

**FINANCIAL PLANNING ASSOCIATION**

**CONDUCT REVIEW COMMISSION**

SD 2012\_2

**TERMS OF SUMMARY DISPOSAL DETERMINATION**

UNDER CLAUSE 8.2A OF THE FPA DISCIPLINARY REGULATIONS 2007

**CRC Chair:** *Professor Dimity Kingsford Smith*

**DATE OF FINAL DECISION:** 30 November 2012

## FACTS:

1. This matter concerned alleged breaches of FPA Rules of Professional Conduct by an AFP<sup>®</sup> Member (the Member) who was an Authorised Representative of a Licensee. The client (Complainant) alleged that his risk profile was wrongly classified, the asset allocation recommended to him was unsuitable and the Member failed to take steps to minimise loss on his investment portfolio.
2. The Complainant engaged the Member as a result of circumstances beyond his control necessitating the services of a new adviser.
3. On or about 22 May 2006, the Complainant met with the Member and was given a 'Client Profile & Lifestyle Questionnaire' which the Complainant took away and later returned. This completed document included the following:
  - a. The Complainant's reasons for seeking financial advice were to invest his superannuation and gain the best possible return with minimal risk. (page 9)
  - b. A specific issue of particular importance to the Complainant was to "set exit and stop loss prices on his superannuation investments". (page 9)
  - c. The Complainant described his past experience with investments as being very bad due to inappropriate advice from two advisers resulting in a loss of capital. (page 9)
  - d. The Complainant's Security score (on a scale of 1-10) in the Risk Profile was '3'. Therefore he was more concerned with his original investments, or accumulated growth or income, never falling in value over any time period rather than the other extreme of wanting to achieve the highest level of return and being prepared to risk any amount. (page 16)
  - e. The Complainant's Performance score in the Risk Profile was also a '3'. Therefore he was more concerned with preservation of capital and was prepared to accept a lower level of performance from his investments rather than the other extreme of strongly believing that total performance was significantly more important than any other issue. (page 16)
4. At the time the Complainant was 74 years of age, had a superannuation investment balance of about \$165,000 and was drawing an allocated pension of \$12,820 p.a.
5. By a Statement of Advice issued by the Member and another adviser on 20 July 2006, a re-balance of the Complainant's asset allocation was recommended as follows:

<b>Asset Class:</b>	<b>Recommended:</b>	<b>Current:</b>
Cash/Fixed Interest	35%	28%
Australian Shares	30%	35%
International Shares	15%	17%
Property	20%	20%
<b>TOTAL</b>	<b>100%</b>	<b>100%</b>

6. Consideration of the Complainant's age, retirement and the points referred to in paragraphs 3 a-e should have clarified in the mind of the Member that the Complainant was a person who was risk averse with a high level of concern for capital protection.
7. Although the Member increased the Complainant's asset allocation to defensive assets, the recommended asset allocation was in line with a 'balanced' portfolio with 65% of the asset allocation to growth assets.
8. By a Record of Advice dated 26 August 2008 the Member advised the Complainant that his portfolio had fallen in value by 12.41% to a balance of \$138,189 and recommended re-balancing back to the previously recommended asset allocation.
9. By a Statement of Advice dated 3 September 2008 the Member confirmed that the Complainant is a 'Balanced investor' and 'This means you are willing to take above average level of risks in return for above average returns and some capital preservation'. The Member also recommended a new target asset allocation of 40% defensive assets 'based on your overall situation and we believe that this portfolio is better suited to your risk tolerance'. There is no evidence available to suggest the Complainant's tolerance to risk had changed, nor that it had been actively re-examined since the earlier recommendations.
10. The Complainant became dissatisfied with the remaining balance of his investment portfolio (about \$101,000) and lodged a complaint with the Licensee in January 2009, claiming a loss of about \$68,000 based on his contention that the portfolio should have been invested in 'cash'. This complaint was ultimately resolved by FOS determination ordering the licensee to pay the Complainant compensation in the sum of \$21,203.08. This was based on the Panel's view that the Complainant's investments should have instead been in a 'conservative' portfolio. In large, this determination was based on the conduct of the Member.
11. The Complainant similarly complained to the FPA.

### **BREACH ALLEGATIONS:**

Following the FPA's investigation, the complaint was reported to the Chair of the Conduct Review Commission (CRC) who directed the FPA to issue a Notice of Charge to the Member for alleged breaches of Rule 110 (Develop a suitable financial strategy based on relevant information collected and analysed), Rule 111 (Provide an explanation of investment risks in terms that the client is likely to understand), Rule 113 (Take reasonable steps to place the client in a position to comprehend the recommendations) and 6 of the Code of Ethics (Not bring discredit to the financial planning profession).

### **MEMBER'S OWN RESPONSE TO BREACH ALLEGATIONS:**

In responding to the alleged breaches, the Member did co-operate with the FPA. The Member has recognised and accepted responsibility for his conduct in a number of ways, including compensating the client and further education and auditing.

### **SUMMARY DISPOSAL BY AGREEMENT**

As a result of the Member's response to the FPA's Breach Notice, the FPA invited the Member to discuss terms for a summary disposal of the matter. Under clause 8.2A of the FPA's Disciplinary Regulations 2007, the Member and the FPA can have discussions to form an agreement to dispose of allegations in a Breach Notice, without the need for a Conduct Review Commission hearing.

Following discussions, the FPA reached agreement with the Member whereby the Member acknowledged a breach of Rule 110 (Develop a suitable financial strategy based on relevant information collected and analysed):

- The SOA issued on 20 July 2006 indicated that the Complainant's asset allocation should be re-balanced, with the allocation in defensive assets increased to 35%. A number of the recommended investments explicitly made it clear that they were suited to investors with a medium to long term investment horizon wanting moderate to high returns who are comfortable with some short term volatility in returns and capital value of the investment. In light of the Complainant's risk aversion as outlined in the fact find (see also paragraph 3 above), such investments were unsuitable and were more appropriate for a 'Balanced investor'.
- The SOA issued on 3 September 2008 further recognised the Complainant to be a 'Balanced investor' and demonstrated the Member's failure to accurately assess the Complainant's risk profile. The Statement of Advice also recommended that the Complainant's asset allocation be adjusted to 40% Defensive Assets (a conservative portfolio would have 60% Defensive Assets) and thereby evidenced the Member's mistaken view that the Complainant was a balanced investor.
- The Member's recommendations did not give proper weight to the Complainant's age and status as a retiree.
- The Member's response to the complaint lodged by the Complainant to the FPA highlighted that a recommendation with a higher allocation to defensive assets would have led to the Complainant feeling unsatisfied with the Member's services due to a reduced probability of success. However, while this may be true, the Member was obliged to act on the Complainant's explicit indication of being risk averse and to work within the limits outlined in the fact find, while explaining the practical effect on returns of doing so.
- The Complainant's previous losses caused him to request that set exit and stop loss prices be put into place, as requested in the fact find. The Complainant's repeated requests for set exit and stop loss prices, along with his retired status should have alerted the Member that the Complainant was a conservative investor rather than a balanced investor. The Member therefore should have realised that his proposed asset allocation for the Complainant was unsuitable.

Following discussions, the FPA reached agreement with the Member whereby the Member acknowledged a breach of Rule 111 (Provide an explanation of the investment risks in terms that the client is likely to understand) because:

- The Statement of Advice dated 20 July 2006 specified the importance of diversification in reducing a person's exposure to risk. However, the Statement of Advice failed to highlight the specific nature of the risks faced by the Complainant in adopting the recommendations provided by the Member. Cross reference to the inclusion of the various Product Disclosure Statements for the recommended securities was insufficient to enable the Complainant to have the risks identified in terms understandable to him.
- The Record of Advice dated 26 August 2008 provided generic information regarding the risks associated with active management and day trading. There was no express statement regarding the nature of the specific risks faced by the Complainant in adopting a 'Balanced investor' strategy.

- The Statement of Advice dated 3 September 2008 was accompanied by the Product Disclosure Statements of the recommended securities without discussing the nature of risks associated with these investments.

Following discussions, the FPA reached agreement with the Member whereby the Member acknowledged a breach of Rule 113 (Take reasonable steps to place the client in a position to comprehend the recommendations):

- The Statement of Advice documents both recommended increases in the Complainant's allocation towards defensive assets. While the Complainant indicated that 'Finance' is one of his hobbies and was in a position to understand that this was in response to his risk profile, the Member failed to ensure that the Complainant was in a position to comprehend the reasoning and judgment behind these recommendations. As a risk averse investor, the Complainant was not given any explanation as to why his asset allocation was being positioned in favour of growth assets.

Following discussions, the FPA reached agreement with the Member whereby the Member denied a breach of 6 of Code of Ethics (Professionalism) and this breach is dismissed.

- The Member denies a breach of this Rule and contends that the Complainant's complaint against him is not substantial enough to find a Breach of this Rule.
- The Member's conduct did not involve 'moral deficiency' and the calibre of the Member's departures from acceptable financial planning practices was not to the extent of being 'grossly inappropriate'.

### **SANCTIONS IMPOSED BY AGREEMENT:**

The FPA and the Member gave consideration to suitable sanctions to be imposed for the breaches of Rules 110, 111 & 113 having regard to the following factors:

- i) The Member's cooperation with the FPA and demonstrated contrition;
- ii) The steps taken by the Member to learn from this complaint and to improve his level of professional skill and competence.
- iii) The Member has since completed CFP® studies and obtained the designation.
- iv) The length of time since the conduct subject of the Breaches.
- v) The Member has compensated the Complainant in accordance with the FOS decision.
- vi) The Member was not identified in the FOS Determination.

FPA reached agreement with the Member as follows:

1. That the Member acknowledges a breach of Rule 110 and is reprimanded and fined \$1000.
2. That the Member acknowledges a breach of Rule 111 and is reprimanded and fined \$1000.
3. That the Member acknowledges a breach of Rule 113 and is reprimanded and fined \$1000.
4. That the Member denies a breach of 6 of Code of Ethics and this breach is dismissed.

That no public interest (i.e. general or specific deterrence or in educating the profession) would be served in the public identification of the Member in any published report, that could not otherwise be achieved via anonymised publication. Accordingly the FPA agrees not to identify the Member in any report of this determination.

The Member remains a member of the FPA and has through his continuing assistance to the investigation, obtaining further qualifications, negotiating this agreement and other expressions of contrition demonstrated his desire and capacity to continue as a compliant and professional financial planner. Proceeding to a hearing may turn the Member away from this encouraging and restorative course because of its adversarial quality.

Upon making of the agreement between the FPA and the Member, the Chair of the Conduct Review Commission has approved the agreement and determined that the allegations in the Breach Notice be summarily disposed of on these terms.