

FINANCIAL PLANNING ASSOCIATION

CONDUCT REVIEW COMMISSION

SD 2015_1

TERMS OF SUMMARY DISPOSAL DETERMINATION

UNDER SECTION 7.3 OF THE FPA DISCIPLINARY REGULATION 2011

CRC Chair: Dr. June Smith

DATE OF FINAL DECISION: 15 January 2015

FACTS:

This matter concerned alleged breaches of FPA Rules of Professional Conduct by a CFP® Member (**the Member**) who was an Employee Representative of a Corporate Authorised Representative of a Licensee. The substance of the Trustees (of an SMSF) complaint was that the Member's recommendations to them in June 2006 (though contends this was never received) and February 2007 were unsuitable and that they did not understand the risks of accepting the Member's recommendations.

In December 2005, the Trustees were proposing to sell their business and then retire. The Trustees received an opinion from their accountant about considering potential investments to mitigate CGT liabilities arising from the sale. The Trustees, who through their own inquiries had developed a strong interest in a particular unlisted property trust (**ABC**), contacted the Company responsible and were then referred to the Member, of this Company. Although the Member was ultimately unable to assist with the CGT issue, there were various meetings between the Member and the Trustees relating to the SMSF and the Trustees impending retirement leading up until the SMSF's subsequent investments in June 2006 and in February 2007.

The relevant documented circumstances, goals and objectives of the SMSF included:

- invest \$1M with advice and the Trustees invest \$300k themselves – possibly residential property;
- income in retirement of \$80k - \$100k (later about \$88k);
- preserve capital;
- invest in a diversified portfolio; and
- low capital volatility.

It was unclear whether the Member had taken into account that the clients were trustees rather than individuals, including the joint risk profiling which arrived at Balanced. This carried on into the Member's advice documents.

Furthermore, the SMSF Investment Strategy prepared by the Member was reasonably broad, as permitted by the Trust Deed; and included:

- long term income of at least 6.5% (CPI 5 year average from 2006 was 3%) in line with the expected return from a balanced portfolio;
- sufficient liquidity to meet current and future liabilities;
- the absence of key risks of unlisted property trusts such as portfolio diversification, related party transactions and limited or no withdrawal rights. Instead, the main risk identified is volatility; and
- the Trustees intend to hold fixed interest investments, including mortgage funds, for the short term (0-3 years).

A summary of the Member's June 2006 recommendations, contained within the Statement of Advice (**SoA**) for the \$1M portfolio was to invest 50% of the total portfolio across seven unlisted property trusts, including 25% across four funds managed by one particular fund manager (**XYZ**) and 15% in ABC.

In relation to the recommended unlisted property trusts:

- the Product Disclosure Statements (**PDSs**) and this SoA identified these as illiquid investments and identified limited and/or no withdrawal rights; and
- examination of the relevant PDSs revealed diversification of the XYZ portfolio (25% of the total SMSF portfolio) was further reduced by related party transactions, being:
 - one XYZ funds extensive investment in two of the other XYZ funds recommended and in six other XYZ funds; and
 - one XYZ funds investment in four properties for which XYZ is the Lessee and has provided a rent guarantee, and a fifth property being developed by XYZ. The fund is invested in a total of only eight properties.

This reduction in diversification was not referred to in this SoA, which instead referred to, among other things, reduced exposure by spreading investments across all main market sectors, in accordance with the Investment Strategy of the SMSF.

The Trustees were about to embark on a holiday in June 2006 and investment in ABC was closing to new investments at the end of that month, so the Trustees made an investment of \$150k in ABC only at that time.

The Member and the Trustees subsequently met again and in February 2007 the Trustees underwent more advanced and individual risk profiling, a psychometric risk tolerance assessment. Recommended asset allocations for the Trustees were considered to be conservative and moderately conservative (although unclear whether this related to their capacity as Trustees or individuals). The Member presented the Trustees with a Statement of Additional Advice (**SoAA**) and it is uncontroverted that there was lengthy discussion and reference in this SoAA to the Trustees investing outside of their risk profile in order to meet their desired level of income. However, the versions of the Trustees and the Member differed on material aspects of the discussion, including around the actual level of risk to capital the Trustees would be assuming.

A summary of the Members 2007 recommendations, contained within the SoAA, for the then \$850k portfolio (after the 2006, \$150k investment in ABC) was to invest 35% of the total portfolio in three unlisted property trusts; and again 25% in XYZ trusts.

In relation to the recommended unlisted property trusts:

- the PDSs and this SoAA identified these as illiquid investments and identified limited and/or no withdrawal rights; and
- examination of the relevant PDSs revealed that diversification of the XYZ portfolio was further reduced by related party transactions, as well as one of the XYZ funds' subsequent (to the SoA) investment in another unlisted property trust also recommended by the Member in this SoAA.

In both the June 2006 SoA and the February 2007 SoAA, the Member gave no consideration to the reduced diversification within the XYZ portfolio and in his responses to the FPA referred to sources other than the PDSs. Similarly, in addressing concerns of liquidity, around 50% of the portfolio being invested in unlisted property trusts, the Member relied generally on the offer of periodic withdrawals without considering limited and/or no withdrawal rights.

The Trustees complained to the FPA in February 2012. The Trustees received an undisclosed amount of compensation in a confidential settlement, independent of the FPA, in May 2013. This prevented the Trustees from continuing with the complaint; however, the FPA became the complainant at this point.

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); and Rule 111 (Provide an explanation of investment risks in terms that the client is likely to understand).

MEMBER'S OWN RESPONSE TO BREACH ALLEGATIONS:

The Member has accepted full professional accountability for the advice given. Equally importantly, the Member has fully cooperated during the entire FPA investigation and gave appropriate consideration to his responses, as is deserved of an investigation of this nature. There is an acceptance of using this experience to grow understanding and to change conduct and processes personally as a financial planner and in the routines of the business. The FPA acknowledges the Member's explanation that a factor in these breaches was the strategy guidance provided by the Member's employer at the time, which was heavily geared towards an over-exposure in property during 2006 and 2007.

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):

1. The Member's recommendations to the Trustees in the Statement of Advice dated 26 June 2006 and the Statement of Additional Advice dated 14 February 2007 were unsuitable because allocating a total of 50% of the portfolio placed too high a proportion of the Trustees investment capital in a high risk, illiquid asset, particularly for retirees who were in pension phase; and
2. The Member's recommendations to the Trustees in the Statement of Advice dated 26 June 2006 and the Statement of Additional Advice dated 14 February 2007 were unsuitable because allocating a total of 25% of the Trustees portfolio to unlisted property trusts managed by the one fund manager (XYZ) was unsuitable in this failed to provide adequate diversification, particularly in view of related party transactions referred to in the PDSs.

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:

1. The Investment Strategy formulated by the Member identified the main risk of unlisted property trusts as volatility to the unit price and failed to refer to other main risks, including liquidity risk;
2. In verbally explaining his recommendations to the Trustees in June 2006 and February 2007 to invest 50% of their investment capital in unlisted property trusts, the Member diluted the risk of illiquidity by placing too high an emphasis on the *'ability to offer periodic withdrawals'* and insufficient emphasis on the disclosure in the PDSs that the recommended trusts funds offered only limited withdrawals or had no withdrawal rights and that investors may not be able to sell or redeem their capital promptly or at all, as there is no secondary market; and
3. In verbally explaining his recommendations to the Trustees in June 2006 and February 2007 to invest 50% of their investment capital in unlisted property trusts, the Member conveyed that *'low risk to capital'* is one of the characteristics of unlisted property trusts. Low risk to capital is not a characteristic of unlisted property trusts.

SANCTIONS IMPOSED BY AGREEMENT:

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

1. The Member's cooperation with the FPA and demonstrated contrition;
2. Motivation for the breaches;
3. The Member's disciplinary record;
4. The length of time since the conduct subject of the Breaches; and
5. The Trustees have been compensated.

FPA reached agreement with the Member as follows:

1. That the Member acknowledges a breach of Rule 110, is reprimanded and fined \$1,500;
2. That the Member acknowledges a breach of Rule 111, is reprimanded and fined \$1,500;
3. That the Member successfully completes the CFP 1: FPA Professionalism unit of the CFP Certification Program (Semester 1 or 2, 2015);
4. That the Member completes the e-learning module for the FPA Code of Professional Practice (by 31 March 2015); and

REASONS FOR DECISION:

1. One of the objects of the FPA professional accountability framework is to ensure that Member's engage with their professional obligations, understand, accept and learn from non-compliance with the Code. I am satisfied that this has occurred in this instance.
2. The Member has engaged in a constructive and genuine manner with the FPA during the investigation process.
3. The Member has acknowledged a breach of Rules 110 and 111 and is entitled to have this taken into account when determining the fairness and content of the agreement between the Member and the FPA.
4. The imposition of the agreed sanctions (including fines) is commensurate with all of the circumstances of the matter.
5. I note that the FPA makes no recommendation in relation to costs.
6. I accept the FPA's recommendation no public interest would be served in publication of the Member's name.
7. I note the time limit for payment of the relevant fines is 21 days in accordance with action 19 of Schedule C of the FPA Disciplinary Regulations.