

FINANCIAL PLANNING ASSOCIATION

CONDUCT REVIEW COMMISSION

DETERMINATION

AND REASONS FOR DECISION

CRC 2012_1

FPA MEMBER: *The CFP[®] Practitioner Member (Name not published)*

PANEL MEMBERS: *Mr Michael Perkins (Chair)*
Mr Chris Benson
Mr Ian Heraud

DATE OF HEARING: *26 August 2011*

DATE OF FINAL DETERMINATION: *11 April 2012*

PARTIES' REPRESENTATIVES: *Mr Mark Murphy (FPA)*
The CFP practitioner Member did not attend or appear

Determination and Reasons for Decision

Summary of Determination and Reasons

The Conduct Review Commission Panel (CRC Panel) convened to hear this complaint, finds that The CFP practitioner Member made investment recommendations to the complainants (Mr & Mrs. H) that:

1. contained misrepresentations,
2. were not suitable or appropriate for the complainants,
3. did not use terms the complainants were likely to clearly understand, to explain the reasons for the proposed move of investment capital, that substantiated the appropriateness of the move, and
4. failed adequately to explain the investment risks involved in the recommendations.

The CRC Panel also finds that The CFP practitioner Member's conduct amounted to a breach of Ethic Principle 6 that has brought discredit to the financial planning profession.

The Panel finds that all of these breaches occurred with disregard for the reliance placed on The CFP practitioner Member by the complainants and the responsibility of The CFP practitioner Member as an FPA member.

There was no evidence of conduct by The CFP practitioner Member of a deceptive, dishonest or fraudulent nature.

Determination

This CRC Panel determines that the charges are proven to the extent set out in this determination:

Charge 1 – Rule 101 of the Rules of Professional Conduct

That The CFP practitioner Member has, in the conduct of her professional and business activities, engaged in conduct and acted in a way that was misleading to the complainants.

Charge 2 – Rule 110 of the Rules of Professional Conduct

That the recommendations prepared for the complainants by The CFP practitioner Member were not suitable for their needs or situation.

Charge 3 - Rule 111 of the Rules of Professional Conduct

That the explanation of the nature of the investment risks involved in the recommendations given to the complainants by The CFP practitioner Member were not in terms that the client was likely to understand.

Charge 4 – Rule 118 of the Rules of Professional Conduct

That the change of investments recommended by The CFP practitioner Member was not appropriate for the complainants.

Charge 5 – Rule 6 of the Code of Ethics (Professionalism).

That the conduct of The CFP practitioner Member has brought discredit to the financial planning profession.

Reasons for Decision

The Complaint

The complaint in this matter was made in writing by Mr and Mrs H (the complainants) on 10 February 2009. The complainants were clients of The CFP practitioner Member, a CFP practitioner member of the FPA. The CFP practitioner Member was, at all material times, an authorised representative of Storm Financial Pty Limited.

This complaint initiated charges being made against The CFP practitioner Member by the Financial Planning Association of Australia Ltd ABN 62 054 174 453 (FPA) in its disciplinary capacity under its constitution, disciplinary regulations, rules of professional conduct and code of ethics. These charges are contained in a letter dated 30th May 2011 from the FPA to The CFP practitioner Member.

The complainants gave oral evidence to the CRC Panel hearing on the 25th October 2011 that amplified the written evidence they had tendered to these proceeding by their joint written statement dated 22 January 2011.

The CRC Panel relies, in part, on the written and oral evidence of the complainants in this determination.

The CRC Panel has determined that The CFP practitioner Member has been given adequate and appropriate opportunity to test the evidence presented by the FPA in this matter. This determination is made on the basis of the

information presented by the FPA, The CFP practitioner Member and the complainants.

The CRC Panel is satisfied with the truthfulness of the evidence of the FPA, the complainants and The CFP practitioner Member.

Reasons

Charge 1 –

This charge states:

In the conduct of professional and business activities, a member shall not engage in any act or omission of a misleading, deceptive, dishonest or fraudulent nature.

The CRC Panel determines that there is no evidence that The CFP practitioner Member has engaged in conduct that is deceptive, dishonest or fraudulent.

The term misleading however means giving the wrong idea or impression. This results in a person conducting themselves in such a way that others relying on that conduct are lead to make errors or misconceptions about their circumstances or affairs.

The Australian Competition and Consumer Commission make the following observation on its website¹:

“It makes no difference whether the business intended to mislead or deceive you—it is how the conduct of the business affected your thoughts and beliefs that matters.”

The CRC Panel determines this statement is also applicable to the current proceedings.

The fact that The CFP practitioner Member believed what (the member) was doing was appropriate is no defence to this charge. In her relationship with the complainants as a financial adviser, it is reasonable that they should be able to rely on the statements the member made in connection with the advice being given.

At page 16 of the transcript of the hearing on 25th October 2011, (the transcript) the following exchange appears:

“MR H: The first information session he (the accountant)² suggested we go to went for over two hours and, quite honestly; it was full on and very heavy. I don’t know how many people were there, there could have been 50 or more people. It was in the Tannum Sands High School Community Centre. And I would

¹ <http://www.accc.gov.au/content/index.phtml/itemId/815335>

² The accountant of the complainants also referred the complainants to the Storm model at the same time as The CFP practitioner Member was advising them.

be very surprised if only a small – I would expect only a small percentage of people really understood. It was Mr C himself that did the talk. And in retrospect now, it was right over the top.

MR MURPHY: Well, separate to anyone else, what did you understand following that seminar?

MRS H: What did he talk about? He talked to us, and he talked about all those things.

MR H: I suppose his main line of promotion was that you had these chooks that laid more eggs, that's the words we used to use.

MR MURPHY: And what did you understand about the Storm strategy?

MR H: Well, supposedly, as against super or your pension going down, your main assets. In this system, supposedly, it would always increase in value and you wouldn't lose the value of your assets.

MR MURPHY: And what did you understand about the technical aspects, the finer points?

MR H: Well, we didn't. We were relying on two professionals to advise us, one the professional adviser and the other one the professional accountant. And in The CFP practitioner Member's words were, "We didn't have a worry in the world to go to this system."

The following exchange appears at page 18 of the transcript:

"MR MURPHY: And was there anything about the debt aspect of what Storm was proposing that you considered?"

MR H: The debt aspect?

MR MURPHY: Yes.

MR H: Well, as retirees, we have no means of repaying the debt, except for Storm income. We were assured that it was as safe as and, again, in The CFP practitioner Member's words, we didn't have a thing in the world to worry about.

MR MURPHY: And did you have any view on whether you wanted any debt or not?

MRS H: No, we didn't want debt.

MR H: We didn't want debt in retirement, that's crazy. But, of course, you know, you were encouraged to believe that you had nothing to worry about, because they had all this strategy in place that you could never get into trouble. That was how it was promoted to us."

It is clear from the brief of evidence in this matter and the oral evidence of the complainants on the 25th October 2011 that The CFP practitioner Member had initially established her credibility with the complainants' whilst the member was part of H Financial Services Limited. At tab 4A of the brief of evidence in this proceedings is a copy of the advice given by The CFP practitioner Member dated 18th January 2005. The CRC Panel, which includes 2 CERTIFIED FINANCIAL PLANNER[®] practitioners, determines this letter is an example of appropriate and suitable advice for persons in the complainants' circumstances.

It is also clear from the transcript and in particular the sections extracted above, the complainants were led to the view that the Storm strategy was not only appropriate for the circumstances but also with a risk profile that was comparable to their existing strategy.

The trust that the complainants had developed in The CFP practitioner Member caused them to believe her assertions rather than any analysis they had made for themselves. The CRC Panel determines that the complainants could reasonably rely on the statements made by The CFP practitioner Member in support of her written advice.

The CRC Panel has considered the letters from The CFP practitioner Member to the FPA dated 8th August 2010 at tab 7 of the brief and dated 11 July 2011 at tab 9 of the brief. In the latter letter the CRC Panel takes particular notice of the following statement by her:

"I was an Employee Representative by Storm. As I have stated previously, Storm were very prescriptive in their dealings with their Employee Representatives. Employee Representatives were NOT permitted to manage the Storm Strategy. Employee Representatives did not:

- *Formulate the individual strategy for the client*
- *Deal with margin Lenders, bankers or fund managers*
- *Recommend or formulate "Next Steps"*
- *Manage the client's investments."*

In considering the letter from The CFP practitioner Member to the complainants dated 21 April 2008 at tab I of the brief and 22 January 2008 at tab H of the brief and 23rd August 2007 at tab F of the brief, these restrictions are not reflected in her communication with her clients. The CFP practitioner Member may well have been an Employee Representative of Storm Financial Pty Limited, but the member concurrently was trading on her trusted adviser relationship with the complainants that had been established in the course of her previous employment.

The CRC Panel notes with approval the following statements by the Australian Securities and Investment Commission in its Regulatory Guide 53 that was issued in 2003 at page 7:

"7.1 It may be **misleading** to accentuate the potential benefits of a financial product or service without also giving a fair indication of any significant disadvantages that the audience would not be aware of.

7.1.1 This is a general principle. Other provisions in Section 7 give more detail on common imbalance issues relating to the use of past performance information.

7.2 A promotion may be misleading if it highlights the potential for higher returns without giving a fair indication of any significant additional risk factors that the audience would not be aware of.

7.2.1 For example, if a fund differed from most peers because of a gearing strategy, an unusual hedging arrangement or an unusual foreign exchange exposure, it may be necessary to note this in the promotion.”

The CRC Panel determines that the significance of gearing in the Storm strategy which had the effect of magnifying both gains and losses was not explained sufficiently in the advice that was tendered to the complainants. This contributed to the complainants holding an erroneous belief that the risk of operating the Storm strategy would not be a substantial threat to their underlying financial security.

The CRC Panel determines that it was the personal advisory relationship between The CFP practitioner Member and the complainants that caused them to proceed with the Storm strategy whilst also holding the misconception or belief that the risk of operating the strategy was comparable to the previous strategy that The CFP practitioner Member had recommended.

The CRC Panel determines that The CFP practitioner Member has, in the conduct of her professional and business activities, engaged in conduct and acted in a way that was misleading to the complainants.

Charge 2 –

This charge states:

In preparing oral or written recommendations to clients, a member shall develop a suitable financial strategy or plan for the client based on the relevant information collected and analysed.

The word suitable means right or appropriate for a particular person, purpose or situation. The complainants were retirees with no substantial income other than their investment income. Whilst relevant information was collected from the complainants, it was the failure of The CFP practitioner Member to translate that information into a suitable plan or strategy that is at the heart of this charge. The advisory obligation in this situation rests on The CFP practitioner Member, not their employer.

The clients were from their testimony, not initially prepared to borrow in retirement. The clients believed that the borrowings to which they were committed did not impose any heightened risk upon them. This belief evidenced that the clients did not understand the true nature of the investment strategy being recommended and because of this; the Panel determines that the recommendations being made were not in fact suitable for the clients.

At page 19 of the transcript the following exchange appears:

MRS H: *Well, because we still hadn't agreed to join Storm. And, you know, D would say, "That's a ridiculous idea. You don't borrow money in your retirement. I don't want to know about it." And, but, like, each time (the member) visited, (the member) would have another little niggle about it. And as is written here, (the member) did say these words, "The Storm strategy will protect your capital better than the allocated pension and you don't have anything to worry about with these strategies."*

MR PERKINS: *Now, Mrs. H, its Michael Perkins. What you've just touched on with The CFP practitioner Member said to you words around, "You couldn't protect capital inside the superannuation." Can you just, as best you can, recall how did (the member) explain that idea of protection? Did (the member) tell you what it was in superannuation that made protection not possible?*

MRS H: *Well, (the member) said with an allocated pension, that your main capital would decrease and you would have nothing left. Whereas with the Storm strategy, the main capital would increase, and there would always be money there to pay – to pay out whatever you chose to live on for the rest of your days."*

The potential for borrowings to amplify losses as well as profits in the strategy was not explained.

At page 33 of the Transcript the following exchange appears:

“MR HERAUD: So you viewed those boxes from most risky to less risky, and so you went towards the bottom, but not all the way down.

MR H: That’s right.

MRS H: Yes.

MR HERAUD: Thank you.

MR PERKINS: Okay. Thank you.

MR H: Because we were assured that the backup of this whole system was as safe as, right? There was a lot of that reassurance that all this safety stuff was in place, they called it the dam or something, which we never really understood, and that’s what we understood was our safety barrier.”

At page 46 of the transcript the following exchange is recorded:

“Did The CFP practitioner Member explain what this SOA meant to you?

MR H: Well, my recollection of it was that, because of those top 300, that it was well invested and, again, nothing to worry about, secure as.”

The CRC Panel determines that the requirement of the Storm strategy for additional capital contributions to protect against market movements in their investment program was neither adequately explained to the complainants nor understood by them.

For the reasons discussed now and those discussed in relation to charge 1, the CRC Panel determines that the recommendations prepared for the complainants by The CFP practitioner Member were not suitable for their purposes or situation.

Charge 3 –

This charge states:

In preparing oral or written recommendations to clients, a member shall provide an explanation of the nature of investment risks involved in terms that the client is likely to understand.

The evidence outlined in charge 2 is also relevant to the determination of this charge.

For the reasons set out under charges 1 and 2, the advice tendered by The CFP practitioner Member was unsuitable, inappropriate and misleading. The CRC Panel therefore concludes that because of these factors, the advice tendered did not explain the true nature of the investment risks involved in terms that the client is likely to understand. The misrepresentation goes to the heart of the complainant's ability to understand the risks of the strategy.

The client remains the decision maker in an advisory engagement and therefore must be equipped by their adviser with sufficient information from which they can make a reasoned decision about the suitability of the advice for their purposes. Understanding the risks which underpin the returns to be provided by the offered strategy is fundamental to this decision making process and did not occur in this case.

At page 34 of the transcript the following statement appears:

“MR H: Well, all I'm sure of is that The CFP practitioner Member reiterating that we didn't have a problem in the world going in the Storm strategy. We would never have a problem.

With the money we had, we would never have a problem. (The member) sat at this very table and told us that a number of times over time. And it certainly would have happened at that time as well, we were discussing moving there.”

This statement typifies the “assurance” style of communication adopted by The CFP practitioner Member in dealing with her clients. The panel determines that the advisory approach typified by this statement does not amount to an appropriate explanation of the investment risks of the strategy.

The CRC Panel determines that the explanations of the nature of the investment risks involved in the recommendations given to the complainants by The CFP practitioner Member were not in terms that the client was likely to understand because the explanations given did not explain the true effect of the investment strategy or its inherent risks to the complainants.

Charge 4 –

This charge states:

A member shall not move a client or cause a client to move from an investment to another investment without explaining to the client, in terms the client is likely to understand, the reasons for the move. The CFP practitioner Member must demonstrate that the move is appropriate for the client.

In the letter at tab C of the brief dated 29th September 2006 to the complainants, The CFP practitioner Member is clearly attempting to discharge this responsibility.

This attempt however is faulty because it does not explain the risk of capital protection and does not consider whether investment strategies inside superannuation can be made more efficient or effective.

The risk to be undertaken in order to generate increasing returns is not sufficiently explained.

Increased reward comes from increased investment risk. This is axiomatic and within the common knowledge of financial advisers. It is not the role of the financial adviser to be merely a conduit for this technical information to the client. Rather, the adviser must objectively measure the risk on behalf of the client and then apply the result to the investment strategy being considered. The CRC Panel determines the evidence tendered does not show this standard of common financial planning practice was followed in this case. The assumption that market momentum and performance would rectify within a reasonable period all volatility suffered by the investment portfolio is not sufficiently clear in the advice tendered in evidence.

The CRC Panel determines that the assertion that the strategy was as “safe as houses” meant that the Storm strategy would neutralise the market, agency³ inflation and asset specific risk inherent in the strategy thus providing the security that the complainants sought. This is erroneous and not justified on the evidence provided in this matter. This assertion is a further factor compounding the misleading character of the advice given by The CFP practitioner Member.

The CRC Panel determines that the change of investments recommended by The CFP practitioner Member was not appropriate for the complainants.

³ The risk that arises from using agents such as fund managers for the investment of money

Charge 5 –

This charge states:

A member shall ensure that their conduct does not bring discredit to the financial planning profession.

The term “professionalism” means the competence or skill expected of a professional. Discredit means the loss or lack of reputation or respect. It is the damage caused to the reputation of professional financial planners by the conduct of The CFP practitioner Member that has caused reflection by the Panel.

It is a client’s expectation of professional conduct that imposes the initial burden of professionalism on an adviser. Community expectations of professional conduct are captured in the professional rules of organisations such as the FPA. Members of the FPA are expected to be exemplars to the community of the appropriate professional conduct mandated by their professional body. Departing from this expectation brings discredit to the professional community as a whole including those members represented by the FPA.

The CFP practitioner Member by the evidence in this matter was previously well regarded by members of her community and had a history of satisfactory business relationships with the complainants.

Disrepute means the state of being held in low esteem by the public. The complainants are members of the public and their low esteem of the accountant and The CFP practitioner Member who both referred them into the Storm strategy is well evidenced by their testimony.

The fact that The CFP practitioner Member was well intentioned does not compensate for the damage caused to the complainants or her professional community. Disrepute in the eyes of the public and her professional community is the necessary result of her actions as evidenced by these proceedings. The CRC Panel acknowledges that her employee role was in administering the Storm investment approach. It was this action that was contrary to the professional standards of the FPA and was a direct contributor to the damage suffered by the complainants.

The CRC Panel must therefore determine that the conduct of The CFP practitioner Member has brought discredit to the financial planning profession. Her conduct is not that of a reputable member of the financial planning profession or representative of the normal and expected conduct of that profession.

That said, the Panel is also mindful of the material put in correspondence between The CFP practitioner Member and the FPA and referred to previously in these proceedings and the discussions held between the FPA officers and her current employer.

The CFP practitioner Member was as convinced of the merit of the Storm strategy as her clients and by her evidence has lost financially more than any

financial penalty that this Panel could levy under the FPA's professional conduct rules.

The CFP practitioner Member has continued in the financial planning profession and maintained employment since the collapse of Storm. The member clearly has an ability to continue to contribute positively to the financial planning profession. The CRC panel wishes to encourage The CFP practitioner Member to remain a member of the financial planning profession and the FPA, but must have regard to her conduct in this matter.

The CRC panel believes it is appropriate to frame its sanctions with a view to continuing and facilitating the completion of the remediation of her professional knowledge, skills and reputation that The CFP practitioner Member has already started.

For this reason, the CRC Panel determines that the financial penalty of paying for the education course provided for in the sanctions is an appropriate alternate to the fine otherwise provided for in the sanctions we have determined. Completion of the courses outlined is considered sufficient financial penalty, the fine in the sanctions is an alternate to the education course prescribed and is intended to be an incentive for The CFP practitioner Member to complete the required course of education as soon as practicable.

The education course prescribed is deemed necessary to ensure that The CFP practitioner Member's professional knowledge on the subject remains current and appropriate for her continued practice as an FPA member and so that The CFP practitioner Member is fully aware of the current standards of professional responsibility that remains on her as a continuing member of the FPA. The acquisition of the current knowledge provided in this course is expected to rectify the professional responsibility mistakes made by The CFP practitioner Member in this matter.

If The CFP practitioner Member fails to undertake the education, costs and the fine imposed by the sanctions, then the rules of the FPA will operate to expel her from membership and rightly so because that conduct will repudiate the contract that implicitly lies between The CFP practitioner Member and her fellow members of the FPA.

The CRC Panel determines that because of the objective of remediation of her professional standing that the name of The CFP practitioner Member should not be published and that her name and any personal identification be redacted from any public reference to these proceedings.

Sanctions Imposed By the Panel

Whilst The CFP practitioner Member did not attend the hearing, the member provided substantial assistance to the FPA in carrying out its investigation in this matter. This has been considered in formulating these sanctions.

The Panel is aware that it is imposing a financial penalty on The CFP practitioner Member. If the conditions of waiver of the penalty are not met, the alternate fine is not paid and the reimbursement of FPA's expenses is not paid then expulsion of The CFP practitioner Member from the FPA will result.

Since the CRC Panel has found breaches of the FPA Ethics and Rules it is authorised 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 (revised 4 June 2010).

The Panel determines that due to:

- the disregard exhibited by The CFP practitioner Member to the original apparently suitable financial strategies already established by her with the complainants,
 - the lack of clarity exhibited by The CFP practitioner Member in relation to her explanation to the complainants of the reasons for switching from the prior investment strategy to the Storm investment strategy, and
 - the damage triggered by The CFP practitioner Member promoting unsuitable and inappropriate advice to the complainants,
- that a penalty needs to be applied, but this penalty should be reduced due to:
- the contrition shown by The CFP practitioner Member,
 - her continued commitment to the financial planning profession and,
 - her continuity of employment in the financial advice sector.

Therefore the panel determines that The CFP practitioner Member be disciplined by requiring that:

1. The CFP practitioner Member provides an undertaking that the conduct or circumstances which gave rise to the charges has been rectified and will not be repeated.
2. The CFP practitioner Member provide a letter from her current employer confirming her current employment, AFSL authorisations and role and:

- a. as far as the employer is aware, whether any breaches of her authorised representative conditions have occurred during her employment, and
 - b. whether The CFP practitioner Member remains a satisfactory employee, and
 - c. any other matter or observation that the employer considers relevant to the employer supporting the continuing professional standing of The CFP practitioner Member as an FPA member.
3. The CFP designation of The CFP practitioner Member be suspended and only reinstated when the course of education required by sanction 4 is completed to the satisfaction of the FPA by its designated officer and the FPA or its designated officer is satisfied that the letter received under sanction 2 evidences that The CFP practitioner Member is currently practicing in accordance with satisfactory current professional standards.
4. The CFP practitioner Member satisfactorily completes the current CFP 1: Ethics, Professionalism and Professional Behaviour course required for CFP designation. Proof of satisfactory completion of the course must be provided to the FPA within one month of completion of the course. The CFP practitioner Member must bear all the costs of the course.
5. That The CFP practitioner Member pay a fine of \$2500. The payment of this fine will be waived by the FPA if the course required by sanction 4 or an alternate course approved by the authorised officer of the FPA, is completed and passed within 9 months of the date of this determination or such other period as the FPA by its designated officer determines.
6. The CFP practitioner Member pay the costs of these proceedings in the amount of \$5,250.13 within 9 months of the date of this determination or such other period as the FPA by its designated officer determines.
7. That this determination only be published in a redacted form that does not identify The CFP practitioner Member. However, in the event The CFP practitioner Member is expelled from the FPA for failing to undertake the education, costs and fines then her name will be published in any public reference to this determination.