PROFESSIONALISM AND ETHICS: A LEGAL PERSPECTIVE

SPAA CONFERENCE , SYDNEY, 9 MARCH 2007

The Hon. Sir Anthony Mason AC KBE

Introduction

1. At the outset, I should offer a disclaimer of expertise in the area of superannuation, particularly the "self managed" species of superannuation. I don't own or run a superannuation fund. And you will have divined from my career and my appearance that my age disqualifies me from taking advantage of Peter Costello's Budget generosity by selling assets or borrowing a huge amount of money and putting it into a superannuation fund. In any event, borrowing would be a dubious strategy. The interest payments would not seem to be deductible.

2. But I have some sympathy for those who do manage superannuation funds and for their advisers. My sympathy arises from the regulatory regime which, though simpler than it was, is by no means "user friendly". My objection is not to regulation as such. It is necessary to regulate superannuation investments in the interests of both the public and superannuitants for the interests of the two groups do not coincide. It is also necessary to have strong regulation, backed by stern sanctions to ensure that the privileges given to those who own and manage SMSFs are not abused. And sanctions need to be stronger in an era, such as ours, where the prevailing ethos is economic rather than ethical and the emphasis is on profits and money-making.

3. But does this regulatory regime need to be quite as complex as it is? For example, statements of advice (SOA) about which I shall have something to say later. Governments of various political persuasions appear to believe that problems can be solved simply by enacting legislation without recognising that the difficulties and costs of compliance are major causes of non-compliance.

4. On the other hand, complexity is inevitably a problem in a system based on self-management. It is not a problem confined to SMSFs. An article in *The Sydney Morning Herald* last week[1] explored the problems associated with strata title properties where size and complexity are significant factors, where the system appears to be experiencing great difficulty in coping with these problems. The article makes the point that poor standards of management and governance are contributing causes. Schemes are governed by volunteer committees whose members have limited skills and few resources.

5. This results in conflicts of interest, poor decision-making and lack of supervision of professional managers. Strata managing agents often lack the skills to provide the required levels of professional service. With SMSFs, fortunately, there is a greater level

[1] Gary Bugden, "Close fit, not close-knit needs better legislation", *SMH*, 27 February 2007, p. 11.

of professional skill available to assist self-management. Yet surveys to which I shall refer reveal a lower than expected level of professional performance. Our object must be to ensure that professional skills are provided at a high level and that they are in fact accessed.

6. The issue of compliance, always important, has become even more important, since the September 2006 Federal Budget. According to Alan Kohler's *Eureka Report*,[2] new figures from the ATO show that SMSFs account balances per members have shot ahead by $54,000 in the 15 months to September 2006 and they will continue to soar. Almost one quarter of Australia's superannuation savings is held in SMSFs. The Report makes the comment that the increase in super money in the 15 months to September 2006 "held by the average DIY fund member represents almost as much as most people have accumulated in their entire lives". I am informed that there now are over 320,000 SMSFs with investments amounting to $260 billion,[3] while superannuation assets now exceed $1 trillion.

7. I had intended to say that there is a dark cloud on the horizon, referring to increasing policing of the sector by the regulators. But that dark cloud actually descended on the Conference on Wednesday in the person of Michael D'Ascenzo, the Commissioner of Taxation. He announced that the ATO planned to increase its compliance checks on SMSFs. He also said that the ATO would be knocking at the doors of high risk auditors. More positively, he spoke of providing instructive guidance to those conducting SMSFs, guidance which will unquestionably be welcomed. The Government is concerned at the level of compliance by SMSFs with superannuation law and the level of trustee education and understanding of their responsibilities.[4] This is one reason why compliance issues are now of the utmost importance. And compliance inevitably raises issues of professionalism and ethics.

The rise of professional society

8. Before I refer to professionalism I shall say something about the rise of professional society. The dominant feature of modern English and, for that matter, Australian society, has been the rise of professional society since 1880.[5] The ascendancy of professional society prevailed until the 1970s when it is said to have gone into decline, the consequences of which are now evident in the criticisms made of the professions, notably the medical and the legal professions.

9. It is by no means clear what is meant by the decline of professional society. There has certainly been a decline in the respect accorded to professional people and their opinions. Clients and patients are now more inclined to question their advisers, to

---

[2] Trish Power, "Australia's exploding DIY funds", *Eureka Report*, February 16, 2007, p. 1.
[3] These figures are rather larger than those stated by Senator Sherry when speaking on the Parliamentary Joint Statutory Committee on Corporations and Financial Services Report "Statutory oversight of ASIC", Senate proceedings on 1 March 2007, p. 20.
[4] "Simplified Superannuation – Final Decisions", 10 January 2007.
[5] See generally H.J. Perkin, *The Rise of Professional Society since 1880*, Routledge (1990).

criticise them and to sue them when things go wrong. And professionals don't enjoy the same status they enjoyed in earlier times. Compared with sporting and entertainment personalities, business leaders, managers, politicians and certainly those "famous for being famous", professional people do not rate highly in the pecking order. The professional person's principal passport to fame is to become "famous for being infamous".

10. On the other hand, if we look beyond the superficial world portrayed by the media, professional life is still flourishing in Australia. One reason for this is that the class of professionals has extended well beyond the traditional categories of doctors, lawyers, dentists, engineers, accountants and others to include a very wide range of occupations backed and supported by university courses and degrees. The extent of that success is evidenced by the great demand overseas for our professionals and our companies offering professional services. The outstanding achievement of our universities has been to produce competent professional graduates in large numbers. This is why we attract so many foreign students.

What it means to be a professional

11. The distinctive and idealistic claim of the professional is that he or she offers a service which is expert in the sense that it is the product of special skill and knowledge and it is provided for the benefit of the client (or patient) and in the interests of the client and not in the interests of the provider except in so far as the provider receives a reasonable remuneration for the service rendered. Generally speaking, it was a characteristic of the professional service that the client or recipient lacked the requisite skill and knowledge to assess the competence of the provider and the worth of the service provided and was therefore forced to take in it on trust. This may well be the situation today with many recipients of SMSF advice.

12. The distinction between a trade, a business or a mere occupation and a profession has often been based on the public service ideal of the professional. Sir Laurence Street said:[6]

> "A trade or business is an occupation or calling in which the primary object is pecuniary gain ... But in a profession, pecuniary success is not the only goal. Service is the ideal, and the earning of remuneration must always be subservient to this main purpose."

13. Anthony Trollope, the novelist, was more cynical, describing[7] a profession as "a calling by which a gentleman not born to the inheritance of a gentleman's allowance of good things might ingeniously obtain the same by some exercise of his abilities".

14. The traditional statements of the professional ideal are deficient in one important respect. They fail to identify the independence of the professional adviser and the

[6] *Re Foster* (1950) 50 SR(NSW) 149 at 151.
[7] A. Trollope, *The Bartrams*.

objectivity of the advice which was given, these being two of the qualities which distinguish the true professional from the vendor of a product, whether it be land or goods or something else.

15. The traditional view of a profession has given way, as many traditional views have, to the advance of commercialism. Sir Daryl Dawson noted in 1996[8] that there had been a transition from "trustee professionalism" (being the use of knowledge in the service of the client or the community) to "expert professionalism" (being concerned with the marketing of expertise *per se*) and its consequences for the ideal of public service. Commentators instance large law firms as examples of "expert professionalism" because they no longer pursue the public ideal. It is then said – and I am not to be taken as agreeing with the statement - that these firms are therefore carrying on a commercial activity in which independence and objectivity are not central elements.

16. There is now an increasing community perception that professionals no longer pursue the professional ideal. To the extent this ideal is invoked by professionals, it may be regarded simply as part of the mystique which the professions call in aid to repel criticism. Some professional people, by their conduct, have contributed to this perception. The failure of a profession to maintain high standards of conduct results in a forfeiture of trust and confidence in the profession.

17. There is also a concern that professional advisers should have done more to shield the community from corporate collapses and other untoward financial problems. In the past, it was expected that professional people – accountants, auditors and lawyers, acting independently, giving sound prudential advice and delivering responsible, objective reports, would act as a brake on the commercial adventurism which has taken place in the United States and Australia in recent decades. In the United States, pointed comments were made about the performance of accountants, auditors and attorneys in the events that led to the collapse of the savings and loans corporations. Later the activities of lawyers, accountants and auditors were instrumental in the dealings which led to the collapse of Enron Corporation, a story which has been graphically documented in "The Smartest Guys in the Room".[9]

18. In Australia, we had the collapse of the development boom in the late 1980s. Since then we have had the James Hardie affair and the HIH collapse, events which are still being played out in the courts, with no end in sight.

19. In the context of SMSFs, the Federal Government, principally through the ATO, has endeavoured to redress the consequences of this decline in the professional ethos by imposing stern sanctions for non-compliance, by increasing the monitoring and policing of compliance and by undertaking a comprehensive campaign to educate professionals, trustees, managers and members so that they understand their responsibilities. The ATO publications in this area are of high quality , are very informative and are clearly

[8] Dawson, "The Legal Services Market", (1996) JJA 147 at 148.
[9] B. McLean and P. Elkind, *The Smartest Guys in the Room: The Amazing Rise and Scandalous Fall of Enron*, Portfolio (2004).

expressed. And the SPAA has played a significant part in identifying and encouraging standards of professional excellence.

Professionalism and ethics

20. The events in the United States and Australia already mentioned marked what was a crisis in the decline of professionalism and ethics. Professionalism now signifies high professional standards of competence. On the other hand, ethics signifies high standards of ethical conduct. The attainment of high standards of professional competence is not enough on its own. It is necessary to pursue high ethical standards as well. It is instructive to read what is now alleged against defendants in the James Hardie case. You will recall that the object of the exercise there was to locate the headquarters of the company in the Netherlands. One consequence was to impose a limit on the company's liability to its Australian employees who suffered from asbestosis. It is suggested that there was a failure to inform the court approving the scheme of arrangement that it was contemplated that the company would cancel its uncalled capital. If there was such a failure – and I am not saying there was - it could be regarded as a matter of ethics. But it could perhaps also be regarded as a failure to discharge a legal and professional responsibility.

21. As the allegation reveals, the boundary line between professionalism and ethics is a shadowy one. Professional codes of conduct prescribe pursuit of high standards of both professional conduct and ethical conduct without drawing a distinction between the two. And, for present purposes, I shall treat professionalism and ethics as one topic without differentiating between them. This is the approach taken by the ATO to the role and responsibilities of auditors.

What is an SMSF?

22. First, however, it is necessary to say something about an SMSF. SMSFs (also known as DIY funds) perform the same role as other funds, by investing contributions and making them available to members on retirement. The distinctive feature of an SMSF trust is that the members are the trustees – they control the investment of their contributions and the payment of the benefits.

23. Subject to some exceptions, a fund is an SMSF

- If it has a trust deed which complies with the Superannuation Industry (Supervision) Act 1993 (the SIS Act)
- It has 4 or less members
- Each member of the fund is a trustee
- No member of the fund is an employee of another member of the fund, unless they are related, and
- No trustee of the fund receives remuneration for his services.

24. A trust is a relationship between trustee and beneficiaries with respect to the trust property. The trustee holds the property for the benefit of the beneficiaries, subject to the terms of the trust. A trust is a relationship. It is not an entity, unlike a corporation.

25. As Arlene Macdonald points out in her instructive paper, an SMSF is a particular kind of trust where the trustee holds property and undertakes specific responsibilities for the long term benefit of the beneficiaries: to provide age pensions and retirement benefits. In doing so the trust serves a public purpose by encouraging people to look after themselves. Nonetheless it is a private not a public trust. An SMSF is an unusual trust in that all the members are required to be trustees.

26. SMSFs must meet the sole purpose test under the SIS Act. This test means that a SMSF must be maintained for the sole purpose of providing benefits to members upon their retirement, or to their dependants if a member dies before retirement. The consequence is that the members cannot enjoy a benefit from the investment before they retire, subject to some strict exceptions. Another consequence is that the fund cannot provide financial assistance or a benefit to a person or entity outside the fund. Yet Michael D'Ascenzo pointed out on Wednesday that a key contravention of the sole purpose test has been making loans to a member or relative.

The role and responsibility of trustees

27. It is convenient to deal with the trustees' responsibilities first. They do not exhibit in quite such a striking way the ethical standards which are clearly evident in the auditors' responsibilities. The primary responsibility of an SMSF trustee, as with any other trustee, is to comply with the provisions of the trust deed and with the relevant provisions of the law. In the case of the SMSF trustee, the relevant provisions of the law include the SIS Act and regulations and the Corporations Act as well as the provisions of the general law such as tax and trust law.

28. The SIS Act sets out rules which are deemed to be included in the trust deed of every regulated fund. According to the ATO, the rules require a trustee to

- act honestly in all matters
- exercise the same degree of care, skill and diligence as an ordinary prudent person
- act in the best interest of the fund members
- keep the money and assets of the fund separate from other money and assets (for example, your personal assets)
- retain control over the fund
- develop and implement an investment strategy
- not enter into contracts or behave in a way that hinders trustees from performing or exercising their functions or powers, and
- allow members access to certain information.

But s. 52 of the SIS Act sets out the trustee's covenants (duties) in more detail and it is important to have regard to the section. The SIS provisions on the trustee's covenants are

deemed to be incorporated in the trust deed (where it does not contain provisions to the effect of the covenants).

29. Failure to comply with the rules exposes the trustee and the fund to various consequences

- the fund may be deemed a non-complying fund and lose its concessions
- the trustee may be disqualified
- the trustee may be liable to prosecution and liable to substantial penalties
- the trustee may be liable to civil action by other members.

30. A complying fund that is made non-complying can suffer serious tax consequences. The fund's total assets (less member contributions for which no tax deduction has been claimed) are subject to tax at the highest marginal rate. In addition, any income in a year in which the fund is non-complying is taxed also at that rate.

31. Setting up a SMSF to gain improper early access is illegal. Trustees who knowingly allow improper access to benefits are liable to heavy fines and imprisonment. If a trustee is prosecuted and found guilty of either a civil and/or criminal offence under a civil penalty provision, the maximum penalties under Part 21 of the SIS Act are $220,000 (civil proceedings) and/or 5 years imprisonment (criminal proceedings).

32. An important obligation of a trustee is to formulate an investment strategy and to implement it. Another is the obligation to keep proper records.

33. I should say something more about the sole purpose test. The sole purpose test is divided into core and ancillary purposes. A regulated fund must be maintained for at least one core purpose and one or more ancillary purposes. The core purposes relate to the provision of benefits for each member on or after certain events. Ancillary purposes relate to the provision of benefits in circumstances being termination of employment or cessation of employment due to ill health, death and other ancillary purposes approved in writing by the regulator. This last ancillary purpose allows a fund to provide benefits in situations of financial hardship and/or compassionate grounds. But note written approval of the regulator is required.

34. One way of determining whether there has been a contravention of the sole purpose test is to examine the character and purpose of the fund's investments. Hence the provision of a direct or indirect financial benefit to any party cannot be a factor in making investment decisions and arrangements.

35. If a fund conducts a business, that will be regarded as a possible indication that the sole purpose has been contravened. This is because the conduct of a business is thought to indicate that the fund is not administered for the sole purpose of providing benefits for the members and beneficiaries of the fund.

The role of the adviser

36. Although the role of an adviser in advising whether an SMSF is suitable for a client and how it should be run is of paramount importance, there are only two points I want to make at this stage. The first is, and I shall make the point again later, that the quality of advice given by advisers leaves a lot to be desired. The second point is that advisers have important obligations in relation to conflicts of interest, a matter to which I shall return.

Responsibilities of approved auditors

37. The responsibilities of SMSF auditors exhibit a marked ethical content, stemming largely from the requirement of independence. Among the duties of an SMSF auditor is the audit of a fund's compliance with the requirements of the SIS Act and regulations. The ATO publishes an approved form which prescribes those provisions that are to be included as part of the audit compliance form. In addition, the auditor is required to provide the trustees with a report of contravention of the SIS Act and regulations. The auditor is also required to provide the ATO with a written report on any contravention of the SIS Act here it may affect relevant interests. He is also required to report superannuation surcharge and reasonable benefits limits information to the ATO.

38. Auditing Standard AUS 202 *Objective and general principles governing an audit of a financial report* requires an auditor to comply with the ethical requirements of CPA Australia and The Institute of Chartered Accountants in Australia. The ethical principles governing an auditor's professional responsibilities include independence, integrity, objectivity, professional competence and due care, confidentiality, professional behaviour and technical standards. Although the SIS Act does not specifically deal with auditor independence, an auditor should conduct an audit in accordance with Australian Auditing Standards and Guidelines. Any departure from them can constitute a basis for an allegation of negligence or breach of duty against an auditor in a civil action.

39. Statement of Auditing Practice AUP 32 – *Audit Independence* defines independence as a freedom from any interest incompatible with integrity and objectivity. Independence requires a freedom from bias, personal interest or association and susceptibility to undue influence or pressure. Likewise, the Code of Professional Conduct – *Professional Statement F.1 – Professional Independence* and the *Code of Ethics for Professional Accountants* APES 110 s. 290 state that professional independence is a concept fundamental to the accounting profession, requiring a member to approach their work with integrity and objectivity. Audit independence has been further explained by statements issued by the accounting bodies and the Auditing Assurance Standards Board. As you will see, accountants and auditors are inundated with publications relating to professional standards, all emphasising independence and objectivity. The only rational explanation for such a flurry of publications on the one topic is that they are directed at a major problem – a perceived need for these qualities.

40. Involvement in the day to day management of a fund or occupation of a position in which an auditor can influence the fund's decision-making processes, including its accounting or management functions will compromise an auditor's independence and

objectivity. Other matters which can compromise these qualities are identifying too strongly with the client and the client's interests and being intimidated by the client. An auditor must not allow the possible loss of the client's work to affect the auditor's independence and objectivity. If we look back again on Enron, the willingness to engage in or endorse constructive accounting along with an apprehension that the auditing and legal work might otherwise be lost was central to what happened.

41. Audit of the sole purpose test is a fundamental aspect of the auditor's obligations, as is the audit of the trustees' investment strategy and implementation of that strategy. Important also is the audit of the SIS Act restrictions on the investment practices of self-managed funds. These restrictions aim to protect members from being exposed to undue risks. These restrictions include the in-house assets rules, restrictions on lending and providing financial assistance, prohibition on the acquisition of parties from related parties, restrictions on borrowings and the prohibition on giving a charge over an asset of the fund.

42. The auditor's responsibility represents the last line of defence, but the most important defence, of compliance of an SMSF with the statutory requirements. In the corporate collapses to which I referred earlier, the failure of the auditors to maintain their independence and objectivity was a central element in the descent to disaster. In a number of these cases the auditors (and the lawyers as well) got too close to the client, giving the client favourable advice, even suggesting to the client dubious strategies by which legislative and other regulatory requirements could be circumvented by masking the true character of transactions. These were classic cases of professional and ethical misconduct. They demonstrated that professionalism and ethics, backed by strong sanctions, are a necessary and ultimate safeguard of good and compliant commercial and investment conduct but that they will not always be sufficient.

43. Audit responsibility is governed by the SIS Act and the general law. Although the ATO is not a regulatory body with specific responsibility for auditing, the ATO is again focusing attention on auditing of SMSFs, with particular emphasis on the independence of auditors. Belinda Aisbett's paper draws attention to the startling failure of auditors to check important matters. As I understand it, the statistics relate to a relatively small sample and that they involved what are called "high risk" audits. So it would be unwise to draw too much from them.

44. But the figures generate concern about the general level of compliance in SMSFs. I note again the sanctions and the auditor's potential liability for damages for negligence. The consequences for Arthur Anderson of the Enron disaster are an untoward reminder of what a descent into the abyss can entail for an auditor. Although, in terms of scale, an SMSF is a minnow compared with Enron, there are many auditors who are minnows compared with Arthur Anderson.

45. I also draw attention to the sound practical advice given by Belinda Aisbett in her paper as to the circumstances when an auditor should not take on an audit of an SMSF.

Are professionals answering to their responsibilities?

46. No general survey has been made of the administration of SMSFs. So we don't know to what extent trustees, managers and auditors have failed to discharge their responsibilities. But we do know from the ASIC "Shadow Shopping Survey on Superannuation Advice"[10] that the compliance level in the provision of superannuation advice to 306 participants was well below reasonable expectations. The survey revealed that 18 advisers were apparently in breach of the licensing rules – 14 accountants, 2 tax agents and 2 mortgage brokers.[11]

47. In some limited circumstances, accountants can give advice on superannuation issues without needing to come within the AFS licensing regime. They include

- advice to set up an SMSF; and
- advice on the tax aspects of a superannuation product, so long as there is a written warning that other factors may be relevant and the client should seek advice from a licensed adviser.

In 4 cases, unlicensed accountants were within the exemption and the advice seemed to have a reasonable basis. In 14 other cases, however, unlicensed accountants illegally gave advice on issues that required a licensed adviser. These cases included advice about non-SMSF super funds, including contribution levels, consolidation and asset allocation.

48. There was a wide range in the quality of advice provided. 16% of the advice given *clearly* did not have a reasonable basis in some respect and a further 3% *probably* did not have a reasonable basis. Advice was not appropriate to the client's needs in some respect, or insufficient inquiries were made to enable appropriate advice to be given. Non-compliant or probably non-compliant advice was given by 24 different licensees, including several large firms. The proportion of poor advice was regarded by ASIC as higher than acceptable.[12]

49. On the other hand, only a few cases of advice on SMSFs were encountered in the Survey. Most contained reasonable advice (some recommending SMSFs, others advising against). In contrast, problems were more common in advice given to switch funds. 28% of advices to switch did not have a reasonable basis and 5% probably did not.[13]

50. There was a large number of cases in which an adviser failed to provide a written SOA when required.[14] Across the range of compliance issues assessed in the survey, problems were detected with a wide range of licensees and advisers. Problems were not confined to a minority of them.[15]

---

[10] April 2006.
[11] Ibid p. 7.
[12] Ibid. p. 7.
[13] Ibid. p. 8
[14] Ibid p. 9.
[15] Ibid. p. 10.

51. The SOAs generally disclosed the adviser's conflicts of interest. But ASIC was not confident that all consumers could use this information to adequately judge whether the conflicts had influenced, or had the potential to influence, the advice. This seems to have been due to an inability on the part of consumers to appreciate the impact that various types of conflict could have on the quality of advice given. ASIC concluded:

> "While disclosure is a critical part of consumer protection, this survey suggests that it can only play a limited role in protecting consumers from inappropriate or conflicted advice."

The ASIC conclusion is as one would expect. The client reposes trust and confidence in the adviser and therefore looks upon the disclosure as vindicating that trust and confidence rather than viewing the facts disclosed as a reason for subjecting the advice to critical scrutiny. The SOA is not crafted in such a way that it alerts the reader to question the advice which is given.

52. There is, in any event, a major problem with SOAs. To use the language of the book reviewers, they are not "a good read". They are over-technical, formal and complicated. They contain clauses excluding and limiting the adviser's legal liability expressed in that dense, grinding style that lawyers have brought to a pitch of perfection after centuries of practice. Even a seasoned campaigner like myself reaches for the dustbin when such a document arrives. Who reads them, let alone understands them? What is the point of talking about imperfect advice if the recipient doesn't read the advice and may not understand it, even if he reads it? There is a case for saying that the regulatory requirements influence the form of an SOA. Obviously something should be done to improve its readability. Such a reform would be a step forward and a victory for commonsense.

53. It comes as no surprise that the Survey found that conflicts of interest bring a higher risk of inappropriate advice. Common conflicts included remuneration (commission, bonus) which was related to the giving of advice or recommendation of the products of a company associated with the licensee or dealer. ASIC stated its intention to hold discussions with licensees and industry associations about the issue of further guidance by ASIC and/or industry on how such conflicts might best be managed and what conflicts need to be avoided by licensees.[16]

54. I strongly commend to all participants in the industry, especially advisers, the ASIC discussion paper on "Managing conflicts of interest in the financial services industry". I have a problem with the expression "managing conflicts" because it tends to suggest that conflicts are inherently capable of being managed. A lot depends upon what you mean by the word "managed" in this context. Some conflicts can only be adequately managed by being avoided and, when you read the paper, you will see that it makes this very point. A person who is a fiduciary - and, depending upon the particular circumstances, an adviser may conceivably be a fiduciary - is bound by law to avoid being in a position where his personal interest conflicts with his duty. It would be a mistake to think that disclosure of a conflicting interest is a magic wand in a situation

[16] Ibid. p. 49.

where personal interest conflicts with duty. Disclosure has its own problems, as I shall point out shortly.

55. Many, if not most, instances of inappropriate advice, relate to "switching" investments where conflict of interest is very often involved. It would, however, be a mistake to assume that all cases of inappropriate advice are the result of self-interest dictating the advice. There are other important factors at play, including the limited familiarity of the adviser with products other than those he knows and the lack of expertise of the adviser (how knowledgeable is he or what experience of the industry has he?). Sometimes the adviser fails to take account of the fact that switching will entail exit fees and the loss of incidental benefits such as insurance cover, other benefits or lower expenses.

56. According to ASIC, cases of switching involving inappropriate advice generally concern switching from a low cost fund to a retail fund or, in some instances, a wholesale fund. Studies reveal what the difference in cost can mean to a client over a 20 year or longer period. Even then there may be imponderables such as an increase in fees on the part of the retail or wholesale fund. ASIC can point to cases where a client, having been advised to switch, is substantially worse off at the date of projected retirement than the client would have been had it remained with the original low cost fund. The difference can amount to as much as 37% and it is due primarily to higher fees and charges in the new fund, the assumption being that the income of the original and the new fund would remain the same. On the FIDO calculations, the earnings from the new fund would need to be over 2¼% per annum higher than those of the old fund to yield the same amount on retirement.

57. These cases do not involve an SMSF. In the case of an SMSF the critical question generally for the client is whether they should set up an SMSF. And an important aspect of that question is whether the SMSF structure will be suitable to the client's circumstances in the long time span that ensues after the decision to set up the fund.

58. Fashioning answers to these problems is a very difficult exercise. Prohibition of commissions would involve a radical change to the traditional mode of remuneration in the industry. The financial services industry is not based on a fee for service basis such as the legal, medical and dental professions. Like the real estate industry, it is based on percentage charges. And quite apart from the way in which charges are calculated, the structural relationships in the industry may constitute an important part of the problem.

59. In this respect, there is a significant difference between the traditional professions and the financial services industry. The difference is relevant to standards of professionalism. Lawyers, doctors and dentists provide professional services for a fee. But financial service providers also engage in product selling which is inherently a commercial operation and is different from the provision of advice. Unfortunately, in many instances, the two roles are combined so that the adviser who is product selling (for which he may be remunerated by commission or bonus) is also acting as adviser. This

situation may well lead to a dominant culture of selling to which the role of advising is subordinated.

60. In other words, there is a risk that the role of professional adviser will be subordinated to that of the salesman. The risk is compounded by the circumstance that the salesman is described as a licensed financial adviser.

In many cases this is what happens

61. The combination of conflicting roles has led to the suggestion that financial advisers be required by law to act in the best interests of their clients. This suggestion is backed by a Newspoll survey released three days ago which, it is claimed, reveals that almost 85% of Australian adults support that suggestion.[17]

62. One possible answer to existing problems would be to insist on a higher level of educational qualifications for financial advisers, extending beyond that required by ASIC's PS146. It may even be that trustees of super funds should undergo a level of training. Higher educational standards might not be a complete answer to the problem. And they would entail higher costs simply because more highly qualified advisers would attract higher remuneration. But clearly higher educational standards seem to be an option worthy of serious consideration.

maybe in a Court of Law.

63. One important point I should make is that a client adviser, who has a conflict of interest because he is paid a bonus or commission on the sale of a product, may be more vulnerable in an action for damages for negligent advice than the adviser would be if he gave the same advice unhindered by any conflict of interest. This vulnerability is not removed by the making of a full disclosure of the conflicting interest. It stands to reason that the existence of a conflicting personal interest for giving advice which is alleged to be negligent may induce a tribunal of fact to conclude that the conflicting personal interest was a contributing factor in the giving of the advice.

?? FICS

Financial Planning Industry largely fails this test

64. I should emphasise that, in the context of a conflict of interest, the obligation is one of full disclosure. What is required is a full disclosure of all facts which would enable the client to fully understand how the conflicting interest (say, the mode of remuneration) might compromise the integrity of the advice given. The provision of this information is necessary to enable the client to decide what weight should be given to the adviser's advice.

65. In a case where an adviser is restricted by his engagement to advising on and selling the products of a particular issuer, the disclosure would need to be comprehensive. The adviser would need to disclose his relationship and that of his employer with the product issuer and how that relationship affects the recommendations given by the adviser. The client should clearly understand that the adviser cannot recommend other issuer's products, that the advice is necessarily limited and that the client may suffer detriment. Even if disclosure along those lines is made, as ASIC suggests, there are problems. Does the adviser engage in a comparison with rival products? The difficulty here is that, in reality, the adviser is a product seller, yet he is described as a licensed

[17] Industry Super Network, Media Release, 6 March 2007.

This is why "Sales" needs to be separated from "ADVICE" Reps

financial adviser, a description which endows him with a very different aura of authority and influence.

66. One aspect of SMSF advice which concerns accountants merits attention. Accountants, unlike lawyers, as I understand it, are not required by law or practice to provide the client with an estimate of fees for work to be done. It can be a matter of significance to the client who is advised to set up an SMSF to ascertain how much it is going to cost. There seems to be a strong case for saying that the provision of such an estimate should be mandatory.

Civil liability

67. Professionals in the superannuation industry, particularly advisers and auditors, should be alert to the risk of being held liable in civil proceedings for damages for negligence or other breach of duty. This form of liability is quite distinct from the statutory liability for a civil penalty. Damages for negligence would be related to the client's loss and could be quite substantial. You will recall that for some time the Federal Government has had under consideration the notion that advisers at least should be required compulsorily to take out professional indemnity insurance. This proposal has much to commend it. To those who do not have such insurance, it can amount to a significant additional expense of carrying on business.

Conclusion

68. In conclusion, I reiterate the importance of achieving high professional standards. The future of public confidence in the industry depends upon it. In this respect, I commend the work of the SPAA. It is working to support the attainment of high standards of integrity, professionalism and ethics across the industry. This it does by developing independent national professional standards and encouraging specialist categories of membership with an emphasis on maintaining skills and knowledge through continuing education. I conclude my remarks on that hopeful note.

Not achievable without separating sales from advice.