FINANCIAL PLANNING ASSOCIATION

CONDUCT REVIEW COMMISSION

DETERMINATION AND REASONS FOR DECISION

CRC 2012_2

John Christian Schluter

PANEL MEMBERS: ***Professor Dimity Kingsford Smith (Chair)***
Ms Sandra Bowley
Mr Greg Cook

DATE OF HEARING: 26 August 2011

DATE OF FINAL DETERMINATION: 6 JULY 2012

PARTIES' REPRESENTATIVES: ***Mr Mark Murphy (FPA)***
Mr Schluter did not attend or appear

DETERMINATION
AND REASONS FOR DECISION

I. SUMMARY OF DETERMINATION AND REASONS

The CRC finds that the member John Christian Schluter made investment recommendations to Mr and Mrs F (complainants) that contained misrepresentations, which were unsuitable and failed to explain adequately the risks involved in those recommendations. The CRC Panel also finds that Schluter acted so as to bring discredit to the financial planning profession. The Panel finds all of these breaches occurred at the highest level of disregard of the interests of the complainants. The final determination is set out at the end of these reasons in part VIII and the sanctions the Panel is imposing, 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 *John Christian Schluter (Schluter)* a member of the FPA. The complainants Mr *and Mrs F (the complainants)* complained that they received defective financial advice from Schluter. Schluter was at the time an authorized representative of Storm Financial Pty Ltd (Storm Financial) a principal member of the FPA, the holder of an Australian Financial Services License and now in liquidation.

2.2 After investigation and correspondence between the FPA and Schluter it was alleged that Schluter had a case to answer under the FPA's Code of Ethics and Rules of Conduct (FPA Ethics and Rules). The case to answer alleged breaches of the Ethics and Rules as follows:

2.3 (1) In breach of Rule of Conduct 101 Schluter engaged in deceptive and misleading conduct, including dishonesty, in that he misrepresented to the complainants:

(a) That their asset base was insufficient 'to fund the lifestyle you desire now, or in the future.'

(b) That their investments were safe because 'Storm Financial index funds are diversified and much safer than ordinary shares. Any borrowings up to 60% of your investment is fine.'

(c) Schluter represented that he was assisting the complainants to select a lower level of investment risk when the recommendations he actually

made in the statement of advice dated 13 July 2007 were much higher risk.

(d) The cash flow worksheets in the statement of advice of 16 February 2007 are misleading. The six monthly tables in the worksheets show cash reserves going into deficit without any indication of how this deficit is to be funded. In fact the gap between the cash reserve deficits and the unrealised accumulation in investment growth, also shown in the cash flow worksheets, was met by subsequent increases in the margin loan. There was no statement or other explanation whether in the statement of advice or orally that inherent in the strategy was continual increase in the size of the margin loan. The complainants relied on the cash flow worksheets to assure them that the strategy would give them sufficient funds to live on in retirement, to meet their financial obligations and to do so safely and securely. This omission misled the complainants.

The complainants relied on these representations to their detriment.

2.3 (2) In breach of FPA Ethics and Rules 110 Schluter failed to develop any suitable financial strategy or plan for the complainants before making his recommendation that they invest. In particular:

(a) the complainants were advised to adopt a geared investment strategy at the heart of which were large margined loans and large loans on their residence. This was even though they were approaching retirement and would within 5-7 years, cease all employment.
(b) This was despite the fact that the complainants had chosen an investment profile that 'would accept volatility if in the medium to long term the investment growth is higher and the risks over that term are minimal or eliminated.'
(c) The cash flow worksheets in the statement of advice of 16 February 2007 show cash reserves going into deficit without any indication of how this deficit is to be funded. In fact the gap between the cash reserve deficits and the unrealised accumulation in investment growth, also shown in the cash flow worksheets, was met by subsequent increases in the margin loan. This was an unsuitable strategy for a couple 58 years of age and concerned about having enough capital to live off during retirement.

2.3 (3) In breach of FPA Ethics and Rules 118 Schluter made recommendations that caused the complainants to move from one investment to another without explaining in terms the complainants were likely to understand the reasons for the move. The FPA repeated the particulars as to the unsuitability of the general strategy and alleged that the recommendations to switch related to a portfolio of shares worth $21,000, an AXA life insurance policy and $42,000 cash at the bank.

2.3 (4) In breach of FPA Ethics and Rules 111 Schluter failed to provide any explanation of the nature of the investment risks involved in this margined loan investment strategy in terms that the complainants were likely to understand.

2.3 (5) Repeating all the breaches alleged above, the FPA also asserted that Schluter had breached FPA Ethics and Rules 6, which requires members to ensure their conduct does not bring discredit to the profession of financial planning.

2.4 The CRC held a hearing of these allegations on 26 August 2011. At the hearing the CRC took submissions and evidence from the FPA through its investigation officer. The FPA presented evidence in a folder of exhibits numbered 1 to 20 (FPA exhibits). The complainants gave evidence by a statement and personally by telephone link.

2.5 Schluter did not appear either himself or by a representative at the hearing. He corresponded by email and letter with the FPA investigation officer from mid-2010 up until the date of the issue of the charge notice in this matter, dated 25 March 2011, setting out his arguments and facts in his possession. This correspondence is referred to by date where appropriate in these reasons. After the issue of the charge notice, despite many opportunities to do so being offered to him, Schluter declined to respond to the FPA's allegations.

2.6 There is a typed transcript of the entirety of the hearing conducted on 26 August 2011 which is also referred to in these reasons by relevant page numbers.

III. BACKGROUND TO THE COMPLAINT

3.1 Schluter is an Associate Member of the FPA. Schluter was an authorised representative of Storm Financial from 23 May 2003 to 18 June 2009. On 12 January 2009, Storm Financial entered into voluntary administration. Prior to becoming an authorised representative of Storm Financial Schluter was a representative of Company A Limited. It was as customers of Company A Limited that the complainants first had dealings with Schluter. They were planning retirement and were introduced to Schluter, and then followed him when he moved to Storm Financial.

3.2 In 2005 the complainants began to receive invitations from Schluter to investment seminars run by Storm Financial. The general topic of investing in the share market did not interest them, and they did not proceed with obtaining financial advice at that time.

In September 2006 the complainants, then 58 (Mr F) and 57 (Mrs F) years old, were concerned about whether they had saved sufficient for retirement. They had also inherited approximately $200,000 and were concerned that it should be well invested, rather than spent inconsequentially. Both the complainants were still working and wished to continue, but to have the option to retire at 60 years if they desired on reaching that age. At that time they were living in Mackay on a combined annual income of $73,582 from both their wages and salaries. They had expenses of approximately $38,194 per annum. Further,

their two daughters had married overseas, and they wished to be able to take a trip each year to see each of them and their grand-children.

3.3 In September 2006 the complainants met with Schluter at Storm Financial's offices. In the course of the meeting Schluter said:

'Shares in Storm Index funds are safer than buying shares. Storm index funds are a combination of the top 200 Australian listed companies and can give you exposure to particular segments of the stock market, such as mining or banking.'

On 16 February 2007 the complainants had another meeting with Schluter where they completed a Confidential Financial Profile (Exhibit 1). In completing that document they explained that their financial circumstances were as follows:

Assets			Liabilities	
Cash	$242,000		Expected Outlays	$40,000
Shares	$21,000			
Cash value of Life Insurance Cover	$34,000			
Combined Superannuation	$243,000			
Family Home	$500,000			
1 Investment House and attached block of land	$210,000			
Total	$1,250,000		Total	$40,000
Net Assets	**$1,210,000** net home			

The Confidential Financial Profile (FPA Exhibit 2A) also contained a statement of the complainants' risk tolerances (p 22). At the same meeting the complainants agreed to have Schluter prepare a Statement of Advice ("**SOA**").

They also signed authority documents in favour of Storm Financial to allow Storm to conduct correspondence with banks to open negotiations on the complainant's behalf for bank loans. At a subsequent meeting on 16 March 2007 (referred to in SOA p2, FPA Exhibit 2) the complainants and Schluter had an initial discussion about cash flow. This was subsequent to Storm Financial having sought preliminary opinions from several banks as to whether they would loan funds to the complainants, at what rates and for what loan periods (see SOA, FPA Exhibit 2, at Appendix C).

3.4 In April 2007, Schluter spoke to the complainants to arrange a meeting to discuss the SOA (FPA Exhibit 2). On 27 April 2007 the complainants' evidence is that they listened while Schluter read the SOA to them and then asked them to sign the SOA which he explained was an acknowledgment by them, that he had done so (Transcript 33-36). Schluter did not give the complainants the SOA to take away with them at this time (Transcript 36). The SOA at page 108 bears signatures which the complainants acknowledge as being theirs and dated 27 April 2007, and instructing Storm Financial to implement the recommendations set out in the SOA.

3.5 In the SOA (pp50-51) the complainants signed Schluter recommended an investment strategy which involved the borrowing of funds to invest along with the complainants own capital as follows:

- Invest $200,000 of the complainant's own capital;
- Borrow $568,000 secured on their home from the Commonwealth Bank;
- Borrow $70,000 via a margin lending facility from Macquarie Bank; and using these funds to
- Purchase $750,000 of Storm Financial badged index funds managed by Challenger Managed Investments Limited;
- Keep cash on hand of approximately $25,000;
- Pay $59,780 in advisors fees to Storm Financial.

3.6 On the same day, 27 April 2007, the complainants were asked to sign a lot of other documents which they thought were account opening and bank loan application documents (Transcript 33-36). In fact documents have been found since the hearing on 26 August 2011 on a disk from Korda Mentha (the liquidators of Storm Financial) and copies of which have been furnished to Schluter with an invitation to provide further submissions to the panel. These documents which the complainants were also asked to complete, bearing that date (or likely completed that date), are as the follows:

- Macquarie Cash Management Trust Application. Account No 122629744;
- A cheque for $17,209 made out to 'MIML Apps.A/c of Mr & Mrs F' being part of the complainant's own cash contribution to the investment;
- A Direct Debit Request to Macquarie Cash Management Trust Account No 122629744 for $1100 per month from the complainants' Queensland County Credit Union Account;

- An application for Storm Australian Indexed Funds being $241,000 investment in Australian Industrials Indexed Trusts and $88,000 Australian Resources Indexed Trusts and $21,000 Australian Technology Indexed Trust;
- A cheque for $182,791 made out to 'CMIL APPS A/C Mr & Mrs F' being part of the complainants' own cash contribution to the strategy;
- Two Applications for a Macquarie Margin Loan, one selecting $250,000 as the credit limit, and another which appears to be an amended version of the first, selecting $1,000,000 as the credit limit.
- A letter application to increase Mr & Mrs F's margin loan by $195,000 (the original margin loan recommendation in the SOA of the same date being $70,000). In fact it seems the original recommended loan amount of $70,000 was never drawn down, and the application for increase was made part of the initial request for margin funds. This can be deduced from adding up the amounts $195,000 which was borrowed plus the complainants' own monies of $182,791 and subtracting the fees of $27,791. The remainder is $350,000 the amount in the complainants' application for Storm Australian Indexed Funds.

In early June 2007 a valuer attended to value the complainant's residential property (Transcript 37-40).

3.7 Further documents discovered after the hearing and also made available to Schluter for further submissions, show that the Commonwealth Bank signed a Consumer Credit Contract in favour of the complainants for $584,000 on 8 June 2007. This document is signed by the complainants though they have not dated it. Mr F also signed a mortgage over three lots in Queensland, to secure the loan, though again they do not reveal what date the signature was added. A Storm Financial memo dated 14 June 2007 and signed by the complainants (again, undated by them) directs the disbursement of the loan funds.

On 25 June 2007 the complainants signed and dated an application for Storm Australian Indexed Funds being $289,000 investment in Australian Industrials Indexed Trusts and $100,000 Australian Resources Indexed Trusts and $16,000 Australian Technology Indexed Trust. The complainants gave evidence that they attended the Storm Financial office in late June 2007 to sign the loan documents to mortgage their house (then unencumbered since 1981) (Transcript p40). This evidence and the date of the application for further Indexed funds being 25 June 2007 suggests that the loan agreement, the mortgage and the authority to disburse funds was most likely signed on that day as well. This deduction is further supported by the dates on two cheques drawn by the Commonwealth Bank in favour of Mr & Mrs F's accounts at Macquarie Bank companies dated 29 June 2007 for $400,000 and $140,000. There is a receipt given by Storm Financial on 29 June 2007 for a cheque for fees for $31,989. These figures exactly match the authority to disburse funds signed by the complainants. Finally, there is Confirmation of Loan Proceeds

Disbursal dated 29 June 2007, on Storm Financial footer, which appears to confirm the funds were disbursed as agreed.

3.8 In the early days of July 2007 Schluter requested the complainants to attend the Storm Financial offices again. On that occasion Schluter gave the complainants the SOA and asked them to initial each page and to read it, and to return it to him at Storm Financial by 13 July 2007 (Transcript 36-40). They did this, but although they attempted to read the SOA they did not understand it. Mrs F told Schluter she did not understand the document (Transcript 37).

3.9 About August 2007, the complainants received a telephone call from Storm Financial to advise them that they are ready for the next investment step according to the strategy set out in the SOA. This process of making further investments or taking additional investment steps occurred when the market value of a customer's portfolio had risen, and the ratio of their margin borrowing to the value of their investment (their LVR) had fallen. This freed up additional value in the investment. Shortly afterwards, the complainants on the advice of Ms D a Storm Financial adviser, extended their margin loan by a further $53,630. This was done on advice given in a Statement of Additional Advice (SOAA) dated 2 August 2007 and implemented by a letter signed by the complainants (undated) directing Macquarie Margin Lending to extend their margin borrowing. At the same time the complainants applied for further Storm Australian Indexed Trusts and paid Storm Financial fees of $3630.

3.10 Still in August 2007, the documentary record shows that the complainants signed another extension of their margin loan, this time for $43,977. This was done on advice given in a Statement of Additional Advice (SOAA) dated 17 August 2007. These funds were directed to be disbursed as $41,000 to further acquisition of Storm Australian Indexed Trusts at Macquarie Bank companies and $2977 to Storm Financial for fees. The rear page of the application form for the Storm Australian Indexed Trusts acquired with this margin loan extension is signed by Schluter.

3.11 About October 2007, the complainants received yet another telephone call from Storm Financial to advise them that they were ready for a further investment step. Shortly afterwards, the complainants on the advice of Ms D a Storm Financial adviser, extended their margin loan by a further $268,563. This was done on advice given in a Statement of Additional Advice (SOAA) dated 15 October 2007 and implemented by a letter signed by the complainants on 18 October 2007 directing Macquarie Margin Lending to extend their margin borrowing by this amount. At the same time the complainants applied for further Storm Australian Indexed Trusts of $250,000 and paid Storm Financial fees of $18,563. The rear page of the application form for the Storm Australian Indexed Trusts acquired with this margin loan extension is also signed by Schluter.

3.12 In late 2007 or early 2008, the complainants, again on the advice of Ms D extended their margin loan by a further $59,084. This was done on advice given in a Statement of Additional Advice (SOAA) dated 15 October 2007. The complainants implemented this advice by a letter they signed (again undated) directing Macquarie Margin Lending to extend their margin borrowing by this

amount. The application the complainants signed for further Storm Australian Indexed Trusts of $55,000 was dated 27 December 2007. The complainants paid Storm Financial fees of $4,084.

3.13 The complainants agreed further margin loan extensions documented in the same fashion as those described above, on 25 January 2008 and 13 June 2008. The first of these was advised under a SOAA dated 22 January 2008, and signed by Schluter. The second was for $20,000 advised under a SOAA dated 15 April 2008, and signed by Schluter.

3.14 As a result of these borrowings the liabilities of the complainants by mid- 2008 were as follows:

No.	**Date**	**Investment Amount**	**Margin Loan**	**Home Equity Loan**	**Fees**	**Exhibit**
SOA	27 April 2007	$750,00 in SOA, but $890,000 in fact (see loan extension)	$70,00 in SOA but $195,000 in fact (see loan extension letter)	$584,000	$27,791 and $31,989= $59,780	**A**
SOAA	17 August 2007 margin loan extension letter	$41,000	$43,977	Nil	$2977	**B**
SOAA	2 August 2007	$50,000	$53,630	Nil	$3,630	**C**
SOAA	October 2007	$250,000	$268,5630	Nil	$18,563	**D**
SOAA	December 2007	$55,000	$59,084	Nil	$4,084	**E**
SOAA	January 2008	$25,000	$26,856	Nil	$1,856	**F**
SOAA	April 2008	Nil	$20,000 (for Holiday)	Nil		**G**
	Total	**$1,311,000**	**$667,110**	**$584,000**	**$90,890**	

3.15 On about 8 October 2008, the complainants received a letter from Storm advising that they sell 100% of their portfolio of Storm Financial index funds. The letter was signed by Mr C and accompanied by an authority form to complete the request. The complainants signed the authority form and returned it to Storm Financial. Although the authority is undated, Mrs F gave evidence that she thought the form was signed a little after 7 October 2008 (Transcript 58). The complainants also attended a meeting of Storm Financial investors on about 18 October 2008, when the principal of Storm Financial Mr C reassured clients that there was nothing to worry about. Mrs F gave evidence that Schluter reassured her in the same way (Transcript 58).

3.16 In fact, a letter from Macquarie Bank dated 19 October 2009, explains that redemption of Mr & Mrs F's Index Funds investment did not take place until 29 October 2008. Their account was not in margin call. Instructions were received by Macquarie Bank from Storm Financial on 28 October 2008 to redeem 40% of the complainants' holding in each of their Australian Industrials Index Trust, Australian Resources Index Trust and Australian Technology Index Trust. Macquarie implemented the instructions incorrectly, and redeemed 80% of the complainants' Australian Industrials Index Trust. This was a breach of mandate, but benefited the complainants financially by $27,302.61. The proceeds of the redemption were applied by Macquarie Bank to pay down the complainants' margin loan, and $189,280.31 remaining capital was transferred to the complainants.

3.17 In January 2009 after Storm Financial went into liquidation, the complainants were advised by another financial planner to redeem the rest of their index funds, and received an amount of approximately $190,000 cash.

3.18 In summary, the complainants had a retirement asset base (minus their home) of approximately $644,000 when they implemented the advice received from Schluter. At the time they lodged their complaint with the FPA the complainants had $125,000 in cash but still owe $589,000 to the Commonwealth Bank on their home equity loan. During the 4 ½ years of being provided advice by Schluter, the complainants used funds from the investment strategy to travel overseas. In total the complainants travelled overseas using $20,000.

IV THE FPA'S POSITION

FPA Ethics & Rules 101 - the Misleading and Deceptive Conduct Allegation

4.1 The FPA alleges that through the Statement of Advice dated 27 April 2007 Schluter represented to the complainants that:

'We have identified that your current asset base is not large enough to fund the lifestyle you desire now, or in the future' SOA p12.

The FPA argues that to the extent that Schluter identified the investment goals of the complainants at all, the then current and retirement income they identified as wanting was well within their means without adopting a risky investment strategy given the retirement savings they had accumulated, and the fact they were 8 years from total retirement.

4.2 The FPA also alleges that at a meeting with the complainants on or about 16 February 2007, Schluter discussed the Mr & Mrs F's risk profile with them. Schluter showed them page 22 of the Confidential Financial Profile he had filled out with the complainant's answers. On that page there is a menu of risk levels and the client is asked to select one. Schluter said to the complainants words to the effect:

'Read the four investment categories and tick and sign the one that is appropriate for you. Don't tick the top two categories – they're too risky, and the bottom category will give you no growth, and you need growth.'

In so directing the complainants, Schluter represented that he was recommending a lower level of risk, when the recommendations he actually made in the Statement of Advice of 27 April 2007 were much higher risk.

4.3 The FPA further asserts that at a meeting with the complainants on or about 16 February 2007 in response to a query by the complainants:

'We don't want a risky investment. Is this safe?'
Schluter said words to the effect:

'Yes, its very safe, Storm Index Funds are diversified and much safer than ordinary shares. Any borrowings up to 60% of the value of your investment is fine.'

In fact the FPA argues that the recommendations Schluter made were not 'very safe' and were risky because of the large borrowings involved for a couple who were transitioning to retirement, and because the investment strategy advised was undiversified.

4.4 The FPA also argues that the cash flow worksheets in the Statement of Advice of 27 April 2007 are misleading. The six monthly tables in the worksheets provide no indication of how the complainants living expenses are to be paid after they retire in 2015, since this item is not provided for. If this item (conservatively $40,000 per annum) were added it would quickly show cash reserves going into deficit yet there is no indication of how this deficit is to be funded. Further, in the cash flow documents the SOA provides for interest on a home equity loan of $750,000 but in fact the loan was $890,000. Likewise, the cash flow figures in the SOA provided for a margin loan of $70,000 but in fact it

was implemented by borrowing $195,000. Finally, the FPA argues the figures in the cash flow worksheets were a misrepresentation because they included a contribution of the Mr & Mrs F's own funds of $13,200, after 2015 when they planned to retire and would have no source for such a contribution. Accordingly, the FPA argues the cash reserve figures were incorrect from the beginning, and would have quickly moved to a large cash reserves deficit once the complainants retired in 2015. It is from these cash reserves that the complainants' interest payments and living expenses were to be met.

In fact the gap that would have opened up between the cash reserve deficits and the unrealised and nominal increase in accumulated investment growth, but not shown in the cash flow work sheets, was met by subsequent increases in the margin loan as shown in the table above even before 2015. There is no statement or other indication in the Statement of Advice of 27 April 2007 that inherent in the strategy was the continual increase in the size of the margin loan in order to provide these cash reserves. This omission to explain the fact and significance of the actual growing deficit in cash reserves and that it could only be sustained by banks continuing to make further advances, the FPA argues was a misrepresentation.

4.5 The FPA asserts the complainants relied on these cash-flow worksheets, as recommended to them by Schluter, to assure them that the strategy would give them sufficient funds to live on in retirement and to meet their interest and other financial obligations and would do so safely and securely. The FPA says the complainants relied on these representations by Schluter in their decision to become Storm Financial clients and implement the investment recommendations made by Schluter in the Statement of Advice of 27 April 2007.

FPA Ethics & Rules 110 – the Failure to Provide a Suitable Financial Strategy Allegation

4.6 The FPA alleges that in breach of FPA Ethics and Rules 110 Schluter failed to develop any suitable financial strategy for the complainants before making his recommendation that they invest. In particular the FPA alleges that the complainants were advised to adopt a geared investment strategy at the heart of which were large margined borrowings and large borrowings secured on their residence, even though they were close to retirement and concerned about whether they had sufficient funds for retirement. This recommendation was mostly made in the SOA of 27 April 2007 and was reinvigorated by incorporation by reference in a series of subsequent SOAAs up until 2008.

4.7 At the hearing the FPA argued that the complainants had chosen a level of risk for their financial plan that was not matched by the advice they were given (Transcript p 17, 21-23). In the Confidential Client Profile (Exhibit 3 p 14) the complainants selected a level of risk that declared 'I am prepared to accept volatility if in the medium to long term the investment growth is higher and the risks over *that term* are minimal or eliminated.' On the same page they chose a

5-7 year time horizon – it was one which matched their risk level. The FPA argued that the leveraged investment strategy which the complainants were advised to adopt, was much higher in risk than the level they chose. The FPA argued further that the level of risk implemented, was just one manifestation of the general allegation that the complainants were given investment advice that was unsuitable. It was unsuitable because they did not want the level of risk that the strategy imposed. Their choice of risk level and the requests for reassurance about riskiness (Transcript 17, 25) were also evidence that they did not welcome a risky strategy.

4.8 The FPA also argued that the strategy Schluter advised was unsuitable because the complainants investing purposes were much more modest than to require such a complex high risk strategy. In the Confidential Client Profile and the SOA investment goals of the complainants are barely identified. See SOA page 13. The complainants made it known to Schluter during meetings in early 2007 that they were content to live on approximately $50,000 per annum to meet living expenses. The FPA argued that given the retirement funds the complainants had amassed, and were likely to continue to amass by retirement, the complainants were encouraged to agree to a strategy with a risk level that was both unnecessary and unsuitable.

4.9 The aspect the complainants were not expressly advised of, and which the FPA alleges they were misled about and which was particularly unsuitable, was the large borrowings to fund cash reserves, and that these borrowings would increase. The FPA argues that these borrowings, especially given they were to fund income over and above the amount the clients needed to live, were unsuitable for a couple both retired and with no income independent of their investments. Further, the advice was unsuitable because it involved investing borrowed funds in index funds which could go up and down. The risk of losing the capital of the borrowed funds and losing the asset on which it was secured (their home) and other savings, when transitioning to retirement made it impossible for the complainants to replace that capital, had very serious consequences for their financial welfare.

FPA Ethics & Rules 111 – the Failure to Provide an Explanation of Risk Allegation

4.10 The FPA alleges that Schluter failed to provide an adequate explanation of the risks involved in the strategy and recommendations he made to the complainants. The material in the SOA was extremely general as to the risks being run in a margined strategy, especially one secured on the complainants' home. The SOA provided no comparison between the margined strategy recommended, and any other strategy for a couple approaching retirement.

4.11 The discussion of risk that was included in the SOA was very general: taxation risk, market risk, inflation risk, risk of the failure to sufficiently diversify and so on. There was no place in the entire SOA where the risks involved in the margined strategy recommended to the complainants, were explained in terms of the *specific risks which if they were realised would effect the financial future of the complainants*: there was just no such content in the SOA at all. The FPA

argues that it is only risk disclosure of this character which could satisfy the requirement of FPA Rules and Ethics 111, and where that risk is explained in terms the complainants could understand. In fact, as is obvious from paragraphs above, the FPA's allegation is that far from explaining risk in a way the complainants could understand, Schluter misrepresented the nature and effect of the risks involved.

The FPA argues that nowhere in the paper work nor in the conversations Schluter had with the complainant's is there any instance where the risks associated with the strategy recommended were explained so that they could understand. The FPA asserts that reading the SOA to the client's verbatim (Transcript p 33-37) is not providing a sufficient explanation. Nor is giving the client's the SOA to initial each page after the investments have all been made (Transcript p 33-37). Finally, the FPA relies on Mrs F's evidence that she told Schluter that she did not understand the SOA and he said 'That's fine, as long as you've signed it' (Transcript p7).

FPA Ethics & Rules 118 – Causing a Client to Move Investments Without Explaining the Reasons so the Client can Understand

4.12 The FPA asserts that Schluter advised the complainants to switch a portfolio of shares, a life insurance policy and cash to the geared strategy invested in index funds described above. The FPA repeated the assertions it made about Schluter's failure to explain the rest of the strategy he recommended in a way the complainants would understand. The FPA argued it applied with particular force, to the switching advice he gave them.

The FPA argued that Schluter had done nothing to demonstrate that the switch was appropriate for the complainants. They point out that there is no place in the original SOA that a comparison is given of the benefits and drawbacks of the switched assets, and those in the recommended strategy, let alone comparative analysis of a second alternative. There is no evidence that any such oral analysis was given to the complainants either.

FPA Ethics & Rules 6 – the Bringing Discredit to the Profession Allegation

4.13 The FPA argued that as a result of the conduct alleged in the paragraphs above, Schluter had bought the profession of financial planning into discredit.

V THE MEMBER'S POSITION

5.1 As has already been stated Schluter neither attended nor appeared at the hearing. The following account of Schluter's position is therefore taken from the letter of response to the FPA's initial letter setting out the facts of the matter as related to the FPA by the complainants. This letter (FPA Exhibit 10), dated 9

July 2010, was written by Schluter to the FPA before the FPA issued its breach notice to Schluter. Schluter did not take the opportunity he was given to furnish the FPA with a formal response to the breach notice. Instead in an email of 9 July 2011 (FPA Exhibit 12) to the FPA's Investigation Officer, he stated that he did not intend to respond again, and would rely on the matters he had already raised in his prior letter of 9 July 2010.

FPA Ethics & Rules 101 - the Misleading and Deceptive Conduct Allegation

5.2 Schluter does not deny that the complainants were long-standing clients of his, and that he encouraged them to attend Storm Financial educational workshops. He says that it was compulsory for clients to attend Storm Financial seminars to understand the Storm model. In his letter (Exhibit 12) he says:

'Storm did not adjust the model for the investor. The investor either accepted the model after extensive education and discussions or went elsewhere for advice. So the investor was fully informed and chose the risk level by choosing to invest with Storm'.

5.3 Schluter does not deny that he made representations to Mr & Mrs F. He says in response to the claims made by the complainants and relayed by the FPA investigation officer, that he has no recollection of conversations that took place several years before. He says: 'I do not recall verbal statements made over two years ago.'

5.4 Schluter has responded to the allegations of misleading representations related to the negative cash reserve figures in the cash flow statements, the reassurances that the strategy was not risky and the allegations that he told the complainants their asset base was insufficient to fund their retirement plans. He does this by quoting portions of the Confidential Financial Profile (FPA Exhibit 1) and the SOA of 13 July 2007. In particular Schluter makes the following statements in his letter of 9 July 2010:

'You have sought our advice on ways to expand your income streams so that you can become more financially independent from work and have more lifestyle choices in the future.' SOA p12

Also:

'We have explained this approach to you; you have acknowledged and accepted that this is an appropriate way for us to give our Recommendations to you.' SOA p9

Further he points to pages 33-38 of the SOA where there is material about risk, and says this was a discussion the complainants 'read, asked clarifying questions, understood and signed'.

There is no evidence or explanation directed to the specific misrepresentations alleged. The response relies entirely on general statements and excerpts from the documents.

FPA Ethics & Rules 110 – the Failure to Provide a Suitable Financial Strategy Allegation

5.5 From his letter of 9 July 2010 (Exhibit 10) Schluter argues that the complainants agreed to Storm Financials 'prescriptive' approach. He argues, that although this approach is quite different to other financial planning, the complainants

'accepted the approach by selecting 'Yes' and signing 'the prescriptive approach' on page 24 of the CFP.'

He quotes further parts of the SOA and CFP in support of the proposition that the complainants agreed to accept recommendations that they were uncomfortable with, as part of the 'prescriptive approach'. He goes on to say:

'However, Storm did not adjust the model for the investor. The investor either accepted the model after extensive education and discussions or went elsewhere for advice. So, the investor was fully informed and chose the risk level by choosing to invest with Storm.'

And later in the same response letter:

'There is no intention of low risk in the option referred to on page 22 of the CFP. The four volatility statements do not attempt to classify people into low risk, medium risk and high risk.'

The risk options referred to on page 22 of the CFP, are the list of risk alternatives of which Schluter asked the complainants to choose one, and they believed they were choosing a low risk option.

It is also clear from several passages in his letter, that Schluter considers that even though he was an Authorised Representative of Storm Financial, he had no control over the contents of SOAs or the strategies recommended in them. The giving of advice, we are led to believe was centralised and the adviser a conduit to the client from the licensee and its para-planners.

FPA Ethics & Rules 111 – the Failure to Provide an Explanation of Risk Allegation

5.6 The member responds to this allegation in his letter to the FPA of 9 July 2010 (Exhibit 10) by arguing that the complainants attended educational workshops

prior to becoming Storm Financial clients, and then attended subsequent workshops in which the risks associated with their current investment strategy were covered.

Schluter also argues that the SOA given to the complainants, had sections dealing with risk management which discharged his obligations under this provision of the FPA Rules & Ethics. He also asserts that the complainants attended meetings with him over a period of 2 years, and that they had plenty of opportunities which they took, to enquire, ask questions and receive explanations.

Schluter also argues in his letter of 9 July 2010, that the complainants signed statements in the SOA and CFP that they accepted and understood many of the aspects of the strategy and recommendations he made to them.

FPA Ethics & Rules 118 – Causing a Client to Move Investments Without Explaining the Reasons so the Client can Understand

In his letter of 9 July 2010 Schluter does not address this allegation bought by the FPA.

FPA Ethics & Rules 6 – the Bringing Discredit to the Profession Allegation

5.7 Schluter denies that his conduct has ever bought the financial planning profession into discredit.

VI THE LEGAL QUESTIONS

Either expressly or by inference, Schluter's response to the FPA's allegations, raised a number of legal questions. These questions are dealt with below, and guide the final determination of each of the allegations, set out in Part VI.

Is a Representative Member Personally Liable for Conduct Done at the Direction of their Principal?

6.1 The FPA rules do not answer this question directly: unlike the *Corporations Act 2001* where section 945A (2) expressly provides that it is a defence to liability for unsuitable advice, if the principal has given the representative information or instructions about the giving of personal advice. Another salient difference between the *Corporations Act* provisions and the FPA Rules is that the former can result in criminal prosecution whereas the FPA Rules are squarely civil in character, and the sanctions are limited. There is therefore an important qualitative difference in the consequences of following directions as between the Corporations Act and the FPA Ethics and Rules.

6.2 That leaves us with the following questions: what is the personal *civil* liability of an agent who acts on instructions in giving advice, or passes to the client advice prepared by the principal? And, how does that civil liability in the ordinary law of agency fit in with the contractual membership rules of an

industry association such as the FPA? The usual consequences of an authorised representative acting as an agent for a principal to conclude an advisor-customer agreement, is that the agent will create a privity of contract between the principal and the customer, without itself becoming an party to the contract. In this case, Schluter causing the complainants to become a Storm client created a contractual relationship between them and Storm Financial – the complainants were Storm's customers. That made Storm Financial liable for unlawful acts done by Schluter causing damage to the complainants. No doubt the authorised representative agreement between Schluter and Storm provided that Schluter should indemnify Storm for any liability it incurred to customers, because of Schluter's conduct.

6.3 In response to the allegation that he gave unsuitable advice to the complainants, Schluter argues that he acted on instructions from Storm Financial and has no liability. It is true that the general law imposes on agents the duty to follow the instructions of their principals. But Reynolds points out in *Bowstead on Agency* (Sweet & Maxwell, 1985) at 140-141 that: 'Instructions which involve the performance of an illegal act normally need not be obeyed' citing *Cohen v Kittel* (1889) 22 QBD 680; *Donovan v Invicta Airways Ltd* [1970] 1 Lloyd's Rep 486. Further to our point Reynolds points out also at pp140-141:'In the case of a professional man he will be bound to a considerable extent by the rules and ethical standards of his profession and he could not be required to perform an act which was contrary to those rules or standards.' And 'thus a stockbroker is only required to carry out a sale of shares in accordance with the rules of the stock exchange and cannot be required to act other than in accordance with those rules.' *Hawkins v Pearce* (1903) 9 Com Cas 87; *Cunliffe-Owen v Teather & Greenwood* [1967] 1 WLR 1421. The same would likely follow from the principles set out in *Bell Group Ltd v Herald and Weekly Times Ltd* (1985) 9 ACLR, 697.

6.4 So although it is usually the case that an agent must act on the principal's instructions there are limits, and asking an agent to break the law or depart from the professional standards by which he or she is governed, overreaches these limits. Just as a stockbroker in Australia cannot act in breach of the Market Rules of the Australian Stock Exchange and all contracts it enters are subject to those rules, a financial planner cannot act in breach of the Rules and Ethics of the FPA. All other contracts, including the authorised representative agreement and the contract the representative planner procures the customer to enter with the principal, are subject to the FPA's rules. In well drafted authorised representative agreements, this position would be stated expressly.

So the second question above, about how civil liability in the ordinary law of agency fits with the contractual membership rules of an industry association, is answered by saying that the professional or legal obligations have priority. No liability in agency will be incurred by a representative planner who does not follow instructions to act unlawfully or in breach of professional standards.

6.5 The first question above, on the personal *civil* liability of an agent who acts on instructions in giving advice, or passes to the client advice prepared by the principal, depends on the nature and origin of the liability. Here we are

concerned with liability for breach of the FPA Rules. There is nothing in those rules which exonerates a member who is a representative planner because he or she followed instructions. Indeed, the priority given by the general law to professional standards over contractual agency, points in the opposite direction. So where the FPA Ethics and Rules require the representative planner to observe the suitability rule, there is nothing in those rules or in the general law of agency which excuses the planner from that requirement. To the extent that any provision of an authorised agency agreement would try to excuse a representative from liability for unsuitable recommendations it would likely face a challenge of being void for breach of public policy.

6.6 To the extent that the information or advice that is passed to the client by the representative having come originally from the principal consists of misrepresentations, the law divides the liability between the instances where the representative adopts the statements as their own, and instances where the representative passes on the information for what it is worth, without adopting it or endorsing it. Where the representative has adopted or endorsed the information or advice, they will be liable for it with the principal. It is not a large step to suppose that the same principle might apply for unsuitable recommendations.

FPA Ethics & Rules 101 - the Misleading and Deceptive Conduct Allegation

6.7 FPA Rule 101 prohibits acts or omissions of a 'misleading' nature. By contrast with the prohibitions in the TPA (applicable at the time) and ASICA 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.

6.8 Rule 101 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.

6.9 Generally for conduct to be misleading there must be a representation or conduct amounting to a representation (eg 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.

6.10 Predictions are a fertile ground for misleading conduct unless reasonably based and properly explained. To make lawful predictive statements the law requires that the maker have reasonable (objective facts and defensible assumptions) grounds to make the statement. The cash flow statements which were included

in appendices to the various SOAs were predictions of the sort which the law requires to be supported by objective facts and defensible assumptions. Although the SOA of 27 April 2007 states that the cash flow charts are only viability tests and not predictions or projections (at page 23 of the SOA), it is clear that is what they were. Indeed, in pages 23-26 of the April 2007 SOA some trouble is taken in setting out what is described as conservative assumptions for the calculation of the figures set out in the cash flow charts. However, one important assumption which was missing, and which the FPA alleges made the cash flow charts misleading, is the assumption that the complainants would have to rely on further loans from banks in order for the cash flow to support the strategy which Schluter advised.

6.11 A misrepresentation made in one part of a document 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 deceptive and misleading conduct. The Storm Financial SOA given to the complainants was very long, with many appendices. The cash flow statements on which the FPA says the complainants relied were in these appendices, but the narrative which was supposed to provide assumptions for the cash flows and explain their operation was in pages 22-27 of the main body of the SOA. In fact this material contained nothing which corrected the omission to explain the need for reliance on bank loans to fund cash reserves alleged by the FPA to be a misrepresentation, but the length and multiplicity of parts of the SOA may have hidden that explanation if it had been there.

6.12 There is a further legal point to be made about the allegations of misrepresentation arising from the failure to explain the reliance on continuing loan funds implicit in the cash flow charts. This is that silence can amount to misleading conduct. This position is express in the terms of FPA Rule 101 which includes the word 'omission' in its description of 'conduct' which may be misleading. It is also clear from the legal interpretation of the term 'conduct' in many other contexts in Australian law – and we see no reason to deviate from that interpretation in seeking the meaning of the FPA Rules when they are intended to be protective of member's clients. To determine otherwise would leave a large gap in that protection.

FPA Ethics & Rules 110 – the Failure to Provide a Suitable Financial Strategy Allegation

6.13 The material words of FPA Ethics and Rules 110 require the planner to 'develop a suitable strategy or plan for the client'. This plan must be 'based on the relevant information collected and analysed' a reference to the requirement to collect information from the client in FPA Rule and Ethic 108. These two rules operate together, and are two sides of the one coin. The planner collects

information from the client to make an assessment of the type of strategy or plan that would meet the client's needs. This strategy may be to do nothing: or it may be to go home and pay off the mortgage and continue to make the highest contributions to an existing super fund that are affordable. Many Australians need only quite modest financial plans, at least in the earlier stages of their lives.

6.14 But often the strategy should be more sophisticated, and it may require the planner not only to develop a plan from the client's information, but also to access or do research to identify which interests or instruments (ie which products) are suitable for the client. The identification does not have to result in recommending the 'best', the rule requires only that what is recommended is suitable. In short the FPA Ethics and Rules prescribe a two step approach to a suitable recommendation: collection and analysis of client information to identify client needs and research and analysis to match the needs with suitable recommendations (usually but not always, acquiring financial products). The overall result is the development and implementation of a financial plan.

6.15 We have set out this discussion of the rules to make two related important points about the suitability obligation on advisers. The first point is that the adviser must match the plan and its implementation to the client's needs, not the client to the strategy and products. If the plan or strategy and its implementation is not based on meeting needs it will not satisfy the suitability obligation. Put shortly, the advice must be 'client centric' not 'product centric' or 'strategy centric'.

6.16 The second point is this. The role of the financial adviser is to discern the client's needs and put them into financial terms. Those needs include the client's need to be at peace with the level of risk they assume when the plan is implemented. That need may well convert into different (and lower earning) financial terms for risk averse clients than for those who are perhaps younger or for many other reasons may tolerate higher risk. The risks need to be disclosed to the client in terms the client is likely to understand (FPA Ethic and Rule 111). It is not the prerogative of the planner to either ignore the risk preferences of the client or to train them to accept (or appear to accept) a higher level of risk than they wish to assume. The role of the planner is to develop a plan that is suitable for the client's needs, including the need to be content with the risk levels assumed. It is certainly not part of the role of the planner to act as a hidden persuader to get the client to believe they have financial needs greater than they do. It is also no part of the planner's role to coach clients to take on risks (which may not be properly explained) that they do not feel thoroughly comfortable with. Both these examples are, reverting to our prior point, attempting to mould the client to the strategy, not the strategy to the client. They amount to a breach of the suitability obligation and depending on the degree to which the client's instructions about risk have been ignored, may also involve a breach of the express terms of the client mandate.

6.17 Finally on the question of suitability, it is not to the point for a planner to say that he or she has made disclaimers, or obtained concessions or made disclosure which exempts them from the operation of the suitability obligation. The best

view of the effect of exemptions, disclaimers and disclosures on the suitability obligation, is that they are virtually useless in reducing liability. Certainly under s945A of the Corporations Act 2001 there is no room at all for reducing liability flowing from the obligation to have reasonable grounds for advice by any of these devices. Similarly, using contract terms to position the client so their behaviour may be seen as akin to contributory negligence is also ineffective. We see no reason in principle and no compulsion or encouragement from the actual words of the FPA Ethics and Rules, to deviate from the Corporations Act 2001 position in the interpretation of FPA Ethics & Rules 110.

6.18 Speaking about specifics, where attempts by the advisor to avoid or diminish liability amount to paragraphs of general 'boiler plate' say about the nature and effect of risk, then they are not worth the paper they are printed on. Even if such attempts could be effective under the suitability rule, exemptions or disclaimers with force have to be precise and specific to the risks the client will actually face under the plan as implemented. Further, they must be bought to the particular attention of the client, and the effect explained, prior to entry to the mandate or the adoption of the SOA or any other document. Sometimes disclaimers or exemptions which pass these tests, are effective to reduce or avoid liability for negligence, though often in our statutory age, such attempts are ineffective under statutory provisions. But there is no authority that we are aware of where disclaimers and other analogous devices have been successful in reducing liability for breach of the suitability obligation, and certainly in the statutory context in Australia this is just legally not possible.

6.19 So even if fees or commissions are punctiliously disclosed, if they are disproportionately large for the size or duration of the investment, they will still render the advice unsuitable. Even if the majority of an adviser's clients are put into a prominent manager's funds and the return is appropriate, no amount of words saying that predictions are based on historical averages or that research houses were used to provide indicative figures will suffice if there are just no good reasons to put that particular client into those funds. What is suitable for others (even the majority of others) is not necessarily suitable for all, and no number of general statements or disclaimers supported by averages or trends or opinions can change that.

FPA Ethics & Rules 111 – the Failure to Provide an Explanation of Risk Allegation

6.20 Rule 111 requires that an explanation of risk is given to customers 'in terms that the client is likely to understand'. An understandable explanation of risk is at the heart of informed client consent to the investment strategy they are agreeing to. A failure to properly inform a client about risk can result in allegations of misleading behaviour, discharge of the customer contract for breach and negligence in the discharge of advisory responsibilities. Explanations of risk that the client is likely to understand have two crucial components. Firstly, they must be explanations that are directly relevant to the risks involved with the strategy or products that the financial planner is actually advising them to take. An explanation of risk that is general as to product categories or asset

allocation or to exogenous factors such as market volatility, tax liability or change in legal rules, is inadequate. It may be useful to orient the client in a general way, but it is quite beside the point in discharging the obligation to set out the particular risks that might diminish clients' financial wellbeing arising from the specific plan or products being advised. Inadequacy in so doing, is likely to disguise the real risk involved: it may as a result lead to inadequate assessment of suitability of a strategy or product, or even to the making of misrepresentations as to the nature and effect of risks.

6.21 Secondly, to comply with Rule 111 the planner has to explain the risk to the client in terms the client can understand. This will usually involve a one-to-one meeting with the client, in which virtually every page of the SOA they are about to sign is explained. This is consonant with the point just made, that it is the precise risks to be assumed by that client that must be disclosed and explained. It is not the general risks of an investing approach that might be explained in a seminar with others present, that is the object of this rule. It is the precise risks of the individual's proposed strategy that must be explained. And the explanation must be done in a fashion that responds to the client's level of financial literacy and experience, to the complexity of the strategy or products – 'in terms that the client is likely to understand'.

FPA Ethics & Rules 6 – the Bringing Discredit to the Profession Allegation

6.22 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.

VII OUTCOME AND REASONS

FPA Ethics & Rules 101 - the Misleading and Deceptive Conduct Allegation

7.1 The complainants gave evidence that statements to the effect of paragraphs 4.1-4.5 above, were made to them, both in the SOA and in one to one meetings with Schluter (Transcript pp12-26).

7.2 Considering the misrepresentation that **Schluter told the complainants their asset base was insufficient for retirement**: the FPA argued from the calculations set out in paragraphs 12-21 of Annexure 'A' to the Notice of Charge (FPA Exhibit 11) that the complainants could easily have satisfied their retirement income needs with a much less risky strategy than that advised by Schluter. The FPA's evidence concluded that even if their pool of retirement savings at 2015 was invested in an allocated annuity, based on a 30 year period at 6% annual return, they would have had access to $100,297 per annum. Although this is a pre-tax figure, it is very much more than the figure of

$61,050 which is the FPA's estimate of the complainant's 2007 living and travel expenses expressed in 2015 figures.

7.3 Schluter provided no evidence to contradict that given by the complainants nor to contradict the FPA's figures, calculations and conclusions. The CRC accepts the evidence of the complainants as to the statements about adequacy of their retirement funds made by Schluter. The CRC accepts the evidence, calculations and arguments of the FPA that in the light of their retirement income purposes set out in the Confidential Financial Profile the complainants had sufficient retirement assets. They did not need the Storm Financial strategy to have a standard of living they were content with.

7.4 In relation to the FPA's allegations that Schluter **made misleading representations about the safety of investing** using the Storm Financial strategy it is important to recall the context in which these representations were made. The context is one of the complainants fearing that their retirement income provision was inadequate and that they would fritter away an inheritance, unless it was properly invested. (Transcript p 15-6)

7.5 The complainants were also afraid that the Storm Financial strategy was risky (Transcript p 17). The complainants were aware enough of the risks of the Storm Financial strategy to take many months to become Storm Financial clients. They were aware enough of the risks to make a conservative selection of the risk level they preferred in the instructions they gave to Schluter in the Confidential Client Profile they signed. They were aware enough of the risks to be asking Schluter direct questions about the riskiness of the strategy in early 2007 to seek reassurance (Transcript p25). Their evidence was clear that they sought, and were given assurances that the Storm Financial strategy was safe. Schluter purported to verify those assurances, by stating that he invested his own assets in the same strategy (Transcript p25).

7.6 The Storm Financial strategy which was adopted from the time of the April 2007 SOA, left no room for keeping the low Loan to Valuation Ratios at which investing with Storm began. It required increasing borrowings right from the very beginning: it is just that this aspect was never explained to the complainants so that they could understand the risks. Instead they were given assurances written and oral by Schluter that they could rely on Storm Financial's strategies to preserve them from loss. As additional SOAs were offered to the complainants they were lulled by the continuing effect of the misrepresentations and the apparent expertise of their advisers, to continue borrowing. Within a few weeks of implementation of the advice given by Schluter, Storm Financial was in touch with the complainants suggesting that they borrow more. Then followed a series of SOAAs and further loans so that by October 2008 the complainants owed over $1,302,000 and their LVR had risen to over 90 per cent. Although how it would work, and the risks involved were not spelled out in the April 2007 SOA, this financial strategy of increasing loans was implicit in the strategy Schluter recommended to the complainants. It is central to the cash flow charts which use cash reserves, but do not explain how they will be funded.

7.7 The fact is that the uncontradicted evidence of representations made by Schluter about risk were wrong. They did not cover the wider range of risks that could come home to roost when a couple approaching retirement were advised to adopt a highly leveraged investment strategy, where borrowings were secured against their home. The reassurances were not balanced with information about how borrowings increase risk, and that using their home as security, could mean they would lose it. The reassurances did not point out that funds lost could not be replaced late in a working life, and that borrowing increased the risk of irreplaceable losses. The reassurances did not draw the complainant's attention to the fact that the calculations in the cash flow charts relied entirely on bank loans continuing to be forthcoming, and if they were not, relied entirely on the ability to realise funds from accumulated investment growth in a buoyant market. Those funds would be necessary to make interest payments and pay basic living expenses. The reassurances given to the complainants were so unbalanced as to be misleading: they utterly failed to present a realistic picture of the risks that the complainants were being advised to take on.

7.8 Thirdly, the FPA alleges that Schluter **misled the complainants by failing to explain that the cash reserve figures which were are an integral part of the recommendation given to the complainant's, would quickly grow to be a very large debit amount**. The allegation is made by the FPA relying on the cash flow spread sheets attached to Statements of Advice given to the complainants. In particular the Statement of Advice (SOA) dated 27 April 2007 (FPA Exhibit 2) and the SOAA dated 15 April 2008 (FPA Exhibit 4). Each of the original SOA and the subsequent SOAAs given to the complainants contained these cash flow spread sheets. The spread sheets contained virtually identical financial entries (though the numbers rose with each version to reflect additional borrowings) supporting an overall strategy following through from the first SOA in April 2007. The cash flow spread sheets are made part of each advice, by cross reference in the body of the initial SOA dated 27 April 2007, which SOA is referred back to in the opening paragraphs of every subsequent SOAA.

7.9 The FPA argued that the cash reserve deficit, would require continual increase in the Schluter's indebtedness to banks, secured either on their holdings of Storm index funds, or their home and other realty, or both. A search for an explanation of the need for and risk of, continual advances from banks in the SOAs is fruitless. The cash flow charts are in Appendix B and of the April 2007 SOA and there is discussion and some assumptions identified in pages 23-26 of the main body of the SOA. But in neither place is there an explanation of the fact that the cash reserves will only be plausible if further support from banks is forthcoming.

7.10 In evidence the FPA took the cash flow spread sheets in the SOAA dated 15 April 2008 as an example (FPA Exhibit 4). The FPA argued that in the SOAA in July 2010 the complainants had cash deficit of $8890. In July 2015 at which time the complainants hoped to be retired, this figure is $154,198 in deficit. By July 2024 when the cash flow charts in the SOAA end the cash reserves figure is negative $557,331. It is from this cash reserves figure that the interest on the

complainant's loans is to be met, and although neither the SOA of 27 April 2007 nor the SOAA of 15 April 2008 provide for it, the complainants living expenses were also to come, after their retirement in 2015, Similarly the ludicrously optimistic cash flow figures continue to be unrealistically bolstered throughout the annual calculations in both the SOA and SOAA, by the inclusion of a contribution of the complainant's own funds of $13,200, despite the fact that they planned to retire in 2015 and would have no source for such a contribution. Finally, there are different assumptions for the forward projections for the same years in the SOA and the SOAA, despite them being barely a year apart. The SOA assumes no accumulated investment growth from 2007-2013. By contrast the SOAA assumes accumulated investment growth starting in 2010. There is no explanation anywhere in the documents, nor any testimony of oral explanation of this obvious and important inconsistency.

7.11 The cash flow charts in the SOA and SOAA show unrealised accumulated investment growth in the complainants' investments. Even if the predictions of unrealised accumulated investment growth are conceded to be accurate, the FPA alleges that Schluter failed to explain to the complainants that they would have to rely on further advances from the banks to realise these amounts. The FPA says Schluter failed to explain that the value of the unrealised accumulated growth in the complainants' assets was volatile, and may end up being much less on realisation than the amount of their accumulated deficit in cash reserves. There is no place in the initial SOA where this is explained, and no place in any of the subsequent SOAAs where it is explained. The complainants gave evidence that this aspect of the recommendations was never explained orally by Schluter.

7.12 The member asserts the complainants attended Storm financial seminars where this was explained, and had plenty of opportunities to ask questions. However, the responses the member did provide in his letter of 9 July 2010 rely entirely on quoting general statements and excerpts from the documents. For example, in response to the allegation that Schluter misled the complainants about the risks he makes reference to pages 33-38 of the SOA. This contains a description of general risks that any investor could face. There is no discussion whatever, directed to the specific risks that the complainants were being advised to assume. Nor was there any discussion of the practical effects that the recommendations could have on the complainants financial welfare, if the strategy or the products within it, failed.

7.13 The Panel finds that the long-term *fact* of the growing deficit in cash reserves was never explained to the complainants in writing or orally. Instead it was buried in complex cash flow charts at the end of the SOA and SOAAs. The FPA argues the long term *effect* of the growing deficit in cash reserves was never explained to the complainants. The FPA also argues that the long term *risk* of the increasing deficit in the cash reserves was never explained. And when the complainants asked about the possibility of losses from what they could understand of the strategy, they were reassured by the statements the FPA alleges were made by Schluter.

7.14 The Panel finds that the complainants relied on Schluter's statements and on this conduct in deciding to become clients of Storm Financial and to accept the recommendations made to them. There is nothing elsewhere in the responses Schluter made to the FPA's allegations notice that raises any reasons why the complainants would not have come to trust Schluter after the extended professional association, and to have relied on his representations and other conduct. The Panel finds that Schluter's conduct was misleading and this was central to the complainants accepting the advice and relying upon it. That conduct, misled the complainants into thinking that the advice they were given was much safer and sounder than it was.

FPA Ethics & Rules 110 – the Failure to Provide a Suitable Financial Strategy Allegation

7.15 The FPA alleges that in breach of FPA Ethics and Rules 110 Schluter failed to develop any suitable financial strategy for the complainants before making his recommendation that they invest. In particular the FPA alleges that the complainants were advised to adopt a geared investment strategy at the heart of which were large margined borrowings and large borrowings secured on their residence, even though they were close to retirement and concerned about whether they had sufficient funds for retirement.

7.16 It is clear from the confidential Financial Profile (FPA Exhibit 2) that the complainants chose a low level of risk indeed, they gave evidence they did this partly at the prompting of Schluter. Further, the complainants gave clear evidence that they were worried about risk, and asked for assurances that the strategy being recommended was not risky. They were given those assurances. Instead, the evidence is uncontroverted, that they were advised to take on a series of large loans, one secured on their home. They were advised to invest this fund and assets of their own, in an undiversified portfolio of Index Funds.

7.17 The first of Schluter's defence arguments, is that the complainants agreed to the advice they were given. Schluter's defence here in effect amounts to an argument of contributory negligence by the complainants – they agreed so the advice was suitable, and so they must bear the consequences of their agreement. We made the point in Part VI above that under FPA Rule 110 the adviser must match the plan and its implementation to the client's needs, not the client to the strategy and products. It is not the prerogative of the planner to either ignore the risk preferences of the client or to train them to accept (or appear to accept) a higher level of risk than they wish to assume. It is the responsibility of the planner to develop a strategy which complements the clients' needs, and if they cannot (eg they lack expertise or their APL does not include an obvious product) they must refer the client to another firm.

7.18 It is clear, from the long-standing planning relationship Schluter had with the complainants, that he was very familiar with their circumstances and their investing purposes. It is also clear that he encouraged the complainants to move to Storm Financial and to adopt the Storm Financial approach to

investing. Several months passed as Schluter worked with the complainants to encourage them to borrow money on security of their home, to invest in the equity markets and then to to borrow and invest further. As we have already determined, he was prepared to make misrepresentations to comfort the complainants about the level of risk involved in the Storm Financial strategy.

7.19 In the course of his promotion to the complainants of the Storm Financial strategy, Schluter became blinkered to his responsibility to the complainants to ensure that the strategy he was recommending was suitable. He overlooked that they had chosen a low level of risk from the options presented to them in the Confidential Client Profile (Exhibit 3). He also disregarded that they had said their annual income needs were about $50,000 per annum (Exhibit 3), and he persuaded them that they either needed or could have much more. He downplayed the very considerable risks to a retired couple of mortgaging their home and taking on margin credit loans to invest all their financial assets in the stock market in order to pursue this largely unnecessary greater income.

7.20 Schluter argues in his defence that the complainants knew and understood – that there was plenty of advice in the SOA about the risks of the strategy – that the complainants became well enough educated to make their own decisions. But the point of the suitability obligation is that the responsibility remains with the adviser, it is not the business of the adviser to slough off the suitability responsibility to the client. There is anyway, no warrant for such a permission in the text of FPA Rule 110, or anywhere else in the FPA Rules. As we have said in the legal discussion above, no amount of disclaimers, exemptions or other boilerplate in SOAs or other documents will relieve the adviser from the suitability obligation. No amount of persuasion, supposed education or coaching of clients will relieve advisers of the suitability obligation either.

7.21 The second of Schluter's defence points is that the complainants were clients of Storm Financial and that all the advice they were given was governed by the parameters that Storm had adopted. Schluter asserts that: 'On every occasion all of these requests were sent through to Storm Financial central processing for the advice to be centralised and structured to meet the parameters that my dealer had allowed advise to past through its process' (Exhibit 20). The implication from this statement seems to be that as he was simply following his dealer's protocols, Schluter bears no responsibility for the advice that was given to the complainants. Again, in Part VI we pointed out that this is no defence: a professional is bound by professional rules, before he is bound to his principal to do something in defiance of those rules. As the complainant's primary adviser, who knew them best, and under whose advisory influence they were, it was up to Schluter to ensure the complainants took on only a suitable strategy.

7.22 It should also be remembered, that the Storm Financial authors of SOAs did their preparation on the basis of information and analysis of needs identified for them by Schluter from his conversations with the complainants. It is not that Storm Financial was an entirely robotic provider of identical SOAs. It prepared SOAs on a pattern, but much of the detail was on the basis of what it was fed by its authorised representatives, who had the best opportunity of anyone to

determine what was suitable for the clients they introduced to Storm Financial. Furthermore, there is no suggestion in any of the evidence that Schluter resisted adopting or endorsing the SOAs presented by Storm Financial and the recommendations they contained. In fact, quite the contrary picture seems to be the case. In the end, the suitability obligation in FPA Rule 110 placed a moral and legal obligation on Schluter to decide *on the basis of the complainants' particular needs* what was suitable, and Schluter failed to do this. Instead he was content not to identify a strategy that was suitable to the client, but regardless of the financial consequences to play a central role in trying to make the clients suitable for the strategy. This led to him breaching the suitability obligation in FPA Rule 110.

FPA Ethics & Rules 111 – the Failure to Provide an Explanation of Risk Allegation

7.23 The Mr & Mrs F complained (Transcript p36-37) that they could not understand the SOA. Mrs F gave evidence that she told Schluter that she did not understand the SOA of 27 April 2007, and that Schluter acquiesced in that fact: he did nothing further to explain the strategy. The picture which is presented by the evidence is that the complainants did not really know what they were doing and did not understand. They seem to have gone along with Schluter to a point at which they felt they could not extricate themselves, and then given up the effort to really understand what was happening.

7.24 Schluter responds to the FPA's allegation that he failed to explain the risk to the complainants in a way that they could understand, by pointing out that the complainants attended educational seminars. He also points out that the complainants had the SOA for a period, and that they asked a lot of questions though he does not say to whom those questions were asked, or whether proper answers were given. Mrs F's evidence is that Schluter did not actually take the complainants through the SOA and explain it to them. He read it to them verbatim, not a format of explanation that is designed to elaborate the important points in a 'way the clients can understand'. Further, Mrs F gave evidence that Schluter only gave them the SOA in July 2007 after the recommendations had been implemented, and asked them to read it and sign every page. This makes it difficult to accept the generalised formula that is repeated in his letter of 9 July 2010, that 'Mr and Mrs F read, asked clarifying questions, understood and signed ...the SOA'. They could not have done this at a time that was relevant to the informed grant of their consent, if they did not have the SOA to consider, until it was too late.

7.25 Even if Schluter had made an effort to explain the risks of the strategy to the complainants it would have been difficult to discharge the obligation. First, the SOA itself contained only very general statements about the risks the complainants faced. It utterly failed to set out the particular risks the complainants were being advised to take, and the effect on their future financial prosperity if those risks were realised, in a fashion that they could understand.

7.26 Second, the SOA also contained a lot of information that was incomplete and contradictory, and which no one could really understand. This is not only significant in relation to misleading representations, and Schluter's suitability

obligation as already determined, but also in relation to the effectiveness of explanation of the risks. The fact is that Schluter left the complainants in a situation where they were confronted with an SOA containing large chunks so riddled with inaccuracies, irrelevancies and contradictions, as to be nonsense. No one could have understood the cash flow spread sheets in the SOA of 13 July 2007, except as nonsense, let alone a couple with very limited investment experience. The similar quality of the SOAA of 15 April 2008, only compounded the confusion and the sense the complainants conveyed (Transcript) of having been launched into a program that had a baffling momentum of its own, that they did not understand, and in which they found they had mortgaged their home, in a way they could not reverse.

7.27 Perhaps the most telling evidence of how Schluter failed to explain the risks of his recommendations in a fashion the complainants could understand, is Mrs F's evidence about how she did not understand that they had a margin loan (Transcript, p23-25). Mr F gave evidence that he did not understand either. They both thought that they had borrowed from the Commonwealth Bank and the funds were placed into a cash management account with Macquarie Bank and then used for investment. In the absence of Schluter's evidence on this, the Panel discussed and drew to the complainants' attention that they signed loan documents from two different banks. The Panel drew to the complainant's attention that they signed extensions of the margin loan on Macquarie Bank letterhead, over 5 times. They received loan statements from two different institutions. How could this misconception have developed and persisted?

7.28 Even if it is reasonable to question how long this misconception persisted, the difficulty for Schluter is that it was allowed to develop at all. FPA Rule 111 requires the adviser to explain 'at the time of preparing written or oral recommendations', and all the evidence is that Schluter did not do this. The loans were applied for in a flurry of documentation on 27 April 2007, after a long verbatim reading of the SOA. The complainants were not given the SOA to keep and read. There is no evidence that Schluter provided more specific explanations at the time the loan agreements were signed, and the mortgage entered. He did nothing further in July 2007 when Mrs F having tried to read and understand the SOA told him that she did not understand.

7.29 Accordingly the Panel finds that, it would be practically impossible for the complainants to have been given a clear, concise and effective explanation of the risks of the strategy they were being recommended to pursue. The SOA and especially the cash flow spread sheets were contradictory and mistake ridden. Unless Schluter had gone a lot further than the SOA in oral explanation of the risks the complainants were contemplating (and the weight of evidence is against this), it is not possible to conclude that Rule 111 was observed. On the most optimistic and charitable view, the complainants were left with confused and ineffective written disclosure and no effective oral explanation to clarify matters. It is difficult for us to be convinced that adequate explanations were given at the relevant time, when the clients did not even understand they had a margin loan and did not have possession of the document laying out the details of the strategy from which they could have asked questions in order to understand.

FPA Ethics & Rules 118 – Causing a Client to Move Investments Without Explaining the Reasons so the Client can Understand

7.30 There is no evidence that Schluter made any effort to compare the costs and benefits of the complainant's existing investments with those he was proposing.

The Panel's determination of the unsuitability (or inappropriateness) of the overall strategy and plan recommended by Schluter, includes the advice to move investments. The Panel has also found that Schluter did not adequately explain the overall strategy and plan to the complainants, and there is no evidence to suggest that anything was done differently in relation to the switching recommendation.

7.31 The Panel concludes that on the weight of the evidence and reasons Schluter did not discharge his obligations under FPA Rule 118.

FPA Ethics & Rules 6 – the Bringing Discredit to the Profession Allegation

7.32 Finally, did Schluter's behaviour discredit the financial planning profession? He denies his conduct was ever dishonourable, but provides no evidence or details. His response is mere assertion.

7.33 The calibre of the departures from acceptable financial planning practice in this case is gross. There was flagrant disregard of the suitability requirement – not once, but on several occasions. There was no attempt to properly spell out the risks the complainants were being asked to take, and no attempt to explain them in a fashion that met the complainants' financial capability or experience. We have found that serious misrepresentations were made – mostly to disguise the true nature of the risks that the complainants were being asked to assume.

7.34 The complainants were not only caught between two fears – of the risk of the Storm Financial strategy and the risk of outliving their assets. They were also caught by trust – trust in Schluter. We conclude that most of the investing public would consider that Schluter had breached the professional trust that the complainants reposed in him. Because of this, and the serious breaches of FPA rules set out here, we consider that ordinary people would consider Schluter's behaviour did the financial planning profession no credit. In failing to be utterly and consistently straightforward about the risks that the complainants were assuming, Schluter was leaving open the possibility that ordinary people would think all or at least other financial planners would act as Schluter did. We find that established standards for financial planning advice were thoroughly departed from, underlining further that Schluter's was not decent commercial behaviour. The CRC concludes that Schluter's behaviour is a gross departure from the FPA Rules and Ethics and well established professional standards of the type that could bring discredit on the financial planning profession.

VIII FINAL STATEMENT OF DETERMINATION

8.1 For these reasons the CRC finds the following breaches of FPA Ethics and Rules:

Rule 101 but only that the statements were misleading.
Rule 110 – a finding of grossly unsuitable advice.
Rule 111 - a finding that proper explanations that the clients could understand were not given.
Rule 118 – a finding that there was no sufficient explanation to the client of the reasons for and the appropriateness of a move from one group of investments to another.
Ethic 6 – a finding of breach of Ethic 6 leading to the discredit of the financial planning profession.

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 (revised 4 June 2010).

9.2

On delivering its next to last version of these reasons to the parties the CRC invited submissions in writing from the FPA and the member on the determination and sanctions it was minded to impose. It received no submissions from either party on the substance of the determination, or on sanctions.

9.3 The CRC imposes the following sanctions on the member:
:

(a) That Schluter pay the costs of these proceedings in the amount of $3,175.92 costs to be paid within 30 days of the date of this final determination;

(b) That Schluter be expelled from the Financial Planning Association;

(c) That having regard to the gross nature of the breaches of the FPA Rules and Ethics found by the panel, that Schluter be disciplined by the publication of his name, the fact of his expulsion and the publication of these findings in full (being breaches proven, sanctions imposed and reasons for decision) by the Financial Planning Association.