

How to make the SoA concept more workable & more practical
- including points which enable SoAs to be shorter – and clear, concise and effective.

16 July 2004

Basis for comment

One of the objectives of the FSRA was to make tailored quality advice more accessible to consumers. However, as it stands, FSRA has had the opposite effect. This is because FSRA together with related ASIC policy statements have created a compliance environment in which the cost and risk associated with providing untailed, simplistic, once-off advice has become very low relative to the cost of providing quality ongoing advice to clients and in so doing has biased the financial planning industry towards a product distribution business model and away from an advice-focused business model.

Issue 1: Where an ongoing relationship exists between a client and the Licencee the level of ongoing documentation needs to be sensible and commensurate with the nature and significance of the advice being given.

SoA Construction – what should be in each SoA for ongoing advice.

Simple inclusion of previous advice is required.

Also, each item of advice should be seen as part of the set of advice provided over time and should not stand separate from previous advice. This could be explained to clients in a standard paragraph such as:

This advice should be read as being part of the entire set of advice provided to you over time and does not stand separate from previous advice. Therefore please regard all previous advice as being included in this advice except to the extent that later advice supersedes previous advice. Part of the basis for advice may also be found in newsletters and papers that I have prepared and circulated.

- A sub-issue is that newsletters to clients should be regarded as general advice, even where specific views (which might influence) are provided about a specific investment or class of investment. Newsletters can be a key (and efficient) part of documentation of the basis for personal advice which might be later provided to a specific client.
- Another sub-issue is that file records of a clients circumstances should be regarded as acceptable as part of “basis for advice” - to help ensure that client circumstances do not have to be regurgitated excessively back to clients.

What is sufficient detail?

That the “reasonable in the circumstances test” be the key test to determine whether SoAs have sufficient detail – while acknowledging that each SoA must be only seen in the context of previous SoAs etc, not as stand-alone documents. This can be important in the early stages of a client relationship while the full circumstances are still becoming “discovered”.

Basis for advice

Making “information about basis for advice” mandatory for non-defective SoAs (with all the ramifications of defectiveness) is *central* to the practical problems that bias SoAs towards being undesirably bulky. ***SoAs will continue to be excessively bulky while the risk of civil liability (through deemed defectiveness) remains an unreasonable business risk.***

At the present ASIC presentation “ASIC Speaks” 18/6/04, ASIC's Angus Dale-Jones urged planners to "Use SoAs as a communication tool, not as a risk management tool." However, while the risk of civil liability exists through deemed defectiveness (as a result of insufficient documentation of the basis of advice) remains, most dealers will tend to err on the side of excessive documentation (excessive bulk) in their SoAs.

Documentation of “basis for advice” (while conceptually desirable) is a major problem for anything other than simplistic, simple advice. The requirement to document “information about basis for advice” also works against consumer access to tailored advice. It needs to a matter of professional judgement, the level of documentation of the basis for the advice.

In this regard, Pre-FSRA Corporations Law was far more practical and workable. That is, it is very desirable from a consumer point of view to require that advisor have

- a “reasonable basis for the advice” and that
- “advice be reasonable in the circumstances” and that
- an advisor be able (and prepared) to defend his/her advice in a court of law.

Bottom line: Consumers will get a better result if Corporations Law was amended to its pre-FSRA state re “basis for advice” because this will facilitate

- greater consumer access to tailored advice and
- clear, concise and effective SoAs.

A sell recommendation needs to be achievable under General Advice.

Where a sell recommendation is made to all clients, and transaction fees have previously been disclosed, this advice should be able to be provided as General Advice. For example:

- Recommendation that clients accept the AMP offer to buy back AMP Income Securities.
- Recommendation to redeem a particular share trust for either market timing reasons or because the fund manager ceases to be the preferred manager of this sector of shares.

When an SoA should be completed – a key aspect of practicality of SoA obligations.

For example, in the case of a response to question by a client which is not expected to result in any action then there seems no need for a statement of advice. On the other hand, from time to time it may be appropriate to revise a client’s portfolio substantially in which case an SoA would be appropriate.

Indeed, in order to allow Licencees to communicate efficiently and effectively on an ongoing basis with their clients there needs to be a threshold of materiality and substantiveness below which an SoA is not required. Following are a few of the many examples of circumstances which would not seem to warrant the expense of an SoA.

- A client seeks advice in respect of a minor (relative to the client’s portfolio) redemption to meet cash flow requirement.
- A client has a minor amount of surplus cash and wishes and seeks advice in respect of topping up one or more existing investments.
- A client seeks advice in respect buying/selling/holding an investment following a change in the value of the investment and the Licencee recommends no change.

In essence, an SoA should only be required where:

- financial product advice is provided; and
- there is a reasonable likelihood that the client act on the advice; and

- the action by the client are of significance

That is, SoAs should not be “required every time it could reasonably be argued that an advisor gives an opinion which is intended to influence a retail investor in making a decision in relation to a financial product or class of financial products.”

Related issue: Stockbroker's do not need to to give an SoA with each transaction, whereas financial planners do. This results in financial planners giving excessive SoAs to clients compared to stock brokers when giving similar advice.

There should be one set of rules for listed securities & unlisted securities, for stockbrokers & financial planners. Currently if a client seeks advice from a stock broker the stock broker does not need to provide an SoA, but if the same client were to seek advice from a Licencee that is not a stock broker the Licencees must provide an SoA. This difference in compliance requirements serves no benefit to anyone other than the stock broker and it undermines the relationships that exist between non-stock broking Licencees and their clients.

The Financial Planning industry should not be distorted by creating one set of rules for some Licencees and another set of rules for other Licencees. In particular, Licencees dealing in listed securities should be treated the same as stock brokers dealing in listed securities. Similarly, the rules with respect to listed securities and unlisted securities should be the same.

On 4/11/03 Mr Steven Ciobo MP in Parliament made the following statement.

"Indeed, these provisions deal with highly sophisticated investors that are dealing in shares on a regular basis. It is quite absurd ... to insist that a stockbroker ought to be running back to his very sophisticated client on a regular basis to obtain from them an update on their particular financial situation when the provisions contained here are driven towards those that are sophisticated investors. So an exemption for live market advice and an exemption that there not be a statement of advice provided on a regular basis under this particular provision in this bill is again a very reasonable measure that will ensure that the government is amending the FSRA in such a way that the concerns of stockbrokers are addressed."

Related issue: Initial interviews

“Initial interviews” irrespective of whether a fee is charged or not should not require an SoA unless advice is given in that interview is likely to be acted upon and that advice is of some significance.

Issue 2. Civil liability under FSRA

If the test for civil liability was “is the advice reasonable in the circumstances” and “is there a reasonable basis for the advice” SoAs could focus on providing GOOD ADVICE that is clear concise and effective.

In contrast, we are faced with a situation where civil liability provisions drive rational business risk management to necessarily make SoAs a risk management & compliance document, an outcome which ASIC says it does not want.

As it stands FSRA seeks to achieve too many outcomes – and is therefore compromised. At the moment the extent of emphasis on compliance comes at great cost to GOOD ADVICE. Clearly there is not understood that there is no evidence of any correlation between good advice and compliance. While it is acknowledged that it is sometimes difficult to judge “GOOD ADVICE”, good compliance

can never be a substitute for good advice. Consumers are looking for GOOD ADVICE.

Bottom lines:

- Defectiveness of an SoA should only have criminal sanctions – not civil liability. This is a huge issue.
- The law would achieve a better outcome for consumers if civil liability simply focused on good advice.