltd Group' letterhead (FPA Exhibit Tab 21 last document in the bundle), in which an attempt was made to qualify Mr. B as a lawful participant in a wholesale offering for the Metro Notes. Mr. B signs in agreement that he is being offered the Metro Notes under one of the categories of s708 of the Corporations Act – the category that allows 20 offers to be made in 12 months, without a full prospectus having to accompany the offer. The letter is not dated by the authors, but seems to have been sent to Mr. B in early 2006 and is endorsed at the top as follows: '24/01/2006 13:17 ABC HEAD OFFICE > 093752251'.

6.10 Mr Ahearne argued that the signing of this letter by Mr. B made him a wholesale investor in a sense that took him outside the FPA Rules. The thrust of the argument is that as a wholesale investor he is not a 'retail customer' under s761G and 761GA of the Corporations Act. Therefore he should not enjoy the protection of the FPA Ethics and Rules as these are also intended for the protection of retail clients. Mr Ahearne also relied on this as further weight to his contention that Mr. N had taken sufficient steps to 'quarantine' the Metro Notes transaction from the pre-existing advisory relationship. Therefore it was suggested, the offer was outside the authority given by LG to Mr. N. Following this reasoning it was also outside the FPA Ethics and Rules, since it could not be a 'recommendation' or within FPA Rule 132. Rule 132 requires that the behaviour of the authorised representative be such that it 'relates to conduct of the Principal member's financial planning business'. As already anticipated we consider this last point below. Here we concentrate on the idea that by signing the declaration Mr. B fell within the 20 offers in 12 months exception in s708 Corporations Act and outside the FPA Ethics and Rules by involving him in a wholesale offer.

6.11 The legal difficulty in Mr Ahearne's argument is twofold. First, the point of the 20 offers in 12 months rule in s708(1) and (2) Corporations Act has nothing to do with whether an investor is retail or not. It is to provide an exception to the provision of a prospectus, or one of the other disclosure documents required by Part 6D of the Corporations Act, when offers of securities are made to the public. By signing the letter Mr. B agreed that he would qualify for one of the 20 offers to be made by the issuer in 12 months. In fact the very wording of the letter shows this. After a paragraph starting 'To qualify as a wholesale client…' in which an attempt to deal with this is made the letter continues in the next paragraph 'In addition…" the investors will have to fall within one of the exceptions to section 708 – i.e. they will *also* have to fall into a category that does not require a prospectus. It is the latter

acknowledgement that Mr. B made. He agreed to do without a prospectus, but he did not become a wholesale investor.

6.12 He did not become a wholesale investor and give up his retail client status because the law does not allow him to. To give up retail client status is possible by several routes, but Mr. B did not qualify for any of the likely ones. He was not a professional investor (s761G(7)(d) CA), and he did not provide an accountant's certificate certifying sufficient net assets or annual income to qualify as a substantial investor (s761G(7)(c) CA). Mr. B gave evidence that his income and assets would not have qualified him for this category (Transcript p 23-24). Further, Mr. N did not qualify Mr. B as sophisticated under s761GA CA, and Mr. B gave evidence that he had not invested in instruments like the Metro Notes, before or since (Transcript p 24).

6.13 In conclusion then, the letter Mr. B signed, and on which Mr Ahearne relied, does not have the legal effect of taking Mr. B out of the retail client definition for the purposes of the Corporations Act. It only protects the issuer of the Metro Notes from liability for failing to provide a prospectus. While as we have already said the FPA Ethics and Rules have a scope different to the Corporations Act, we see no compelling reason to exclude from the protection of the FPA Ethics and Rules an individual in an existing advisory relationship who has received a 'recommendation' from an adviser, where the individual is a retail client under the legislation. There may be good reasons to exclude from the FPA Rules someone who is not a retail client under the legislation, but the conclusion we have arrived at about Mr. B's retail client status means we do not have to consider that question here. The legal position is that simply by signing the letter received in February 2006 Mr. B did not lose his retail client status. This part of Mr. N's attempt to 'quarantine' the Metro Notes transaction from the wider advisory relationship failed, and the FPA Ethics and Rules applied.

(iv) What Steps Were Required to Create a Legally Effective Exception or Limitation to the Advisory Relationship Between Mr. N and Mr. B?

6.14 Mr Ahearne also argued that Mr. N had taken steps which together constituted creating an exception or limitation to the advisory relationship between Mr. N and Mr. B. This argument must be considered both as a matter of the facts, and as a matter of law. We have already reviewed the evidence and in relation to the use of address lines and other identifiers in written correspondence, we have expressed doubt as to whether it was at all clear that Mr. N had in any sense withdrawn from the advisory relationship at the time of the Metro Notes offer. At best the emails, the FSG, the letter correspondence and the account of conversations, leaves serious doubt as to whether the advisory relationship had been limited in relation to the Metro Notes.

That raises the question of what the general law, and the FPA Ethics and Rules in particular, require to create and exception or limitation to an advisory relationship.

6.15 It is likely that the exception or limitation would have to be created by steps reasonable in the context of the relationship between the parties. So if the advisory relationship had been very informal and created by a pattern of repeated conduct with no writing, it would be effective to limit or terminate the relationship orally and with little notice. Where, as in this case, the advisory relationship was created more formally and was in writing, it will usually be necessary to limit or terminate the advisory relationship also in writing. Indeed, paragraph 7 of the 'terms of business' delivered with the LG FSG (FPA Exhibit 4) expressly provide that writing was required for Mr. B to terminate Mr. N's services, indicating the level of formality required for changing the arrangements between the parties. This is against the background that the FPA Ethics and Rules require that a member

'At the earliest point in the relationship…disclose *in writing* to the client …any other limitation of their capacity to serve the client.' (FPA Rules and Ethics 105).

For these reasons we conclude that writing was required to limit or terminate the advisory relationship between Mr. N and Mr. B.

6.16 There is nothing in any of the written evidence we have seen that limits the scope of the advisory relationship between Mr. B and Mr. N in a fashion that excludes the Metro Notes transaction. Indeed as we have observed already in discussing the facts there is plenty of evidence at the time of the transaction which suggests that the advisory relationship was in full swing. It is only after the default on repayment that Mr. N changed his address lines and asked Mr. B to acknowledge his status as a 20 offers in 12 months investor under s708 Corporations Act. We do not think any of this rises to the description of written disclosure to Mr. B that sufficed to give him informed consent to the creation of an exception to or limitation on the advisory relationship.

Was the Advice Mr. N Gave Mr. B 'Misleading'?

6.17 Rule 101 prohibits acts or omissions of a 'misleading' nature. By contrast with the functionally identical prohibitions in the Trade Practices Act (s52) and Australian Securities and Investments Act (s12DA) the FPA rule does not prohibit conduct 'likely to mislead'. It follows that conduct which has caused confusion or uncertainty in the minds of clients will not alone be enough to mislead. However, circumstances which do induce confusion or uncertainty are very much more likely to result in misleading conduct being relied upon,

and loss occurring. They are also more likely to allow proof that conduct was objectively misleading.

6.18 The FPA rule is silent about whether intention to mislead is required. Following the interpretation of the TPA and ASICA provisions, and because of the burden of proving intent, the CRC considers it appropriate that a breach of Rule 101 is not confined to conduct which is intentional, but that a member acting honestly may nonetheless engage in misleading conduct.

6.19 Generally for conduct to be misleading there must be a representation or conduct amounting to a representation (e.g. silence which allows a misunderstanding to persist) inducing error or misconception. The other person must rely on that conduct. It is possible for factually true statements to be misleading if the associated circumstances contribute to error or misconception. In the same way, silence may be misleading. A misrepresentation made in one part of a document, or the oral and documentary record of a transaction as a whole, may still mislead even if corrected in another part, but where it is unlikely that the average client would look or make the connection back to the original misstatement. This is a danger in long, complicated documents, and one reason why ASIC has connected the failure to be 'clear, concise and effective' with liability for misleading conduct.

6.20 Predictions are a fertile ground for misleading conduct unless reasonably based and properly explained. This is relevant to this complaint. Mr. N represented to Mr. B that the investment in the Metro Notes was virtually risk free. In evidence it was not seriously contested that Mr. N said to Mr. B:

"This investment is so safe I'll guarantee it myself. You can make 15% in 30 days"

"At the end of the 30 days the investment plus the 15 percent will be returned to you."

and

when asked by the Panel 'What did you understand Mr. N's advice to be in relation to the Metro Notes offer?' he replied 'This is a good investment, its 30 days, guaranteed, get 15% at the end.' (Transcript p18-19).

To make predictive statements like this, the law requires that the maker have reasonable (objective facts and defensible assumptions) grounds to make the statement. The question which we address in Part VII below is whether on the

facts Mr. N did have reasonable grounds to make the statement, and whether Mr. B relied on it.

What is the Meaning of the FPA Rules and Ethics Requiring Honesty and Integrity (Ethic 1), Fairness and Reasonableness (Ethic 4) and Professionalism (Ethic 6)? Do They Require an Advisor Not to Breach His 'No Conflict' Duty to Clients and to Disclose Benefits in Dealing With Clients?

6.21 FPA Ethic 1 requires FPA members to observe 'honesty and integrity' in conducting their financial planning business, and in the provision of financial planning services. We think 'honesty' requires FPA members to be candid in their business and professional work, and to refrain from saying or appearing to do one thing, while in fact doing something antithetical. In this sense Ethic 1 clearly requires FPA members not to act fraudulently and not to make deliberately false statements. There is no evidence before the CRC that Mr. N or LH Pty Ltd acted fraudulently or deceitfully. Therefore we do not find that Ethic 1 was breached by fraud.

6.22 'Integrity' is slightly different though related to 'honesty'. The Macquarie Dictionary defines integrity as the state of being 'whole, entire or undiminished' or 'unimpaired or in perfect condition'. Integrity as a concept has to do with perceived consistency of actions, values, methods, measures, principles, expectations and outcomes. So if there was an advisory relationship between Mr. N and Mr. B, integrity requires that Mr. N wholly, entirely or consistently treat Mr. B as a client. Interpreting the FPA Ethics and Rules against the background of general law principles where applicable, the finding that the relationship was advisory, imports that it was fiduciary i.e. that Mr. N had a duty not to take undisclosed financial benefits arising from his relationship with his client. In other words Mr. N had a duty, which he had to observe with integrity (or consistency) to put his client Mr. B first. Mr. N could not diminish Mr. B's position as a client by taking benefits from the relationship himself. The only way that Mr. N could alter or avoid this duty to put Mr. B's interests first, was by full and frank disclosure to Mr. B and obtaining Mr. B's informed consent.

6.23 So integrity can only be observed by discerning what is right and wrong, acting on what you have discerned even at personal cost and saying openly to the client that you are acting according to your assessment of right and wrong. So it is not enough to tell a client that you are taking an assignment of their failed investment. Acting with integrity requires that you explain your obligation to put the client first, and seek consent to act otherwise. In doing so an advisor must disclose in detail the nature and extent of the benefits they expect to take from the transaction. In other words the disclosure must not only be full, it must also be frank. All an advisor's acts must be consistent with the fiduciary and beneficial quality of the advisory client relationship, in order to satisfy the requirement of integrity.

6.24 FPA Ethic 4 requires members to provide financial planning services in a manner that is 'fair and reasonable'. We think that against the advisory and fiduciary context of most financial planner's client relationships, fairness means that FPA members must be even handed or equitable to their clients so that the client relationship is free of bias or prejudice in favour of the planner. Again it means that the FPA member must put his or her client first.

Reasonable implies that the standard of fairness must be one that an ordinary person with a normally developed morality and common sense of what is decent commercial conduct, would think was fair.

6.25 FPA Ethic 6 uses the word 'discredit' which the Macquarie Dictionary says means to 'injure reputation or esteem' or 'to destroy confidence in'. There is overlap with the word 'disrepute'. In a prior determination, after much discussion, the CRC concluded that for an FPA member's conduct to discredit the profession of financial planning, a member's conduct would require some 'moral deficiency' or be 'grossly inappropriate'. We adopt this meaning for this determination as well.

When is the behaviour of an authorized representative such that it 'relates to conduct of the Principal member's financial planning business' (FPA Ethics and Rules 132).

In what is set out above we have concluded that as a matter of law none of the behaviour of Mr. N towards Mr. B that LG argued had created a limitation on or exception to the advisory relationship was effective to do that. But what of the wider argument that the nature of the Metro Notes transaction was outside not just those particular advisory circumstances, but the authorized representation from LG to Mr. N? Or put another way, what are the limits of the vicarious liability of LG as principal for the acts of Mr. N?

(i) Were the Metro Notes Issued Under a Scheme but not 'Related to LG's Financial Planning Business'?

6.26 As we have said, some of the FPA Ethics and Rules depend on there being a 'recommendation' made. The operation of FPA Ethics and Rules 132 (which imposes vicarious liability for Mr. N on LG) by contrast, depends on the conduct of the representative being that 'which relates to conduct of the Principal member's financial planning business.' LG has made a number of arguments to support its general contention that Mr. N's conduct should not be attributed to them under FPA Ethics and Rules 132. We address these as follows.

6.27 The first argument is really a more detailed reprise of the requirement for a 'financial product' which we have considered already, but from a different standpoint. Instead of a blanket requirement that all the FPA Ethics and Rules are limited by the requirement for a 'financial product' recommendation to have been made, this version argues that the investment in the Metro Notes was an investment in a 'managed investment scheme', to which none of the three conditions in S601ED CA applies, and again not a 'financial product'.

6.28 Not much is required for a 'scheme' to be established. Mason J in *Australian Softwood Forests Pty Ltd v Attorney-General (NSW); Ex rel Corporate Affairs Commission* [1981] HCA 49; (1980) 148 CLR 121, 129 said "all that the word "scheme" requires is that there should be "some programme, or plan of action". These words were recently cited by Justice Finkelstein in *Financial Services Industry Complaints Service v Deakin Financial Services Pty Ltd* [2006] FCA 1805 where he was considering whether a promissory note issued by the Westpoint Group evidenced an interest in a scheme, and whether it was a financial product. In that case it was found (as an alternative argument) that there was an interest in a managed investment scheme that fell within the definition of 'financial product'.

6.29 There is ample evidence that Metro was operating a 'scheme' – Metro had arrangements for soliciting interest in the scheme, collection of funds and distribution of the notes. The fact that there were a number of other investors whom Mr. B knew and who were approached in a coordinated way, and who invested on the same terms as Mr. B and were issued with the Metro Notes, is sufficient to establish that a scheme was being operated. No attempt was made by LG to refute this state of affairs. So, as a matter of law Mr. B's interest in the Metro Notes is one in a 'scheme' and a 'security' under the Corporations Act. It is also a financial investment of the type commonly associated with 'financial planning business' under the operation of FPA Ethics and Rules 132.

6.30 The panel considers it likely that LGs' 'financial planning business' included its representatives advising and dealing in a number of products, interests and strategies, that are outside the definition of 'financial product' or even of 'scheme' or 'security' under the Corporations Act. We have described in Part IV above in discussing the LG Financial Services Guide used by LH Pty Ltd, the extent of the services offered by LH Pty Ltd under the LG representation. The terms of the FPA Ethics and Rules and the evidence of Mr. N's and LG's own commercial relationship encompasses more than just financial instruments or financial investments. For example, advising on the financing or re-financing of real property is a common aspect of the 'financial planning' role, since this is the main investment of most individuals seeking planning advice. Indeed, Mr. N through EC Pty Ltd conducted mortgage broking. This

is one of the many services authorized by LG's Financial Services Guide, which LH Pty Ltd through Mr. N handed to Mr. B.

6.31 As we have already said in a previous determination financial planning is a wide concept. It is the process of developing strategies to assist clients in managing their affairs to meet their needs, objectives and priorities. These may be immediately financial or financial steps to non-financial goals – e.g.: comfortable retirement, paying for education, a trip. The process of financial planning involves reviewing all relevant aspects of a client's situation across a large breadth of financial planning activities. It involves different types of interests and transactions in which wealth may be stored or created. We have by this reasoning come to the conclusion that advising on interests in a 'scheme' which is intended to help a client meet an objective (making 15% interest in 30 days) would come within that 'which relates to conduct of the Principal member's financial planning business.'

(ii) Does Absence of Authority Mean that the Investment is not 'Related to the Financial Planning Business'?

6.32 If the representative's conduct is outside express authority as Mr. N's was, in one sense it will not fall within the principal's 'financial planning business.' It will be outside the express terms of the authority arrangements (authorized representative agreement, authorized products list etc.) between the principal and the representative. It is in this sense that LG challenges the effect of FPA Ethics and Rules 132. It is true that FPA Ethics and Rules 132 does not have such a clear extension of liability to unauthorized acts as is provided by s917B of the Corporations Act, an earlier version of which was discussed by Victorian Supreme Court in *Newman v Financial Wisdom Ltd* [2005] VSCA 110; [2004] VSC 216. Since that decision there has been little room for doubt that under the Corporations Act a principal license holder is vicariously liable for civil remedies in relation to clients suffering loss and damage from their authorized representative's conduct, whether or not authorised.

6.33 However, FPA Ethics and Rules 132 does make the principal liable for 'conduct by its representatives or employees which *relates* to conduct of the Principal member's financial planning business.' This contemplates a wide range of connection between the principal's business and the representative's conduct. *Relates* arguably includes anything which touches and concerns the principal's financial planning business. It is certainly wider than the possible alternative phrases 'within the Principal member's financial planning business' or 'covered by the Principal member's financial planning business.' The use of 'relates to' allows a wide range of representative conduct, including that which is outside express authority, to be included in FPA Ethics and Rules 132.

6.34 There are other indicators in addition to the words of FPA Ethics and Rules 132 which suggest that it should include representative conduct that is outside express authority. The FPA Ethics and Rules are protective of both the Association's members and the general investing public. If FPA Ethics and Rules 132 were limited to authorized behaviour it would have the counter-intuitive effect that the more outrageous the conduct of the representative, the less likely it would be that the CRC could sanction the principal, and the less effective the regulatory effect of the rule in spurring supervision and monitoring of the representative would be. Therefore on this point we conclude that FPA Ethics and Rules 132 include vicarious liability for unauthorized conduct by representatives.

6.35 Mr Ahearne made some elegant points about the limits (in all of common sense, language and logic) of agency. His points are well made in terms of the general principles of common law, applying to agency relationships between commercial equals. But because those limits are easily abused in consumer transactions (including where the consumer is an investor) the Corporations Act has legislatively extended the notions of agency well beyond those at common law. As we have shown their investor protective scope extends to unauthorized transactions, and the FPA Ethics and Rules follow suit for the same reasons.

Finally on this point we repeat that the meaning of 'conduct by its representatives or employees which *relates* to conduct of the Principal member's financial planning business' is wider than conduct which relates to 'financial products' as defined by the Corporations Act.

Should LG be Vicariously Liable Where it has Honestly Tried to Supervise the Representative and Taken No Benefit?

6.36 Still on the question of LG's vicarious liability for Mr. N, Mr Ahearne argued that the CRC should not make LG liable where it honestly and reasonably tried to prevent that conduct and took no financial advantage from it. As we have said already, since the decision of the Victorian Supreme Court in *Newman v Financial Wisdom Ltd* [2005] VSCA 110; [2004] VSC 216, there has been little room for doubt that under the Corporations Act a principal license holder is vicariously liable for civil remedies in relation to clients suffering loss and damage from their authorized representative's conduct. This is whether or not the conduct was authorized by the principal and whether or not the principal knew.

6.37 In that case, like this, the principal received no financial benefit, and did not know of the existence of the authorized representative's clients and the advisory relationship. In that case too, Financial Wisdom asserted that the representative had been acting outside authority, and loss and damage to

clients should not be their liability. Section 917A-F of the current Corporations Act is if anything clearer in its intent to make the principal liable for the acts of the representative in similar circumstances.

6.38 A regulatory purpose similar to that in s917A-F of the Corporations Act and its predecessor is evident in FPA Ethics and Rules 132. That is, making the principal member liable for the conduct of the representative in order to spur supervision and monitoring of the latter. We have already dealt with other questions relative to the operation of the rule: what it means to say that a representative's conduct 'relates to conduct of the Principal member's financial planning business' and whether it operates to impose vicarious liability. Our reasoning there is in line with the beneficial and protective purposes indicated in the words of FPA Ethics and Rules 132 and the context of its operation. It seems to us that it would frustrate those words and protective purposes to limit the operation of FPA Ethics and Rules 132 to circumstances in which the Principal Member knew of the representative's excess of authority. Accordingly we determine that FPA Ethics and Rules 132 applies to impose vicarious liability on the Principal Member, even where the Principal had no actual knowledge of the representative's conduct and took no benefit from it.

Should the words of both FPA Ethics and Rules 135 and 103 be interpreted to allow a reasonableness standard or objective standard related to industry practice to apply?

6.39 The words of FPA Ethics and Rules 135 require a Principal member to 'maintain an effective system of supervision'. Should that be interpreted to require a Principal member to 'maintain a *reasonably* effective system of supervision'? The argument is that FPA Ethics and Rules 135 should read that a Principal member 'shall do all things *reasonably* necessary to ensure' that clients receive the required disclosures.

6.40 The words of FPA Ethics and Rules 135 beg the question as to what an 'effective system of supervision' is to be judged by. In other words what do we mean by 'effective'? Does this amount to a guarantee that no representative will ever be non-compliant? Does it mean that the Principal has to provide a system that is at the same general level as the rest of the industry? Or does it mean that the Principal must supervise in a fashion that is better than most, but not a guarantee of full compliance – in other words at a level that might be called 'best practice'? Unless some benchmark is chosen, FPA Ethics and Rules 135 is really meaningless because we do not know how it is meant to operate.

6.41 We think here, as in a prior determination, that the current stage of development of compliance practice in Australian financial planning is such that it would be impractical to require an absolutely 'effective' system of supervision for FPA Ethics and Rules 135. Instead we think that to discharge these rules it is sufficient that they are complied with to a standard that most practitioners would think satisfactory. In other words the Principal must operate and maintain arrangements that a Principal member in good standing would consider reasonable and neither materially above nor materially below the average standard. For establishing what this reasonable standard is, we rely on the practitioner members on the CRC panel and any evidence that members wish to present to the panel. In short we agree that a Principal member 'shall do all things *reasonably* necessary to ensure' that a Principal member to 'maintain a *reasonably* effective system of supervision' under Rule 135.

What is the Effect of the Findings and Determinations of the CRC in a Court of Law.

6.42 Mr Ahearne expressed considerable concern that the findings of the CRC in this determination would expose LG to civil liability imposed by a court for the losses suffered by Mr. B and the other investors advised by Mr. N. We have reflected on this issue and have come to the following conclusions.

6.43 It is not the role of the FPA's Conduct Review Commission (CRC) to make findings or determinations that are admissible or have any other legal effect in a court of law. The role of the CRC is to make findings and determinations in relation to the FPA Ethics and Rules. Not only are the applicable rules different (courts adjudicate rights under the Corporations Act and applicable general law principles) but the findings of fact made by the CRC are in a context quite different to that applying in a court.

6.44 To begin with, the CRC has no powers of compulsion in relation to evidence. It relies on cooperation and adherence to the rules of membership of the FPA, to obtain evidence. It is fortunate that by and large members make evidence available in compliance with the rules of FPA membership in the majority of cases that come before the CRC. However, the absence of powers of compulsion and the fact that evidence given is not on oath and is not the subject of contempt powers, means that a court of law would almost never rely on the findings of the CRC in making its own decisions.

6.45 Secondly, the rules of evidence adopted in courts do not apply to the CRC. The CRC can rely on evidence that it considers comes from any reasonably probative source. It can rely on types of evidence that the more restrictive rules of evidence which apply in courts, would make inadmissible. For

example the CRC could rely on hearsay evidence, though usually it chooses not to. A court would almost never rely on types and sources of evidence as wide as those the CRC is able to consider.

6.46 Next, the CRC has no particular standard of proof to observe. Courts may only rely on evidence proved to the civil standard - that is, on the balance of probabilities. By contrast the CRC may make a finding that is not as strictly proven as must be the case in a court. One related matter is that the CRC's procedure is not adversarial. It is inquisitorial: instead of evidence being cross examined, the panel asks a lot of questions of the witnesses and representatives of the parties. A court may consider that the absence of a trial of the evidence through cross examination means that it has not been proved to a standard acceptable to a court.

6.47 Finally, the types of sanctions that the CRC can apply are different to those available to a court. The sanctions are milder, even though the proceedings are disciplinary. And turning again to the fact that the CRC has no powers of compulsion, the sanctions too rely on the co-operation of those to whom they are directed. So parties disregarding the sanctions cannot be subject to powers of compulsion put in motion by the CRC.

6.48 For all these reasons, the findings of fact and the sanctions we set out in this determination are relevant to the professional standards guiding members of the FPA, and the protection of the public. However, the CRC's findings and determinations have very limited legal effect or weight, in an ordinary court of law where a disappointed client may seek redress from an advisor or their principal.

VII. OUTCOME AND REASONS

Was There an Advisory Relationship Between LH Pty Ltd and Mr. B?

7.1 LG attacked the question of the extent of the advisory relationship between Mr. N and Mr. B from a number of different directions, factual and legal. We have indicated our conclusions on the legal arguments in Part VII already. On the factual side, we have reviewed the evidence put forward by both the FPA and LG in Parts IV and V and what follows are our conclusions.

7.2 The argument LG placed most weight on is Mr. N's attempts to 'quarantine' the relationship between Mr. B and Mr. N, from that involving Mr. B and EC Pty Ltd. This was mostly done by LG arguing that the document trail, emails, letters and agreements, acknowledgments of 'wholesale investor' status etc.

were all on EC Pty Ltd email address-lines or letter head indicating that it was EC Pty Ltd, not LH Pty Ltd which was the relevant principal.

7.3 The trouble with this argument is that it is not supported by the evidence.

As we have shown already in Part IV of these reasons, under FPA Exhibits tab 26 there is a bundle of emails which purports to show that the transaction on the Metro Notes was done by EC Pty Ltd not by LH Pty Ltd. But they start after the completion not only of the transaction in November 2005, but well after the term of investment. The more relevant emails are in FPA Exhibit tab 12 such as the email of Mr. N to Mr. B on 30 November 2005 which asks for the completion of the 'application for the Promissory note, and the attached loan document by close of business today' and uses LH Pty Ltd address lines. The crux of the difficulty is captured in an email (under FPA Exhibits tab 26 dated 17 August 2006) from Mr. N to Mr. B. There Mr. N states 'EC Pty Ltd will pay fees for current LH Pty Ltd Group fee paying clients.'

7.4 It is true that the loan to Mr. B to make the Metro Notes investment was from EC Pty Ltd. But it is also true that the LG Financial Services Guide which was given to Mr. B at the initial meeting with Mr. N, contemplates that several entities may be called upon to assist in implementing the transactions arrived at in the course of the advisory relationship between Mr. B and LH Pty Ltd. The irresistible weight of this evidence is that the investors in Metro Notes were LH Pty Ltd advisory clients. That is, LH Pty Ltd advisory clients, clients for which LG has responsibility

7.5 Another factual possibility on which LG relied was that Mr. N had orally informed Mr. B that the Metro Notes transaction was outside the advisory relationship that had been established. The evidence here is more equivocal. Mr Ahearne who had enjoyed regular (4-6 weekly) conversations with Mr. N about his financial advisory practice (Transcript p 48) said that from his knowledge and observation, Mr. N was a business-like and professional manager of his advisory practice. He thought it would be out of character for Mr. N to over-look advising a limitation or exclusion of the Metro Notes transaction from the LH Pty Ltd relationship with Mr. B.

7.6 Mr Ahearne told the panel that Mr. N would have known the Metro Notes would never have been included on the LG Authorised Product List, and thereby bought within the Mr. N representative authority. He thought this knowledge and Mr. N's record of compliant professional behaviour made it very unlikely that he would have overlooked warning.

Mr. B orally that the Notes were outside the current advisory relationship. When asked by the Panel whether he had received an oral warning Mr. B was

equivocal: he said he simply could not recall whether Mr. N had recommended he get financial advice from someone else. (Transcript p 20). By itself, this would be a serious weakness for the FPA in asserting that the LH Pty Ltd relationship covered the Notes and made LG liable.

7.7 But this evidence is not by itself. It is against the background of LG not producing Mr. N as a witness. As importantly it is against the background of the document trail just discussed which fails to show that the Mr. N advisory relationship limited or excluded the Metro Notes. Indeed, the fact that address lines and letter heads changed to EC Pty Ltd after the Notes were not repaid, and the attempt to qualify Mr. B as a wholesale client was made then too, suggests after the event action to mitigate the effects of a transaction with LG clients that had gone wrong. Even after that time, there are persistent signs that Mr. N still saw the investors in the Notes as LH Pty Ltd clients, as the email of 17 August 2006 (FPA Exhibit 26) dealing with fees suggests. As we have already pointed out that email contains the statement 'EC Pty Ltd will pay fees for current LH Pty Ltd Group fee paying clients.'

7.8 At the very best, Mr. B must have been in doubt as to whether Mr. N was advising him about the Metro Notes. Given that the FPA rules are protective, and that Mr. B is their beneficiary, he is entitled to their protection, unless it can be clearly shown that the investment in Metro was excluded or entered after the advisory relationship was ended. As we have said in the legal analysis in Part VI, we think in this state of affairs that the only way in which Mr. N could have clearly excluded the Metro Notes from the Mr. N relationship was in writing. The FPA Ethics and Rules also require this. He never did make a clear and unqualified written statement to that effect. So we conclude that as an evidentiary matter and as a matter of law, the steps Mr. N took were not effective to exclude the Metro Notes from the advisory relationship between Mr. N and Mr. B.

Did Mr. N Make a Recommendation to Mr. B Which was 'Misleading'?

7.9 We have already pointed out that on the evidence before the CRC it was virtually uncontradicted that Mr. N said to Mr. B the following about the Metro Notes investment:

"This investment is so safe I'll guarantee it myself. You can make 15% in 30 days"

"At the end of the 30 days the investment plus the 15 percent will be returned to you."

and when asked by the Panel 'What did you understand Mr. N's advice to be in relation to the Metro Notes offer?' he replied 'This is a good investment, its 30 days, guaranteed, get 15% at the end.' (Transcript p18-19). We have also discussed in Part VI the legal requirement that predictions be based on reasonable grounds known to the prediction maker otherwise the law considers them misleading if they are not realized.

7.10 Turning first to the statement by Mr. N that the Metro Notes were guaranteed. It is true that in the disclosure documents and in the terms of the issue of the Notes to Mr. B a guarantee from Metro is included. But it is also uncontradicted that Mr. B was not given, and Mr. N did not offer any grounds (e.g. an assessment of the financial worth of Metro's parent company which gave the guarantee) on which to assess the worth of this guarantee, which after all is only contractual, not secured on particular property.

7.11 The above statement also represents that after 30 days, Mr. B would receive his capital back along with interest of 15% on the Notes. This is partly a statement of fact in the sense that the issuer was offering this return, and this could be seen on the investment documents. It was also clear from the oral and written evidence, that the original 15% return rate had been increased by dramatically reducing the term of the investment from 3 years to 30 days. But in a more fundamental sense, this was also a prediction, for Mr. N's statement was also a forward looking assurance that Metro would pay that return after 30 days. Being a statement about the future, Mr. N could only make it without liability if he had reasonable grounds.

7.12 No evidence was supplied that at the time of making the statement Mr. N had reasonable grounds, and what they were. To the contrary, as a matter of common sense, the fact that the documentation for the Notes offer originally offered 15 % for 3 years, and was now offering the same rate for 30 days, should have alerted Mr. N to a heightened level of inquiry. This was a vastly increased rate of return, which should have signaled to Mr. N a proportionately higher risk. Again no evidence was supplied to address whether Mr. N considered this vastly greater risk and whether he had reasonable grounds for making the prediction of a 15% return in 30 days.

7.13 Accordingly the CRC finds that as no evidence of reasonable grounds was provided for the prediction that the body of the investment plus interest of 15% would be returned to Mr. B in 30 days, the statement was misleading. There is as already explained, no requirement that Mr. N intended the statement to mislead. It is sufficient that there was no reasonable basis for it, and that Mr. B relied on the statement and lost his investment as a result. Similarly, no reasonable grounds were provided to show that Mr. N had an appreciation of the soundness of the guarantee he represented contributed to

the safety of the Metro Notes as an investment. Accordingly the next question that must be addressed, is whether Mr. B relied on these recommendations by Mr. N.

Did Mr. B Rely on the Recommendation by Mr. N?

7.14 The evidence shows Mr. B had never entered an investment of the nature and scale of the Metro Notes before. He did some independent sleuthing (Transcript p17), spoke to other investors (Transcript p17), but eventually he was also swayed by the fact that 'Mr. N himself had said that it was - it was a great investment, that there would be no problems with it and after, you know, after our four weeks we would get our 15 per cent and naively on my part I have to accept that I took it at face value.' (Transcript p17).

7.15 It was Mr. N who suggested the investment to Mr. B after several months of no contact. It was Mr. N who demanded that it be a sizeable investment and required the application forms and loan application to be filled in and returned within 7 days from first approach. The latter factor particularly may have induced reliance in a fashion that a longer time-frame would not have, since Mr. B would have had more time for his own information gathering and reflection.

7.16 The CRC has concluded that the combination of Mr. B's relative lack of experience as an investor, the time-frame in which he had to take up the investment opportunity put to him by Mr. N and the predictions of safety and success of the investment made by Mr. N, resulted in Mr. B relying on Mr. N's advice. The panel has concluded that there is no reliable evidence or legal grounds to conclude that Mr. N clearly conveyed to Mr. B that he had to seek alternative financial advice about the Notes investment. Accordingly the CRC finds that Mr. N did make the statements alleged about the Metro Notes, that they were misleading and that Mr. B relied on them.

That Mr. N was in Breach of FPA Rules and Ethics Requiring Integrity, Fairness and Professionalism Because he Breached His 'No Conflict' Duty to Mr. B and Failed to Disclose Benefits in the Purchase of the Metro Notes.

7.17 Except for the arguments already rehearsed above against there being any advisory relationship at all between LH Pty Ltd and Mr. B, LG did not really contest that Mr. N had used his company EC Pty Ltd to purchase the Metro Notes from his client Mr. B. It was true that Mr. B knew that Mr. N held Metro Notes on his own account. But there was no real opposition to the facts the FPA alleged: that Mr. N did not disclose the extent of his own holdings in the Metro Notes or the financial arrangements he had negotiated with Metro for the distribution of the Notes to clients or the benefits he anticipated from taking the assignment of the Metro Notes from Mr. B. That any consent by

Mr. B to Mr. N taking those benefits was not complete, because Mr. B did not have sufficient information to render his consent informed. These being the facts, the questions for determination here are whether Mr. N and LH Pty Ltd have breached the FPA Ethics requiring honesty and integrity (FPA Ethic 1), that conduct be fair and reasonable (FPA Ethic 4) and that members do not bring discredit on the financial planning profession (FPA Ethic 6).

7.18 As we have already said, there was no evidence of dishonesty in the fraudulent sense by Mr. N. But we do find that there was a lack of integrity. This lack of integrity was in the sense that Mr. N did not consistently put his client first. He expected to benefit from the assignment of the very investments that he had advised his client to acquire. He took the assignment in circumstances in which his company had loaned his client a substantial proportion of the capital amount of the investment, and had rights to repayment and interest on that loan. In taking the assignment he did not tell his client the details of the benefits he expected to take from assuming the ownership of $375,000 face value of Metro Notes for the price of forgiving Mr. B the $150,000 loan EC Pty Ltd had made to him. In short, without appropriate disclosure, he arranged to take benefits arising from transactions with is client. Taking the benefits in this way is inconsistent with loyalty to his client and is a disregard of integrity.

7.19 Was the transaction fair and reasonable? It is arguable that the transaction could have been fair and reasonable. This is because it is clear that by August 2006 when the assignment of Mr. B's Metro Notes to EC Pty Ltd took place, the notes had already been in arrears for over 6 months. Clearly in taking an assignment of all of Mr. B's parcel in exchange for the loan Mr. B owed to EC Pty Ltd, Mr. N was taking a risk on whether and to what value Metro would repay the Notes. But the assignment transaction has to be fair and reasonable at the time it is done. And because Mr. N did not give proper disclosure to Mr. B about the benefits he expected to receive, Mr. B was unable to judge whether the assignment that he agreed to was fair. He was unable to tell whether it was biased in Mr. N's interests or not. The panel considers that not only did the failure of disclosure make the assignment unfair, but it also made it unreasonable. This is because the panel considers that the ordinary person would consider it decent commercial conduct that an advisor taking a parcel of investments from a client with a face value of more than twice the value of the loan being forgiven, should disclose the benefits he expected to receive from doing so.

7.20 Finally, did Mr. N's behaviour discredit the financial planning profession? We accept that Mr. N's conduct to Mr. B was not intentionally dishonest and disreputable. But we do consider that in lacking qualities of integrity, fairness and reasonableness, that ordinary people would consider the behaviour did the financial planning profession no credit. In failing to be utterly and consistently straightforward about the benefits that were coming to him from the

assignment transaction, Mr. N was leaving open the possibility that ordinary people would think all or at least other financial planners would act as Mr. N did. Since we have found that such individuals may well consider the retaining of undisclosed benefits was not decent commercial behaviour, the CRC concludes that Mr. N's behaviour is of the type that could bring discredit on the financial planning profession.

7.21 Mr. N therefore acted in breach of all three FPA Ethics 1, 4 and 6 which respectively require integrity, reasonable fairness and that there be no discredit to the financial planning profession arising from the representative's conduct.

That Mr. N was Negligent in Advising Mr. B to Enter the Investment in the Metro Notes Without Securities Research and a Suitable Financial Strategy.

7.22 The FPA offered no evidence in support of this breach. There was therefore no need for LG to respond. The CRC makes no finding in relation to this allegation.

That Mr. N Failed to Make Other Disclosures Required by the FPA Ethics and Rules?

7.23 The FPA's allegation that Mr. N failed to make the other disclosures required by the FPA Ethics and Rules has not been contested. Instead it was argued that because there was no advisory relationship between Mr. N and Mr. B in relation to the Metro Notes, Mr. N had no obligation to make those disclosures.

7.24 We have concluded on the evidence and the law that there was an advisory relationship between Mr. N and Mr. B. It follows that Mr. N breached the FPA Ethics and Rules in relation to disclosure as alleged in the FPA's Breach Notice. .

Should the Conduct of Mr. N be Attributed to LG Under FPA Ethics and Rules 132?

7.25 We have already concluded in section VI that as a legal matter the conduct of Mr. N should be attributed to LG. The question we must consider here is the extent of that liability. Unlike civil or even punitive damages circumstances where the principal is simply liable in the stead of the agent, the point of vicarious responsibility here is to underline the protective effect of the FPA Ethics and Rules to the benefit of the investing public and the financial planning industry.

7.26 LG knew nothing of the existence of the Metro Notes nor that they were offered to Mr. B. They received no commission. We think in these circumstances our discretion to impose sanctions should be used lightly. Accordingly, on this issue although we find that LG is liable for the conduct of Mr. N under FPA Ethics and Rules 132, we consider it appropriate in relation to this particular rule to sanction them with an admonition and requirements to improve the supervision of external authorized representatives, specified below in Part IX - Sanctions.

Did LG Supervise Mr. N Effectively Under FPA Ethics and Rules 135?

7.27 In section VI we have already set out our view that this rule should be interpreted as requiring a reasonable or objective standard of performance, not an absolute standard of performance. The question here is therefore, whether in the supervision of Mr. N who ran several financial and investment related businesses from the one premises, LG discharged its obligations in relation to the supervision of Mr. N to a reasonable standard for a Principal member in good standing.

7.28 Mr Ahearne was quizzed for some time by the CRC as to why he had not been more alive to the difficulties of supervising a representative who ran several businesses related to financial matters (mortgage broking and structured financial products) as well as being a financial planner. As the CRC pointed out there are really three dimensions to this issue.

The first is, given that LG knew of the structured finance activities of LH Pty Ltd, why no greater efforts were made to supervise this activity. This Mr Ahearne explained was because he believed from his regular conversations with Mr. N that the business in question was 'business to business' not business to financial advisory client. He thought there was no practical likelihood that the structured financial products that Mr. N was working to develop would ever be offered directly to individual clients. The financial services in question were intended to be embedded in agri-business products which if successful could only be offered to LG clients if they made it onto the LG APL. Also, Mr Ahearne had reason to believe that the commercial availability of that business was still well in the future.

7.29 In these circumstances, the correct question to be asked is whether a Principal member in similar circumstances would have thought that it was reasonable to consider this risk as so unlikely to materialise as a practical possibility that it need not be addressed particularly in LG's compliance arrangements.

Bearing in mind that the events in question occurred in 2006, the CRC led by its practitioner members, considers that LG's compliance practices were equal

to those of other principal members of the FPA in good standing. The CRC points out that FPA standards of compliance have lifted since 2006, and a different conclusion may be reached if the same facts had occurred in 2009. But the fact is that in 2006 the practitioner members of the CRC consider it likely that most practitioners in good standing would not have thought it necessary to supervise this activity of Mr. N as part of standard compliance audits. It is also the fact that it was not one of these financial products embedded in agricultural schemes that was sold to Mr. B anyway.

7.30 The second dimension of the question is whether the supervision was reasonably effective in terms of the general requirement for Mr. N not to offer LG clients investments not on the APL. This is a virtually universal requirement in financial regulation, and as Mr Ahearne pointed out, so axiomatic that he had not included a question about it on the internal audit of Mr. N. The CRC considers it an important consideration in deciding what level of compliance was reasonable in 2006, that the outside compliance advisor Paragem had not included this matter in its standard list of audit questions. The questions advised by Paragem, were administered annually to Mr. N by Mr Ahearne.

Further, LG's evidence shows that Mr. N attended all training, adhered to requirements about complaints resolution, and conducted an apparently orderly practice. Risks appeared to be at the low end because Mr. N did not hire staff, did not hold client funds and did not advertise.

Once again, the peer members of the CRC agree that the great majority of other financial planning businesses in good standing would not have had a question on their audit schedule for an external AR, asking if they had put clients into something off the principal's APL. Again, the fact that Paragem does not seem to have thought to include the question, suggests the peer members assessment is accurate. While this might have been the situation in 2006, the decision in *Newman v Financial Wisdom* [2005] VSCA 110; [2004] VSC 216 has well and truly made it obvious that supervision has to concentrate on the conduct of ARs, and the possibility that they may advise clients to acquire investments not on the principal's APL. The CRC has now had a number of cases of this practice bought to its attention at different levels, and the growing prevalence of the practice requires attention through more focused principal member supervision. It is no longer sufficient to assume that an external AR will always advise clients only in relation to those financial products on the APL.

In 2009 it will be necessary for a principal member properly supervising an external AR such as Mr. N, to attend not just to the procedures of supervision (e.g. the administration of a questionnaire) but to the 'acculturation' of the AR

to the same standards as its internal ARs. In LG's case it is clear that its internal ARs operate according to values which would be expected of a financial advisory business in good standing, and that internal controls are high. LG has never come to the notice of ASIC or the CRC before for failures of supervision. But it is also clear that more needs to be done where a firm takes on external ARs, to ensure they have the same values as the internal ARs and employees. External ARs need to be inducted into the principal's values and expectations, bought into the business for meetings and other occasions which reinforce the cohesion of the principal's values and show the external AR what is expected. The APL is a structure for trying to ensure only appropriate investments are offered to clients – but it is not enough. In 2009 more needs to be done to have the external AR internalise the values of the business, and that likely requires more steps to include the external in the internal culture of the business. Finally, the principal needs to be able to prove that this has been done.

7.31 The final dimension of effective supervision relevant to this complaint is whether LG had appropriate processes to ensure that its external representatives did not advise clients on an investment and simultaneously take up the same investment themselves. Once again, the only audit instrument applied to Mr. N did not contain any questions related to this matter. While there was evidence that Mr. N undertook training and continuing development there is no evidence of whether any of it was directed to an understanding of his conflicts of interest and duty obligations, and whether any other supervisory processes were invoked.

As with the departure from the APL, Mr Ahearne assured the CRC that transacting with a client to purchase his investments without disclosure was so far outside acceptable advisory behaviour that he did not think it necessary to include questions on the audit program or other supervisory steps. It was so axiomatic that this should not occur, that again, Paragem did not advise questions in relation to this. The peer CRC members agree with these assessments.

We simply repeat what we have said above in relation to the other two dimensions of LG's compliance supervision of Mr. N. In 2006, it probably wasn't reasonably expected that this basic understanding would be supervised directly. In 2009, we understand more about the importance of substantive values and expectations in compliance, and the weaknesses of procedural compliance. The FPA has announced conduct standards that require that advisors 'put the client first'. We think that financial services businesses should be taking steps to supervise the operationalisation of this principle and the values inherent in it in their businesses. As this and prior complaints before the CRC show, principal members now need to supervise this client first

principle with particular focus on the take-up and retention of it in the conduct of external ARs.

VIII. FINAL STATEMENT OF DETERMINATION

For these reasons the CRC finds:

A. In Relation to Mr. N for Which LG is Vicariously Liable

A breach of FPA Ethics and Rules:

Rule 101 but only that the statements were misleading. There was no evidence of dishonesty

Ethic 1 (Honesty and Integrity), except that the CRC does not find there was any dishonest conduct in relation to the rule

Ethic 4 (Fairness and Reasonableness)

Ethic 6 (Bringing discredit to the financial planning profession)

Rules 102(e), 106 (a) to (c), 107 and 117

Rules 111 and 112

We find no breach of Ethic 5, as the FPA did not offer evidence as to failure to act with due skill, care and diligence.

B. In Relation to LG Securities

A breach of FPA Ethics and Rules:

Rule 132

The CRC finds no breach of Rule 135.

IX. SANCTIONS

9.1 Since the CRC has found breaches of the FPA Ethics and Rules it is authorized to impose sanctions. Those sanctions are available by force of paragraph 3.5.1 of the FPA Constitution and paragraphs 1.2 (definition of sanctions), 9.9 and Schedule B of the Disciplinary Regulations adopted by the FPA Board on 17 July 2007.

9.2 On delivering its reasons the CRC invited submissions in writing from the FPA and the member on the sanctions that it was minded to impose. It has considered those submissions and now makes final sanctions as part of this determination. The CRC gave the FPA and the member 30 days from the date of the delivery of these reasons in draft to make submissions on the sanctions it proposed.

9.3 The CRC now finally determines that as a result of the operation of FPA Ethics and Rules 132 LG is vicariously liable for the conduct of Mr. N. They note however, that LG had no actual knowledge of Mr. N's conduct and took no material benefit from it. However, the FPA Ethics and Rules make LG vicariously liable for this conduct which has caused LG's client Mr. B loss. The CRC admonishes LG in relation to this loss.

9.4 The CRC directs LG to audit Mr. N (or any other external Authorised Representative which LG may appoint) each quarter for the next 12 months, the first three quarters internally, and the last quarter the audit to be done by external auditors. The external auditor and scope of the audit having regard to this determination, to be agreed by LG and the FPA's Legal & Compliance Officer (currently Mr John Bacon). All four audit reports are to be sent to the FPA Legal & Compliance Officer for review and report back to the CRC.

9.5 LG to review their supervision of external ARs and put in place arrangements in line with the reasons in this determination. LG to outline in their next National Quality Assessment Exercise (NQAE), the steps that they have put in place for supervision of external ARs to the standard outlined in these reasons and appropriate to a financial advisory business in 2009. The FPA Legal & Compliance Officer to review the member's proposed revised supervision arrangements and agree changes with the member if required. The FPA Legal & Compliance Officer to review the operation of the agreed follow-up system one year after its implementation, and report back to the CRC.

9.6 LG to pay the costs of these proceedings in the amount of $3,611.82. Costs to be paid within 30 days of the final determination in this complaint.