

Determination

Case number: 496009

15 March 2019

1 Determination overview

1.1 Complaint

The complainant approached Company P, a corporate authorised representative of the financial firm, after viewing a webinar regarding property development. The complainant purchased a property a short time later and engaged Company P to project manage the project. The first builder, recommended by Company P, went into liquidation. The complainant says that he lost approximately \$180,000 because of this.

While the project was ultimately completed, and the complainant is deriving rental income from the completed townhouses, the complainant says the financial firm failed to advise him of the construction risk relating to the property development and failed more broadly to discuss investment options other than investing in property.

The financial firm says the complainant approached the financial firm for specific financial coaching in relation to investing in property development. They say that at no time did the complainant indicate that he was seeking full financial strategy advice across all asset classes. They also say the construction risk was adequately disclosed.

1.1 Issues and key findings

Did the financial firm provide advice in the best interests of the complainant?

The financial firm failed to provide advice in the best interests of the complainant by not adequately identifying the subject matter of the advice sought by the complainant nor adequately limiting the scope of the advice to property coaching only. The panel is of the view that, in all the circumstances, the financial firm was required to provide holistic advice to the complainant.

If there was a breach by the financial firm how much was the complainant's loss?

The panel is satisfied that, applying the “but for” test to loss, the complainant suffered a loss of \$8,396.34. He has contributed to his loss and it should accordingly be reduced by 50%.

1.2 Determination

This determination is in favour of the complainant. The financial firm must pay the complainant \$4,198.17 plus interest at the rate of 1.75% per annum compounding annually from 7 May 2014 until the date of payment to maintain the real value of the compensation.

2 Reasons for determination

2.1 Did the financial firm provide advice in the best interests of the complainant?

The financial firm must act in the best interests of the complainant

The financial firm is required to provide advice in the best interests of the complainant. This requires the adviser to adequately “know its client”, “know its product” and provide advice which is appropriate for the client. The duty requires that the financial firm adequately identify the subject matter of the advice sought (whether explicitly or implicitly). It is also required to take any other steps in the best interests of the client.

The fact find gives no indication the complainant only wanted advice on property

The complainant completed a fact find on 7 February 2014. The fact find indicates, among other matters, that the complainant was looking to retire as soon as possible, and was seeking to gain good capital growth over the mid to longer term i.e. 6 – 10 years. It also indicated he was seeking to grow his wealth through asset acquisition. Notably there is no mention that the complainant was trying to achieve his objectives solely through property investment.

The financial firm did not satisfy the best interests duty

While the panel accepts the complainant saw a webinar and was interested in considering an investment in property development, the financial firm has not adequately identified the subject matter of the advice sought.

The fact find makes no reference to the complainant seeking to achieve his goals solely through property. In fact, the Financial Services Guide (FSG) and Service Agreement clearly indicate that the financial firm could provide services across a range of financial products. Its services were not just limited to property.

It is a key part of an adviser’s role to advise on the pros and cons of any strategy being considered by an investor, and in these circumstances, the panel accepts that the complainant assumed that the financial firm had agreed that the property investment was suitable for him.

2.1 If there was a breach by the financial firm how much was the complainant’s loss?

The breach must cause the complainant’s loss

In calculating loss, the objective is to restore the complainant, as closely as possible, to the position that he would have been in “but for” the conduct of the financial firm.

This is not necessarily achieved by refunding the amount originally invested. It requires comparing the position the complainant was in because of the financial firm’s breach (the actual position) with the position he would have been in had the breach not occurred (the “but for” position).

The breach did not cause a loss

Had the financial firm adequately satisfied its obligations, it should have provided holistic advice. Had it done this, acting in the complainant’s best interests, it should have recommended a diversified growth portfolio. Based on this approach, the complainant’s loss is \$8,396.34. This is calculated as follows:

	<u>ACTUAL</u>	<u>BUT FOR</u>
<u>Contributions</u>		
• Personal equity	• \$367,677	• \$376,677
• Interest Repayments	• \$194,120.51	Nil
• Loan	• \$1,232,000.00	Nil
• <u>Sub-total</u>	• <u>\$1,802,797.51</u>	• <u>\$367,677</u>
<u>Benefits</u>		
• Net rental income	• \$28,520	Nil
• Portfolio value	• \$1,890,000.00	• \$500,795.83
• <u>Sub-total</u>	• <u>\$1,918,520</u>	• <u>\$500,795.83</u>
• <u>Complainant Gain</u>	• <u>\$115,722.49</u>	• <u>\$124,118.83</u>
• <u>Actual Loss</u>	•	• <u>\$8,396.34</u>

(Capital gains has not been factored in to either scenario because it has not been incurred by the complainant. In any event, the panel also notes that it would be incurred in both scenarios.)

The panel does not accept the complainant’s “but for” position

The complainant says “but for” the breach he would have:

- invested in US shares.
- borrowed the same amount he borrowed for investment in the property development

He also says he had additional cash that he also would have invested.

The panel does not accept this submission. Advice in the complainant's best interests would have been to diversify across asset classes, not to invest solely in one asset class. Investing in US shares only would have exposed the complainant to significant sector risk. While US shares did perform well for the period, this is not the test for whether such an investment would have been in the complainant's best interests at the relevant time.

The panel does not accept the complainant would have borrowed funds to invest

Borrowing to invest (known as gearing) is generally considered to be a high-risk approach to investing. This is because gearing increases the investor's investment capital base and magnifies gains in rising markets but also magnifies losses in falling markets.

While the panel accepts that the complainant was interested in capital growth, there is no reason apparent to the panel that the financial firm should have recommended the complainant borrow to invest. He could have achieved significant wealth accumulation by investing in a diversified growth portfolio and contributing his monthly surplus to the investment. There was no need to magnify his risk by gearing.

The panel does not accept that additional amounts should be used in the "but for" scenario

The panel also does not accept the complainant would have used more than the \$376,667 capital he invested in the property development in the "but for" scenario. While the complainant says the reason he did not invest further funds (which he did have available) was because he was invested in the property strategy, to include funds other than those invested would be contrary to AFCA's approach to loss on such disputes, and in the panel's view, is too speculative. The "but for" position needs to be based on the amount he actually invested.

The financial firm is not required to repay the complainant the builder's costs

For completeness, the panel also would like to comment on the complainant's original claim for \$180,000. There are no circumstances the panel can see in which the complainant would be entitled to the \$180,000 sunken costs he incurred due to the builder going into liquidation.

Even if the panel were to find that the financial firm's breach were that it failed to adequately disclose the construction risk, the remedy would not be to require the financial firm to repay the complainant the sunken costs arising from the builder going into liquidation. The remedy would be that, had such risks been adequately disclosed (and the panel confirms no finding is required to be made on this), the complainant would have either proceeded with the strategy, or invested in something with less risk. The "but for" scenario discussed above would be such an investment.

Incidental expenses are not compensable in this matter

The complainant also made a claim for \$10,000 “miscellaneous” incidental expenses. There is no explanation or further detail in relation to what those expenses were and they are not compensable on this basis alone. In any event, the panel has no power to award “incidental expenses” pursuant to the Terms of Reference.

The complainant contribution to his loss

The complainant registered himself on a website expressing an interest in investing in property. Following this, he was invited to view a webinar presented by the financial firm. He then contacted the financial firm for more information about property.

He clearly had a strategy to purchase property and spent time and effort to learn how to make such an investment, including by attending the coaching sessions offered by the financial firm. On balance the panel is of the view that it is fair in all the circumstances that he takes some responsibility for his loss. On this basis, his loss should be reduced by 50%. His loss is therefore \$4,198.17.

Interest should be paid on this amount to maintain the real value of compensation

Interest should be paid on the compensation amount of \$4,198.17 at the rate of 1.75% per annum compounding annually from 7 May 2014 (the date of purchase of the property) to the date of payment, to maintain the real value of the compensation. This approximates the reserve bank cash rate for the relevant period.

3 Supporting information

3.1 The determination is made under FOS Terms of Reference

The Australian Financial Complaints Authority (AFCA) has commenced managing disputes previously lodged with Financial Ombudsman Service (FOS). This determination is made under FOS Terms of Reference but has adopted the following terminology for consistency with AFCA. In this determination the AFCA terms have the same meaning as the FOS terms defined in paragraph 20.1 and Schedule 1, 2 & 3 of the FOS Terms of Reference.

FOS definitions	AFCA term
applicant	Complainant
financial services provider	financial firm
dispute	Complaint
claim	Claim

3.2 Process

The panel has decided this complaint based on what it considers is fair in all the circumstances, having regard to:

- the relevant law
- good industry practice
- previous decisions of FOS and AFCA.

The panel has considered the entire file, including all material received before and after the recommendation. The panel is satisfied that the material it has relied on in making this decision has been exchanged with the parties.

3.3 The panel has not addressed all alleged breaches because they would not result in additional loss

The complainant also raised a number of other potential breaches. The panel is not required to make a finding on these matters because they would not result in additional loss.