

Issues with ASIC's sample SoA

Discussion points from BFPPG –

This is a tidied up version of the rushed submission – grammar etc corrections only. No meaningful change.

Only place where text moved around is consolidation of discussion of ““What my advice doesn't deal with” - P9/10

One additional extension of ideas added at bottom of page 10. A more complete post-meeting assessment will follow.
28 July 2005

Introduction.

We have received this sample SoA on the afternoon of Thursday 21st July in preparation for our meeting on 27th July – not a long timeframe to prepare a thorough analysis of this sample SoA. However, our SoA sub-committee has reviewed this document and views have been consolidated here.

We therefore hereby offer the collective input of financial planning professionals who are principals 9 of our boutique dealer members who collectively represent about 130 years of advisory experience (from these individuals alone) and immense collective investment research and knowledge of markets. So what we offer here is a hands-on practical assessment of the sample SoA by very experienced advisors who are also principals of dealers.

Our apologies for not offering perhaps a more concise critique, but in the timeframes available, we have had the opportunity to provide a quick initial analysis of issues that struck us arising from this sample SoA.

Yours Sincerely
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Overall assessment of this ASIC 27/7/05 Sample SoA.

“If it is meant to take 15 pages to deliver the most simplistic of simplistic investment advice, God help us and our client when we deliver complex or sophisticated advice”.

1. This style of SoA, might only fit once-off product sales.

- The **style** of this SoA may be appropriate for a large product distributor, providing once-off advice.
- However, for regular and ongoing advice, this advice is far too long. It:
 - ◆ is far too long and would not be read by consumers – maximum of 2-3 pages in most cases is what the consumer will read. Some clients insist on 1 page maximum.
 - ◆ Therefore (if this is to be regarded as what is “required” for regular and ongoing advice), imposes excessive additional cost at no benefit to the consumer in most cases.

Therefore the STYLE of this sample SoA might be a suitable format for “once-off product sales advice” only.

2. We think this sample SoA may well have demonstrated the case that it is very difficult to write a compliant SoA as the rules stand.

- In our assessment below, we illustrate many aspects of this SoA that could be attacked as being non-compliant eg by a **litigious client seeking damages under civil provisions** after a share market crash. Clearly because we work in such a complex area of advice, it is difficult (as the sample SOA illustrates) to write an SoA that could not be attacked as being defective, with some of these defects potentially opening the way to actions for civil liability for loss.

→Therefore, it would seem that ASIC may well have proved the case that **under FSRA, competent professional dealers** (and advisors) behaving ethically and professionally and providing good advice, **are unreasonably exposed to commercial uncertainty** (Ref objective in ASIC Act Section (1) (2) (a)) and **business risk** under the civil provisions of FSR and therefore also from FICS.

3. **How might we rate the advice?** Let us test this advice against the following questions:

- Was the consumer well served by this advice?** Quite possibly **not**. See discussion below.
- Was the advice cost-effective from a cost-benefit perspective?** Quite possibly **not**. More information about investment timeframes would need to be provided to assess this question. There is discussion of the issues below. However, in light of the fees charged including entry fees and MER, it is quite possible that the consumer might have been better off with a term deposit or a high-yielding cash account.
 - ◆**Note:** One time-based fee-for-service dealer has costed this advice at \$1500-\$2000. However, I note that the hourly rate she has used to cost this advice is quite low by industry standards. However, even with this costing, **this sample SoA helps to highlight how compliance under FSRA condemn clients with only a small sum to invest, to have to deal with a product salesperson rather than with a real advisor.**
- Has the client been provided with “the level of detail about a matter that is required is such as a person would reasonably require for the purpose of deciding whether to act on the advice as a retail client?” [FSRA Section 947B (3)]** From the discussion points below, the answer seems to be clearly **NO** – **because if an adequate level of detail had been provided (see discussion below), the client could see much more clearly the reasons why they should NOT be taking this advice.**

One of our dealer members made the following assessment of this sample SoA – and this is a useful summary of our overall assessment of this sample SoA.

*“I am not sure if ASIC are planning to do a sample SoA of Regular and Ongoing Advice but I think that is where the biggest issues are in regards to SoA. **Should they tackle the biggest problem issues first.**”*

The point is that is all well and good for ASIC to create a sample SoA where the compliance challenges are the smallest. And we do note from this sample SoA (see comment below) that we think ASIC might be learning much more than they expected about how difficult it is to write a compliant SoA for the most simple pieces of advice. If we are to get a practical and workable regulatory environment, we think it is critical that ASIC also takes on the tough tasks – the task of attempting to write compliant complex and non-simple tailored regular and ongoing advice SoAs. This is necessary because it is only by doing this will ASIC beginning appreciating the compliance challenges it has created in its many kilograms of policy on the provisions of regular and ongoing financial planning and investment advice. **Once that is understood, hopefully it will be clearer why we should move back to the principle-based approach to regulation of advice – which largely FSRA does reasonably well.**

A tick-the-box compliance-based approach to regulation of advice, necessarily will fail consumers. It cannot protect consumers. All a compliance-based approach to regulation of advice can do is:

- to impose significant extra cost (for no additional consumer benefit) and
- to therefore implicitly deny a section of the community access to tailored advice.

By contrast, a principles-based approach (focused on outcomes NOT mechanics) **to compliance will allow consumers to be winners.** A principles-based approach to compliance using the key principles from the law indicated below, can result in:

- A better result for consumers – because the focus would be on bad outcomes for consumers (not whether a box was ticked or not),
- More cost-effective advice for consumers with a greater portion of the community able to afford good financial planning advice.
- A regulatory environment where professional, competent financial planners behaving ethically and giving good advice, can practice without unreasonable business risk.

We would also commend you to review the Conclusion at the end of this document, before reading the discussion points below.

Testing the SoA against key consumer protections under law.

The key consumer protection elements under law are:

- ◆ **Common law** - negligence, duty of care; etc.
- ◆ **The Corporations Act 2001**
 - reasonable basis for the advice and the advice was reasonable in the circumstances. Section 945A
 - financial services were provided efficiently, honestly and fairly. Section 912(1)A.
- ◆ **The ASIC Act 2001**
 - Misleading or deceptive conduct. Section 12DA.
 - False or misleading representations. Section 12DB.
 - Requirements to apply “due care and skill”, and that advice is “fit for the purpose”. Section 12ED.

How has this SoA stacked up?

□ **Page 3.** *“All managed funds and super funds (including the managed funds I have recommended) carry risk. These investments are not like having money in the bank. There is a risk that their value might not go up as quickly as planned (or at all) and that it might **even** go down.”*

→ **Issue:** The word “**even**” would appear to be misleading and deceptive conduct” as it appears to significantly downplay and even trivialised the downside risk.

□ **Page 4.** *“You were hoping to double the value of your investments in the next 10 years or so, but you didn’t want to take too many risks.”*

→ **Issues:**

◆ By implication this goal has seemingly has been accepted by the advisor, and by implication it seems that the advisor is telling the client that her recommendation is consistent with this goal. This would be quite a major claim. Is this **misleading and deceptive conduct**?

◆ The **goal “doubling”** and the **constraint of “didn’t want to take too many risks”** seem to be significantly in conflict, yet the advisor has not even touched on or dealt with this conflict. This potential conflict is potentially of a gravity which might be regarded as **negligent**.

◆ Further, the advisor does not seem to have explored the meaning of this goal. Specifically:

- Is the expectation that the \$102k should double, or that the \$52k should double, or that the \$40k double. Is the doubling in real terms or nominal terms? Was it meant to apply merely to the inheritance money or all investments including super. The client expectation seems largely ignored. Was it a cumulative return including compounded income? Was it before or after tax? The goal is in fact very vague – and seems to have been ignored.

➤ **Note:**

○ In the case study, there seems very little probability that any part of the portfolio will double over 10 years – even in nominal terms – even counting in the accumulated and compounded distributions.

➤ The client necessarily is looking at post-tax returns, clearly the only thing that has meaning for this client.

➤ So by the rule of 72, to double over 10 years the average after-tax after-fees return would need to be 7.2%pa. Before fees (ignoring up-front fees), the returns need to be 9.7%pa. Let's be generous and say there is no tax because it is all in Sue's name.

➤ How does this compare with history?

→ US average share returns 1901-1998 was 9.98% nominal, 6.75% real.

→ UK average share returns 1901-1998 was 9.22% nominal, 5.21% real

→ Australian average share returns 1901-1998 was 12.53% nominal, 8.43% real

and yes, this is a little higher but only because of some unique aspects of Australia in the early 1900s. In the last half of the 1900s, Australian share market performance has been fairly much (on average) in line with US and UK experience.

- Average US bond performance 1901-1998 is 4.7% nominal, 1.48% real is also not too dis-similar from Australian and UK experience
- So, during the 1900s a balanced portfolio, if we use the US and UK averages might have averaged 8% in nominal terms BEFORE fees and 4.8% real. This means that a retail investor paying a 2.5% MER (ignoring up-front fees) like the “Sample investor” might have averaged about 5.5% nominal return or 2.3% real return.
- However, if we look at the 1800s, nominal investment returns were far lower on average. In the 1800s, when deflation was very common, the nominal rates of return or a balanced portfolio BEFORE fees would have been much lower. So we pose the question: **“Has this advisor SALLY STRONG misled the consumer about what returns they should expect from their balanced portfolio?” Probably.**
- **There is very high probability that any expectation by the client that his investments were going double over 10 years, will not be met.**
- Yes, the last 24 years in Australia have seen some of the highest nominal and real returns in Australian investment history, but you just have to look at the previous 10 years to see that this is far from normal. **Unfortunately far too many “advisors” in the product distribution sector of our industry use the investment experience of the last 24 years to sell product based on unrealistic expectations – and this unethical, unprofessional, misleading and deceptive conduct should be stamped out. ASIC needs to be very careful that it does not implicitly endorse this form of behaviour by providing a “sample SoA” that promotes such unrealistic expectations.**

➤ **In summary:**

- The clients seems to have provided a golden opportunity to the advisor to educate them about investments. Through this education, the advisor could have set the clients expectations correctly and could have educated them about what sort of returns might be realistically achieved. This invitation to educate does not seem to have been taken up. As a result, this does seem to be a **potential source of future conflict and complaint** with this clients, because by implication (documenting the goal and providing no other comment), it is probably reasonable for the client to have an expectation that the advisor is promising his recommendation will achieve this goal. **It is advice that leads to these sort of complaints that can give advisors a bad name.**

□ **Page 5.** “While these investments **should produce higher returns over time** than more conservative investments, over short periods they can fall in value and **even** lose money.”

→ **Issues:**

- ◆ **“Even”** is **misleading and deceptive conduct** as per page 3 comment.
- ◆ Is there a reasonable basis for **“should produce higher returns”**? Is this therefore also **misleading and deceptive.**
 - **Explanation:** The reason why **“should”** is misleading and deceptive, is because while this has usually been true over (say) 5 years periods since 1980, it most definitely is often NOT TRUE if you look at investment experience over the last 200 years – even without 2.5% management fees being taken out.
 - **Also note:** 2.5%pa annual management fees is quite a significant portion of what an average balanced fund might have delivered on average over the last 200 years (based on Western developed world investment experience), and this even further diminishes the chance of “should” being a true and accurate statement.
- ◆ **“Over time”** is particularly vague. Has the client been led to believe “over time” means 5 years, 10 years or 20 years or what? Seems to fail the requirement to be “Clear” ref requirement to be “Clear concise and effective”.

→ *The same problem has been repeated on Page 10, where it says “However, over the long term, you can reasonably expect a higher return from these investments.”*

□ **Page 7.** “Why is my advice appropriate for you?”

→ Is the advice reasonable in the circumstances?

- ◆ **Issue:** The client has been recommended \$40K to balanced funds with 4% entry fee and seemingly potentially quite short investment time frames.
- ◆ There **does not seem to be a reasonable basis for the mixture of \$40K balanced to \$12K cash** – or at the very least, this basis is not provided.
- ◆ The client's investment timeframe is defined by the following aspect of the scenario:
 - “they do not want to put the \$102,000 in super just in case **they need money to cover things like** the children's future school or university fees, **renovating the house** or taking the family on a long **overdue holiday.**”
- ◆ It is clear that recommendations with
 - this level of up-front fees AND
 - (seemingly) a high probability of a mismatch between the asset allocation and the timeframes, AND
 - this level of ongoing management feesTHAT *the client may not have a reasonable probability of getting a reasonable return over this period with this recommendation.*
 - So it seems we may have
 - Negligence
 - Failure of “duty of care”.
 - Seemingly, failure of requirement for – reasonable basis for advice.
 - Possibly – “Misleading or deceptive conduct.”
 - Seemingly - “False or misleading representations.”
 - Seemingly, failure of - “fit for the purpose”
- ◆ Yes, some sections of the industry may be providing simplistic advice like this – and we have seen some examples of this BUT ASIC should not be giving implicit endorsement for this sort of advice.

→ **This specific example of simplistic advice (because that is what it is) provides us a great opportunity to discuss the requirement under FSRA to:**

- ◆ **not only have a “Reasonable basis for advice”, but**
- ◆ **to document the “information about basis for advice” - Section 947B (2) (b).**

→ The “sample SoA” seems to have failed this requirement in a number of serious ways:

- ◆ If the requirement is to “**double the money**” in 10 years then
 - First, there seems very little probability of this being achieved. So there seems to be not only **NO reasonable basis that it can be achieved**, but **no attempt has been made to document any information about why this recommendation might achieve that goal**. This is a serious failure – probably technically an outright defect.
- ◆ If a constraint is “**they do not want to put the \$102,000 in super just in case they need money to cover things like the children's future school or university fees, renovating the house or taking the family on a long overdue holiday,**” then
 - No attempt has been made to analyse (or document) the timeframes when the money might need to be withdrawn and then
 - to analyse or consider whether over these time frames, the clients will have recouped their up-front costs and made a reasonable return (after ongoing management fees) – or whether they would have simply be better putting the money (in excess of paying off the home loan) simply into a term deposit or a high yielding cash account. This seems like a quite serious failure. And the failures seems to include:
 - Section 945A (1) (a) (ii) **failure to make “reasonable inquiries** in relation to those personal circumstances” because the timeframes for withdrawal was not inquired of.
 - **Failure to have a reasonable basis** for recommending this proportion of management funds with fees of this magnitude, after considering the timeframes for withdrawal AND the likely rate of return after fees of the recommended investment. That is, it seems to have **failed the Section 945A (1) (c) obligation to ensure that “the advice is appropriate to the client, having regard to that consideration and investigation”.**

- This also seems to be:
 - ▶ a failure to “take due care”. ASIC Act. Section 12ED.
 - ▶ Probably a failure to provide advice which is “fit for purpose.” ASIC Act. Section 12ED.
- Finally, what was the reasonable basis for recommending these two specific balanced funds? No basis for this advice has been provided other than
 - **“This is appropriate for balanced investors like you. It spreads your investments across a number of different classes of assets that suit your goals and objectives. Bluebottle Balanced Managed Fund and Balanced Alphabet Fund invest in an asset mix of about 30%–40% in income assets and 60%–70% in growth assets. These funds are both on Planforit’s approved product list as suitable for balanced investors. “**
 - So there is no basis for these two specific balanced funds other than the fact that they happen to be on the approved list. However, there is no legal obligation that products are on an approved list are fit for any specific purpose. So it seems that **no real basis has been provided for recommending these two specific balanced fund. This almost seems to be suggesting that NO REAL “Information about the basis for advice needs to be provided in an SoA.”**
 - The basis for recommending the balanced funds “class” of product, seems to have simply been that
 - ▶ the clients were “balanced investors”. What is a balanced investor? There is no agreement among the profession of what a “balanced investor” is. In fact, it seems unlikely that the term “balanced investor” would be a term widely used among professional advisors because it is not a “clear concise and effective” term. Rather it is excessively vague. So it seems no real “basis for advice” here.
 - ▶ The second assertion is that in effect “a very widely diversified portfolio fits a balanced investor” seeming regardless of their circumstances and their timeframes and regardless of the fees involved. This is simply a wild assertion – no real reasonable basis.
 - We have separately addressed the question of whether the balanced funds “class” of product was appropriate, and the advice seems to have failed in terms of “basis for advice” and documentation of information of basis for advice.

◆ The sample SoA exercise has been valuable because it has forced ASIC to gain first hand experience with the compliance difficulties with the obligation to document the “information about basis for advice” - Section 947B (2) (b).

◆ Just to state the obvious, if this is the challenge for documenting “basis for advice”, where the advice is very simple and simplistic, clearly this gives some hint about the order of magnitude greater compliance problem (caused by the obligation to document “information about basis for advice”) that exists where non-simplistic investment advice is provided. This is a major cost imposition under FSRA at (in many cases) very little benefit to consumers AND creating great compliance uncertainty for advisors and dealers who provide non-simplistic advice.

□ Page 9. “This is appropriate for balanced investors like you.”

→ Issue: *What is a “Balanced Investor”?*

- ◆ This is a very unclear and imprecise term – and seems to be a failure of requirement to be “clear, concise and effective.”
- ◆ This section goes on to say *“It spreads your investments across a number of different classes of assets that suit your goals and objectives.”*
 - There also seems to be an implication that
 - very wide diversification, of necessity, somehow makes this investment mix right for the client, regardless of their investment time horizons and seemingly regardless of any current market-timing risks. The point is:
 - ▶ No basis for this viewpoint is provided and
 - ▶ There actually is no reasonable basis for this position.

□ Page 9. “By investing in two managed funds rather than one, you reduce your investment risk,

in case one fund performs badly. “

→**Issue:** Most balanced funds are quasi-index balanced funds, and as a result, diversifying between two balanced funds is unlikely to lead to significant diversification. If there are special factors indicating otherwise in tis case, this information has not been provided. Again this poses the question? **Was there a reasonable basis? How much of this needs to be document? Not much was documented here.**

□ **Page 9.** “**Hedge funds** aren’t on the Planforit approved product list so I can’t recommend them. In any case, they are unlikely to be an appropriate investment for you because they normally adopt investment strategies **more suited to aggressive investors.**”

→**Issue:** This is a massive sweeping statement reflecting on a very broad category of different styles of investment and extremely different investment strategies”.

→ *Many professional investors would argue very strongly that the assertion is not true, that hedge funds are only “suited to aggressive investors”.*

→ So arguably this is statement may simply be a mis-statement of fact.

→ For the record, we asked one of our dealers for a response to the sample SoA statement about hedge funds. Here is the response:-

“Hedge funds aren’t on the Planforit approved product list so I can’t recommend them. In any case, they are unlikely to be an appropriate investment for you because they normally adopt investment strategies more suited to aggressive investors.”

This statement is a nonsense. My kindest interpretation is that it is proffered as a naïve diversion about what the advice giver is not able to do - but otherwise constitutes DECEPTIVE AND MISLEADING CONDUCT.

The opinion given in the statement about hedge funds has no basis in fact and indeed conflicts with fundamentals of portfolio theory.

The term hedge means “to insure”. The addition of hedge funds to a typical balanced portfolio should be to “reduce the risk of the portfolio” not to try to shoot the lights out as this emotive and baseless statement implies.

The appropriate inclusion of hedge and absolute return funds by an experienced practitioner is directed at either

- 1. reducing a more aggressive client’s vulnerability to short term stock market movements by the introduction of an investment shown to have LOW or NEGATIVE correlation with equity markets - It is the exposure to equity markets that provides the greatest RISK of loss of capital in most “conventionally constructed portfolios” in the short to medium term [(note actuary’s “medium term” is often long term for an individual investor] OR*
- 2. to modestly enhancing the likely return of a more cautious investor by allowing increased exposure to assets which while having the expectation of significantly better than cash rates of return but which do not proportionately increase the investors exposure to adverse stock market movements*

The statement as it stands is certainly not a statement that should be in ASIC’s sample SOA!’

Other Compliance issues.

□ **Page 3.** “Planforit will be paid an upfront and ongoing commission by the managers of both of the managed funds I have recommended. “

→**Issue:** Too often clients are misled to believe that it does not come out of their investment. Perhaps this should be written as “*Planforit will be paid an upfront and ongoing commission by the managers of both of the managed funds I have recommended. The up-front commission is paid out of the entry fee and the ongoing commission is paid out of the ongoing management fee.*”

□ **Page 5.** “Your risk profile”, “risk category”, “Level of investment risk” descriptions.

→**Issue:**

◆ First, it would be fact if we labelled the different asset allocation mixes as “**Asset allocation categories.**” To glibly label them as “**Risk categories**”, is potentially misleading.

- ◆ Second, this document is implicitly making an assertion “that asset allocations with higher growth asset components are always more risky than asset allocations with very high cash and fixed interest amounts.” This is not always so. For example:
 - as can be seen by the divergent asset class performance in some periods of high inflation. Eg direct property might be lower risk than cash and bonds.
 - Likewise in periods of deflation, cash is likely deliver some of the higher returns ... as it might be during periods of speculative bubbles.
- ◆ In summary, the statement “Generally, investments that *are expected* to pay higher returns involve more risk” is glibly simplistic – perhaps dangerously so. At times, this sort of statement might even be seen:
 - to be negligent, OR
 - failing the due of care, OR
 - perhaps being misleading and deceptive in an effort to sell investments with higher commissions. Similarly the charges of:
 - failing to provide “due care and skill”, and
 - that advice may not be “fit for the purpose” may also be applicable.

□ **Page 5.** “I think you have a general understanding about income and growth, investments, mortgage, tax and so on, but you are not experts in financial matters. My advice has been prepared for you on that basis. “

→ **Issue:**

- ◆ Many advisors believe that the *duty of care* that they owe their clients, is to provide advice which is appropriate to the client's needs. By contrast, the sample SoA seems to be promoting an attitude of giving “*advice that the client can live with or advice that can be sold to the client*” rather than “*advice that is appropriate for the NEEDS of the client*” with the latter obviously then obliging the advisor to then take the extra step of explaining to the client why the “*advice that is appropriate for the NEEDS of the client*” even if the advice is initially uncomfortable.

□ **Page 9.** “*You will pay a fee for adding to or withdrawing money*”.

→ **Issue:** This hints at there being exit fees. If there is so, this has not been disclosed. Seems like a defect in disclosure.

□ **Page 12.** “*You will not have to pay any stamp duty.* “

→ **Issue:** This seems to be un-necessary and irrelevant “filler”, working against the principle of “clear concise and effective.” Why is this comment even in the SoA?

Other issues:

□ **A lot of form (15 pages worth) but was there much substance?**

→ A major concern that has existed regarding FSRA is a seeming obsession of form (tick the boxes) over substance. On reflection considering the points raised above and the lack of much real substance in the advice, one could argue that *this sample SoA graphically illustrates the excess focus on form and the inadequate quote on the most important issue for clients ie. That they are getting good advice of real substance in short, meaningful form in a cost-effective manner. This arguably is a significant area of weakness in FSRA.*

□ **Attention to detail.**

→ Getting clients name right.

- ◆ the According to the scenario:
 - the client's names are Joe and **Sue** Black
 - the advisor's name is **Sally** Strong
- ◆ Yet the SoA, persists in calling Sue, Sally – though not in every instance.
 - Ref footer “Advice for Joe and Sally Black”.
 - Ref Page 4 “Sally is 41”.
- ◆ I am sure the client would be impressed with this “personalisation” of the advice.
 - Is it clear concise and effective, if you confuse the client's name.

□ **Page 7.** The statement *“If Joe doesn’t give the money to Sue, he will still own the investments (even if they are in Sue’s name)”*, seems at face value to be factually incorrect.

□ **Page 10.** *The section “What my advice doesn’t deal with”* seems like maybe a “nice to have” section but not an obligatory or necessary section.

→ **“What my advice doesn’t cover is a trap”.** ASIC needs to understand that if we were to list what the advice does not cover in a comprehensive manner, this would be another few pages on the document. What if the client’s house burns down and it didn’t say in this section, the advice does not cover general insurance. Is the implication he should be able to sue because the advisor did not warn him?

◆ Key points:

- We would encourage a “Scope of Advice” to be outlined at the beginning of the SoA.
- Any requirement to list all the things which were not covered, very quickly becomes a monstrous job – and therefore probably should not be in a document which is meant to exemplify what SHOULD be in a particular form of SoA.

□ **Page 13. Recommended lists.**

→ Issue:

- ◆ There is no obligation under law that a recommended list exists, as far we can tell.
- ◆ And yes, for a large product distributor with many advisors in many geographic locations, a recommended list is a very useful risk management tool.
- ◆ However, for small dealers with only one or only a few advisors, an obligation to have a recommended list should be regarded as excessive – and should not exist.
- ◆ This sample SoA almost implies that a recommended list is an obligation.

□ **PS 175.143 states that “all information about remuneration, commissions and other benefits should be presented in one place in the SOA.”** This seems like a reasonable requirement, if the clear concise and effective requirement is to be met.

→ **In this sample SoA, this is where the fees are disclosed:**

- ◆ Page 3, “Summary of my advice” - \$750 “for preparing this SoA”, though based on the costing elsewhere in this document, this price is really a loss leader to achieve a product sale. Maybe disclosing this fee in isolation, might be regarded as “misleading and deceptive” because in this sense, this \$750 is not the real cost of the advice.
- **Side issue:** What does ASIC feel about loss-leader prices for advice?
- ◆ However, we do note that fees including the \$750 do seem to be comprehensively be disclosed in Section 3.

□ **This is an extremely well formatted document.** The formatting process may have added significantly to the cost of the advice. How much (in dollar terms), does ASIC think the formatting has added to the value of this advice to this client?

□ **How would this “sample SoA” survive a FICS complaint?**

→ This is a valid and very important point that should not be overlooked.

→ Clearly there are many among us that feel that “justice” served up by FICS can be a bit of a lottery.

→ It is therefore very far from clear, how FICS would deal with this SoA. The only real way to test this would be for a real complaint to come in from Joe and Sue Black after making a complaint after they suffered a loss. And clearly, a FICS assessment will be tainted by FICS’s fore-knowledge of knowing that this “advice” came from ASIC, as FICS undoubtedly would be reluctant to find against ASIC. However, it would be interesting all the same to pass this SoA via FICS to gain their assessment.

→ **Many grounds seems to exist for claiming a loss either through FICS or through civil action, potentially including:**

- ◆ was the advice fit for purpose? Given the fees and the investment mix, was there a mismatch between when the client need to spend the money and the balanced fund recommendation? There clearly seems to be a negligence issue in this because it seems that the advisor has made inadequate effort to inquire of the time-frames that the client needed funds to spend on “renovating the house or taking the family on a long overdue

holiday” etc.

- ◆ Was there adequate disclosure of risk of balance funds? This hardly seems to have been addressed at all – just seemingly “promises” that the investment probably will do well.
- ◆ Misleading and deceptive conduct. This has been discussed above.

□ The following observation was also offered by one of the dealers in the BFPPG sub-committee:

→ “My first thoughts are that **the sample SoA is too simple but on reflection of my experiences the client never reads or relies on the document to make their decision, it is always the things that are unsaid in a SOA that influence the client to make their decisions.**”

→ This dealer has captured an issue that all professional advisors know, and that is that the vast bulk of consumers do not rely on the written advice, when making their investment decisions or when choosing an advisor. This is an important issue because:

- ◆ it re-confirms the view that the government and ASIC are placing undue emphasis on tick-the-box compliance as a means to protect the consumer (vs the key common law, ASIC law, Corporations Law protections highlighted in our Conclusion).
- ◆ It also is important because inevitably as it stands, a Statement of Advice is condemned to be a compliance document, and therefore cannot achieve the objective that the full consumer-protection objective that government had in mind for it (i.e. A “communication tool.”)
- ◆ However, one thing that the government can do, is reduce the un-necessary cost imposition that the SoA compliance obligation imposes on consumers and the un-necessary compliance uncertainty that the SoA compliance obligation imposes on tailored regular-and-ongoing advice provider. **A key way to reduce this un-necessary cost imposition (and compliance uncertainty) is to remove the statutory obligation to document “information about the basis for advice” in an SoA.**

□ **Disclosure of fees in dollar terms. (eg PS182).** Broadly, as very largely fee-based advisors, we are very supportive of dollar disclosure because we believe that consumer should know, as far as possible what they are paying. We would like to point out that:-

→ In the sample SoA, again being the simplest of simple cases, using very simple products.

→ We would now like to encourage ASIC to exemplify a similar fee disclosure using the fee structures of the various **platforms**. **The point will become very clear when ASIC attempt this – and that is that it is a bit of a nightmare.**

◆ In the timeframes before meeting of 27/7/05, we haven't got a specific recommendation or solution to offer. Rather at this point, we simply wish to flag a source of problem. We may be able to provide a recommendation over coming days.

◆ **This next point is the only new point added to the the original submission.**

◆ **28/7/05. Note: In the 27/7/05 meeting, the solution appeared. That is that an SoA should only have to disclose in dollar terms, “factors which might influence the advice” in dollar terms. That is:**

➤ **commissions & financial benefits that the dealer and advisor (or related entities) receive, should be disclosed in dollar terms.**

➤ **MERs and product fees should be disclosed in the PDS and should not have to be repeated in the SoA because the MORE and MORE un-necessary clutter that is added to an SoA, the less likely it is to be read, the less likely it will be a communication tool (as ASIC had suggested about May 2004), the more it simply becomes a compliance document and the more expensive it becomes.**

○ Note:

➤ One ASIC (I think) attendee indicated that “all financial planning software now calculates all required fees in dollar terms” suggesting that dollar disclosure was a non-event in terms of extra cost. **Factual error to suggest that the problem has been solved for the industry. Many advisors, particularly those who provide highly tailored personal advice (i.e. Not press-the-button sausage machine advice on a production line), hand-craft advice including the dollar disclosure – so it does add to the cost, of advice.**

Overall Summary and Conclusions:

- 1 In summary, BFPPG initially had some concerns about ASIC creating a sample SoA because we saw the risk that a template would be created which our dealers would be obliged to follow. We saw this as an enormous risk because **it would be totally inappropriate if**
→ **the SoAs of a tailored regular-and-ongoing advice provider were required to look like**
→ **the SoAs of a once-off “advice” product sales person.**
Clearly the advice style and the advice is so different, that to force this form of conformance could not be in the interests of the consumer.

- 2 However, despite all the potential short-comings of creating a sample SoA, **this exercise has proved to be a worthwhile exercise because:**
→ It has forced ASIC to grapple with the practical implementation of this law, in a way which it had not done until now and
→ in doing that it has highlighted many of the very FSRA problems and concerns we have been raising with ASIC and the government over the last 3 years.
→ ASIC can surely therefore now see why under FSRA, it is very difficult to provide a compliant SoA (that cannot be attacked as being defective) even where simplistic advice is provided – as in this example.
 - ◆ Therefore, it would seem that ASIC may well have proved the case that under FSRA, competent professional dealers (and advisors) behaving ethically and professionally and providing good advice, are unreasonably exposed to business risk.
 - ◆ The compliance problem is compounded many times in magnitude when providing non-simplistic advice and where regular-and-ongoing advice is provided.
 - ◆ **Hopefully this will therefore now result in further moves to make this law more workable for tailored regular-and-ongoing advice.**

- 3 **The style of SoA in this “sample” needs to be regarded as only fitting once-off product sales “advice”.**
→ The **style** of this SoA may be appropriate for a large product distributor, providing once-off advice.
→ However, for regular and ongoing advice, this advice is far too long. It:
 - ◆ is far too long and would not be read by consumers – maximum of 2-3 pages in most cases is what the consumer will read. Some clients insist on 1 page maximum.
 - ◆ Therefore (if this is to be regarded as what is “required” for regular and ongoing advice), imposes excessive additional cost at no benefit to the consumer in most cases.

Therefore the STYLE of this sample SoA might be a suitable format for “once-off product sales advice” only.

- 4 This sample SoA, because of the issues raised above, clearly highlights another key point we have been making. That is, that **the tick the box approach to SoA compliance provides NO real consumer protection.** The only **real consumer protection** comes from
 - ◆ **Common law** - negligence, duty of care; etc.
 - ◆ **The Corporations Act 2001**
 - reasonable basis for the advice and the advice was reasonable in the circumstances. Section 945A
 - financial services were provided efficiently, honestly and fairly. Section 912(1)A.
 - ◆ **The ASIC Act 2001**
 - Misleading or deceptive conduct. Section 12DA.
 - False or misleading representations. Section 12DB.

- Requirements to apply “due care and skill”, and that advice is “fit for the purpose”. Section 12ED.

PLUS

- ◆ disclosure of commissions and information that might influence the advice, as required under FSRA.

So this clearly shows that if the consumer is to be protected, ASIC needs to be focusing its attention on these factors, and FSRA needs to be amended to remove the extraneous distractions that add needless cost and needless compliance uncertainty.

- 5 A related point to the point above. **This sample SoA has clearly highlighted how the FSRA requirement to document “information about the basis for advice” [Section 947B (2) (b)] will continue to cause major compliance uncertainty until it is removed** – particularly for those dealers and advisors who provide non-simplistic, tailored, regular-and-ongoing advice.
 - ➔ **Clearly this simplistic piece of advice had major problems in meeting this requirement, while also meeting requirement that “the level of detail about a matter that is required is such as a person would reasonably require for the purpose of deciding whether to act on the advice as a retail client”? [FSRA Section 947B (3)]**
 - ➔ However, this is a much much bigger compliance problem for advisors and dealers who provide non-simplistic, tailored, regular-and-ongoing advice.
 - ➔ While superficially it is clearly desirable to require “information about the basis for advice” to be included in an SoA, from a practical compliance perspective this obligation is a statutory compliance nightmare. **The consumer is far better served that documentation of “basis for advice” be a matter of professional judgement, so that it can be tailored to the budget and information needs of the consumer.** Only then does the consumer have a reasonable chance of getting a good result – and only then will tailored regular-and-ongoing advice providers have sufficient compliance certainty on this issue.
- 6 As per our Overall Assessment at the beginning of this document, **we believe this sample SoA has very substantially proved the case why ASIC should revert from its tick-the-box approach to compliance, to a principles-based approach to compliance** as can largely be found in the law.
 - ➔ **Only then will consumers be winners from FSRA.**
 - ➔ **And only then will professional competent dealers (and advisors) behaving competently and ethically have a reasonable regulatory environment without undue business risk.**