

In the matter of The Constitution of the Institute of Financial Advisers Inc. and its By-laws
and

In the matter of Charges referred for hearing by the Disciplinary Committee

Between: The Institute of Financial Advisers Inc.

and: “Member A”, a Member

Determination of the Disciplinary Committee
(Dated 16 July 2009)

Disciplinary Committee:
Anthony N Frankham (Chairman)
Robert Narev
Karl Schweder

Determination of the Disciplinary Committee

- [1] “Member A”, (“Member A” or “the Member”), a member of the Institute of Financial Advisers (“the Institute” or “IFA”), was the subject of a complaint to the Institute lodged by the complainant on 18 May 2008. Following investigation by the Complaints Committee of the Institute that committee decided to prefer two charges against Member A and to refer those charges to the Disciplinary Committee (“the Committee”) for hearing and determination.

The charges

- [2] The charges against the member and their associated particulars were:

The first charge:

“Principle 1 - integrity

That you, Member A, being a member of the Institute and acting in your professional capacity, did breach Rule 101 of the Code of Ethics in force during the relevant time by making a false or misleading statement to the complainant.

Rule 101

In the course of professional activities, a member will not engage in or associate with conduct involving dishonesty, fraud, deceit or misrepresentation, make a false or misleading statement or break the law.

Particulars

- 1.1 *In or about August 2007 you recommended that the complainant’s Family Trusts invest \$108,025.11 AUD in MFS Pacific Finance Limited 'first ranking secured debenture stock' for 6 months at an interest rate of 9.5%.*
- 1.2 *When making this recommendation, you made a false or misleading statement to the effect that:*
- 1.2.1 *Your recommendation was based on research that included research undertaken by “Company R”;*
- 1.2.2 *MFS Pacific Finance Limited's loan book was comprised of first mortgage securities, mostly in the hotel, motel and tourism*

sectors and that you were regularly updated on the status of the loan book;

1.2.3 MFS Pacific Finance Limited's parent company would repay any defaulted loans under a 'put option'; and

1.2.4 MFS Pacific Finance Limited was a 'rock solid' investment, or words to that effect”.

The second charge:

“Principle 7 - diligence

That you, Member A, being a member of the Institute and acting in your professional capacity, did breach Rule 702 of the Code of Ethics in force during the relevant time by failing to make a reasonable investigation regarding the suitability of the financial product recommended to the complainant’s Family Trusts which is particularised below.

Rule 702

Consistent with the nature and scope of the engagement, a member will make a reasonable investigation regarding the suitability of financial products recommended to clients. Such an investigation may be made by the member or by others, provided the member will act reasonably in relying upon such investigation

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Particulars

1.3 In or about August 2007 you recommended that the complainant’s Family Trusts invest \$108,025.11 AUD in MFS Pacific Finance Limited 'first ranking secured debenture stock' for 6 months at an interest rate of 9.5%.”

Other than the statement about the investment recommendation there were no further particulars pleaded in support of this charge.

The hearing

[3] The Committee convened on 6 July 2009 to consider the charges and submissions against the Member. Mr Adam Holloway appeared for the Institute and Miss Kelly Quinn for Member A. Member A attended the hearing. The complainant, as witness

for the prosecution, attended the hearing but was excluded for the discussion on procedural matters.

Procedural matters

- [4] By changes to the constitution and by-laws of the Institute, the former Disciplinary Committee was reconstituted as the Disciplinary Tribunal of the Institute with effect from 1 June 2009. The chairman noted that the pleadings in this case, the first to be heard since the change in the constitution, had been drawn in a manner that indicated the charges were to be heard by the Disciplinary Committee. He said there was no doubt that charges against a member were to be considered in terms of rules and by-laws extant at the date of the alleged offences, but it was moot as to whether the constitutional changes meant the Disciplinary Committee rather than the Disciplinary Tribunal continued and heard charges under former rules and by-laws. He said it could be that the Disciplinary Tribunal was the properly constituted body to hear charges from 1 June 2009, but would consider the charges in the light of rules and by-laws applicable at the date of the alleged offence. Counsel undertook that their clients would be bound by the determination of the members of the Disciplinary Tribunal sitting as the Disciplinary Committee and to take no point as to which is the correct entity.
- [5] Certain other procedural matters had come to the notice of the Committee prior to the hearing. The Committee had issued memoranda seeking submissions from counsel. After hearing from counsel, the Committee determined that there was no matter the Committee would have regard to in considering the charges made, other than the submissions and evidence put before them by the parties.

The Member's plea

- [6] Member A pleaded not guilty to the charges and denied the particulars as presented.

Submissions and evidence for the Institute

- [7] Mr Holloway spoke to written submissions for the Institute and called the complainant, as a factual witness who gave his evidence on oath. The complainant's evidence covered the history of his dealings with his financial adviser, the circumstances of his receiving advice to reinvest his family trusts' existing investment with MFS Pacific

Finance Limited (MFS) and his recollection of the representations he said Member A had made to him.

[8] Mr Holloway submitted inter alia:

- The applicable evidential standard is the balance of probabilities;
- The complainant is not a naïve investor and has consistently sought professional advice;
- The issues that are the subject of the charges relate to Member A's advice in connection with the reinvestment of a maturing interest bearing investment with MFS;
- The Institute has elected not to call any expert evidence. The Disciplinary Committee is an expert body and is entitled to form its own opinions within its areas of expertise.

[9] The complainant produced a bundle of documents in support of his evidence. His evidence was that, based on what Member A told him during a conversation in the Member's offices in August 2007, he decided on behalf of his trusts to invest \$108,025 in MFS First Ranking secured debenture stock at an interest rate of 9.5%. This was a reinvestment of an existing investment that was maturing. Approximately 22% of the trusts' capital invested in MFS had been repaid to date and the balance remains owing with no interest being paid.

Ms Quinn cross examined the complainant and the Committee asked him questions.

Submissions and evidence for Member A

[10] Ms Quinn made oral submissions for Member A and called Member A to give evidence, which Member A gave on oath. Member A addressed the circumstances of the meeting the Member had with the complainant, the charges, and the particulars, and gave an explanation of what the Member believed was said at the time of giving the advice and the complainant's decision to reinvest his investment with MFS.

Mr Holloway cross examined Member A and the Committee asked the Member questions.

The Committee's reasoning on liability

- [11] The Committee acknowledges that actual and potential investment losses are a matter of considerable importance to complainants. The Committee acknowledges the stress, pressure and emotional pain the plight of MFS has caused the complainant and his family. However, the process is about the IFA acting on a complaint about a member, to ensure maintenance of proper standards and actions by its members and not to compensate a complainant for losses incurred.
- [12] The issues for us to rule on in this case largely flow from opposing viewpoints in the evidence on what was said and what was heard. Our approach has been to review each of the particulars pleaded and consider the evidence to form a view on whether the particulars have been proved. We have no reservation that the complainant is a genuine complainant in this matter and that he gave his evidence honestly believing that his understanding and recollection of events were correct. We think however, that there were instances where the complainant may have misheard or placed wrong interpretation on comments or explanations made by Member A. We found Member A's evidence to be convincing and professional. Generally, where there was conflict we found the Member's evidence to be preferred.
- [13] With respect, we were not assisted by the fact that the prosecution elected not to call expert evidence. Whilst we acknowledge that we are entitled to form opinions within our areas of expertise, two members of the Committee, who are professionally qualified and experienced in their respective fields, are not necessarily expert in matters particular to investment advising. The matters that constitute "a reasonable investigation regarding the suitability of financial products recommended" is an example. A third member of the Committee is an experienced Member of the Institute, but we consider his opinions cannot be overlaid without the parties having opportunity to test and make submission on an opinion that is central to a matter forming the charges.
- [14] It is not the function of the practitioner member of the Disciplinary Committee to act like an "internal expert witness" to provide the two other members of the Committee with an opinion on the case based on his knowledge and expertise as a practitioner. He serves on the Disciplinary Committee as part of its quasi-judicial role. His opinion on the case as part of the decision making cannot replace expert evidence, because it would deprive the parties of fundamental procedural rights, such as knowledge of the

opinion during the hearing, making submissions and the opportunity of cross-examination.

- [15] The Member having pleaded not guilty to the charges as laid and having denied the particulars, and the Committee having considered the evidence and the submissions, we make the following findings with regard to the particulars pleaded and the charges themselves.

THE FIRST CHARGE

- [16] (a) With regard to particular 1.1 we find that despite denying this particular, during evidence Member A admitted making the reinvestment recommendation pleaded.
- (b) With regard to particular 1.2.1, we make the finding that Member A's recommendation was based on research. On the evidence, we find that the research did not include research undertaken by "Company R" because "Company R" did not make research on that form of investment available. It is unclear whether Member A represented that research included research undertaken by "Company R". That might have been an honest but incorrect inference taken by the complainant.
- (c) With regard to particular 1.2.2 we accept Member A's evidence that the Member did not use the word "comprised". The Member said that was the complainant's choice of words. We think it is likely that Member A explained the loan book included (meaning included to a significant extent) first mortgage securities mostly in the hotel, motel and tourism sectors and that the Member was regularly updated on the status of the loan book. That was a correct statement.
- (d) With regard to particular 1.2.3 we find that despite denying this particular, during evidence Member A admitted making the statement, which generally speaking is not an incorrect statement of the position.
- (e) With regard to particular 1.2.4 we find on the evidence that on the balance of probabilities Member A was unlikely to have made the statement complained about. The Member impressed us as having a good understanding of the nature of investments generally and this first-ranking debenture stock investment specifically. All investments carry risk to some extent and the complainant acknowledged that in his evidence.

Based on our findings on the particulars pleaded, we determine that there has been no material false or misleading statement made by the Member. We find that the investment recommendation was made, but the evidence does not support a determination of a breach of Rule 101 by the making of a false and misleading statement as pleaded.

THE SECOND CHARGE

[17] As noted in paragraph 16(b) above the evidence presented demonstrated that the Member did carry out research as the basis of the Member's recommendation

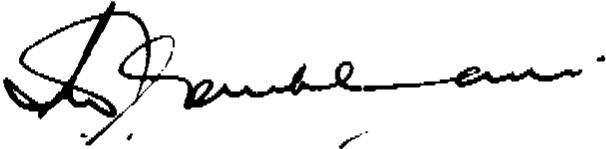
[18] With regard to the charge that the Member breached Rule 702 by failing to make reasonable investigation of the investment product, we find it difficult to conclude that the charge is proved. Although additional research might have been considered useful, we find that, in view of the evidence and submissions presented, but in the absence of expert evidence on just what is "a reasonable investigation regarding the suitability of financial products recommended" in the circumstances of this case, we are unable to find against Member A on this charge.

Determination and Orders of the Disciplinary Committee

[19] The Committee hereby determines that the two charges against Member A be dismissed and orders:

- (a) that counsel shall confer to endeavour to reach an agreement with regard to costs having regard to the Committee's determination, and if they are unable to do so within 14 days of the date of this determination they may each file memoranda and the Committee will make a determination;
- (b) that the Institute shall publish the findings of the Committee in a manner approved by the chairman of the Committee in a way that does not identify the Member, the complainant, or their locations.

By Order of the Disciplinary Committee

A handwritten signature in black ink, appearing to read 'A N Frankham', written in a cursive style.

A N Frankham

Chairman

16 July 2009

Legal representation:

For the Institute Phillips Fox (Adam Holloway)

For the Member Kelly Quinn - Barrister