

# Determination

**Case number:** 545958

9 August 2019

## 1 Determination overview

### 1.1 Complaint

This complaint concerns advice provided by an authorised representative of the financial firm (the adviser) to the complainant to invest in agribusiness and gear to invest in property. He also made insurance recommendations. The complainant says the advice was inappropriate for his circumstances and he has lost \$395,849.65 (\$199,763.62 outside super and \$196,086.03 within super). The advice was provided in two Statements of Advice (SOAs), the first dated 28 March 2013, and the second dated 28 November 2013.

### 1.2 Issues and key findings

#### Was the March 2013 advice appropriate?

No. The advice to borrow funds and invest in agribusiness and property was not appropriate for the complainant's circumstances. Not only did the complainant not have a secure income to meet loan repayments, it was unnecessary for him to take on the additional risk to paydown his home loan, which was his primary goal.

#### Was the November 2013 advice in the complainant's best interests?

The advice to set up the Self-Managed Superannuation Fund (SMSF) and invest in property was also not in the complainant's best interests. Further, the adviser did not have an adequate basis for the recommendation that the complainant obtain \$1,520,000 trauma cover.

#### How much is the complainant's loss?

The financial firm's breach caused the complainant's loss. "But for" the failure to provide appropriate advice, the complainant would not have entered into the recommended investments. He also would have taken out less insurance. His loss is \$169,763.72 in his own name and \$152,933.31 in his super fund, totalling \$322,697.03.

### 1.3 Determination

This determination is in favour of the complainant. The financial firm must pay:

- \$169,763.72 to the complainant
- \$152,933.31 to the complainant's SMSF or nominated superannuation fund

- interest on these amounts at the rate of 1.5 % per annum compounding annually from 30 June 2018 to the date of payment.

The amount paid to the SMSF is a settlement sum not a contribution, or benefit. The financial firm must also pay the complainant \$3,000 for the costs he has incurred in bringing this complaint.

## 2 Reasons for determination

### Was the March 2013 advice appropriate?

#### Financial firms needed to ensure advice was appropriate prior to 1 July 2013

Prior to 1 July 2013, pursuant to section 945A of the Corporations Act, financial firms needed to ensure that personal advice provided to retail clients was appropriate. Critically this required the adviser to understand the client's needs and recommend financial products that were suitable to meet those needs.

#### The complainant first contacted the adviser to complete his tax return

The complainant first saw the adviser in January 2013 after he was referred to him by a friend to complete his tax return. The adviser suggested they meet again to discuss ways to reduce the complainant's tax and they arranged a meeting on 12 March to do so.

#### The advice provided was not appropriate

The adviser completed a fact find at this meeting, and the scope of advice was extended beyond mere tax reduction strategies. The fact find records that in addition to seeking advice on tax minimisation, the complainant's broader goals included to pay down his home loan, "sort out" his super, and have his insurance reviewed. He also wanted to take an overseas trip in the short-term.

In the 28 March 2013 SOA, the adviser recommended the complainant:

- invest \$51,975 in an agribusiness investment to reduce tax;
- refinance his home loan to increase his borrowing capacity and take out a further loan to purchase an investment property;
- rollover his Fund C and Fund M superannuation into a fund recommended by the adviser;
- take out trauma, life and total and permanent disability ("TPD") cover.

The complainant agreed to proceed with all the advice, other than the rollover, at that stage.

#### The complainant was in a good position at the time of the advice

The complainant was 29 at the time of advice and in quite a good overall financial position. He had a net asset position outside of super of approximately \$125,000 (including his house) and a super balance of \$164,491.

While he was in a good financial position, and at the time on a salary of over \$200,000, he was a contract worker, who obtained work on oil rigs. While such work paid well, it was not secure employment.

The complainant was in fact made redundant in April 2015 and he was unable to obtain further employment in Queensland, where he resided. He ended up having to sell one investment property in March 2015 (the Chamonix apartment), and ultimately ran out of funds by early 2016. He then sold the property he was living in in early 2016 (the Avanti Property) and moved into rental accommodation in Victoria. He has had difficulties finding work since that time. The property purchased in his SMSF, which is discussed below was sold on 23 February 2017 (the Yarrabilba property).

### **Borrowing to invest is risky**

Borrowing to invest (known as gearing) is generally considered a high-risk approach to investing. Gearing increases an investor's capital base and while it magnifies gains in rising markets it also magnifies losses in falling markets. Gearing is generally considered appropriate only for investors with a high tolerance to risk and sufficient financial resources to be able to withstand losses.

### **It was unnecessary for the complainant to borrow to invest in property**

The advice to borrow to invest in property was not appropriate for the complainant's circumstances. While the complainant had an aggressive risk profile, this alone is not sufficient to justify a gearing strategy. If a person purchases an investment with borrowed funds they are obligated to make regular monthly interest payments. If the investor can't make the payments, they may be forced to sell the investment at a loss. In the complainant's circumstances, where his income was not secure, gearing was not appropriate.

In any event and further to this, it is difficult to see how the advice assisted him in achieving his primary goal of paying down his home loan. His home loan was only \$290,000 prior to the advice. He was better off using any surplus income to make extra payments to reduce his home loan.

The adviser was also aware that the complainant had a mental health condition at the time of the advice. Due to his condition, losing capital could have a devastating effect on him.

### **The agribusiness investment was also not appropriate**

The agribusiness investment was geared, which meant that it was subject to the risks described above. Also as discussed above, the complainant's income was not secure enough to meet ongoing interest payments and I do not accept that the complainant was in a position to withstand capital loss if the investment failed.

While the fact find states that the complainant was interested in considering ways to minimise his tax, it is clear that he was doing so at the adviser's suggestion. In any event, just because a person shows an interest in reducing tax, it does not follow that a tax-effective investment is appropriate.

Most importantly, the complainant could have achieved his goals without taking on any additional risk. In fact, he could have achieved his goals merely by diverting surplus income to debt reduction and savings.

### **Was the November 2013 advice in the complainant's best interests?**

#### **Advice from 1 July 2013 was required to be in the complainant's best interests**

After 1 July 2013, section 961B of the Corporations Act introduced a "best interests" duty to the provision of personal advice. In addition to ensuring advice was appropriate and knowing the client and product, this required advisers to ensure that any advice provided was in the best interests of the investor.

#### **The adviser recommended the SMSF invest in property**

In November 2013 the adviser recommended:

- the complainant roll-over his two super funds into his SMSF, and use these funds to invest in an investment property
- the complainant take out \$1,520,000 trauma cover to replace the cover held in his previous funds.

The complainant purchased a property via the SMSF on 6 November 2013 (the Yarrabilba property).

#### **The adviser recommended the complainant establish an SMSF**

While the November SOA refers to recommendations for the SMSF, and does not actually recommend establishment of the SMSF, it is clear that the adviser did, in fact, recommend its establishment. In an email from the adviser to the complainant on 2 August 2013 the adviser says *'Hey mate we can do a SMSF and build yarrabilba home inside it'*.

The Corporations Act prescribes that any recommendation made to a person, which takes into account a person's circumstances is "personal advice" and consequently triggers the requirement to satisfy the best interests duty. Any personal advice should also be documented in an SOA.

The reference to *"doing an SMSF and build yarrabilba inside it"* amounted to a recommendation to invest in a financial product. As the recommendation was made by the adviser in consideration of the complainant's circumstances at the time, it constituted personal advice.

#### **The advice to invest in an SMSF was not in the complainant's best interests**

The responsibilities and obligations placed on trustees of an SMSF are significant. ASIC has emphasised that SMSFs are not an appropriate vehicle for every investor.

A trustee's responsibilities include a duty to ensure that investments are made in accordance with the fund's investment strategy. They also are required to ensure the fund complies with all applicable laws and regulations, and to sign off on accounts annually. If a person uses an SMSF for their super, their responsibilities are much more onerous than if they invest in a retail or industry fund.

The complainant was 29 years of old at the time of the advice and there is nothing to suggest that he had any interest in taking on these responsibilities. In any event, the complainant's balance of \$120,796 was much less than the \$250,000 minimum ASIC prescribes for a viable SMSF.

The advice to commence an SMSF was not in the complainant's best interests.

### **The property advice was also not appropriate**

The advice to purchase a property in the SMSF also was not in the complainant's best interests. As discussed above, gearing was not appropriate in the complainant's circumstances. Further the concentration of all his super into property meant that he was not adequately diversified across asset classes and exposed him to significant and unnecessary asset sector risk.

### **The adviser recommended \$1,520,000 trauma insurance**

The adviser also recommended the complainant obtain \$1,520,000 trauma insurance to replace his previous cover. The complainant only partially followed the advice, taking out \$945,000 trauma cover.

### **The insurance advice was not in the complainant's best interests**

The adviser justified the high level of trauma cover on the basis that the complainant had previously had insurance applications rejected due to his mental health condition

I do not accept that such a high amount of coverage was justified on this or any other basis. At the time of the advice the complainant had a debt of \$290,000 and no dependents. As submitted by the complainant, this amount of coverage should have been adequate. Further insurance recommended was not appropriate particularly as much of it was recommended to pay off investment debt, and the extra premiums for this coverage should be reimbursed by the financial firm.

### **How much is the complainant's loss?**

### **Compensation for loss does not automatically follow a breach**

The onus is on the complainant to establish, on the balance of probabilities that:

- the financial firm breached its duty
- the complainant suffered a loss, and
- the breach caused the loss (causation).

A complainant does not need to show that the breach was the only, or even most significant, cause of the loss. It must, however, be a decisive consideration. Generally, the application of the “but for” test will be sufficient to prove the necessary causal connection. I am satisfied that “but for” the breaches the complainant would not have entered any of the recommended investments.

**The complainant’s loss is \$322,697.03**

The complainant’s loss is as follows:

Individual	
Description	Amount
Agribusiness investment	\$40,386.28
SMSF Establishment Fee	\$2,710
Trauma Over Insurance Costs	\$2,817.44
Fee for Financial Advice	\$3,850
Loss on Chamonix Property	\$120,000
<b><u>Sub-Total</u></b>	<b><u>\$169,763.72</u></b>
SMSF	
Description	Amount
Relative Loss SMSF v Fund M/Fund C	\$146,773.31
Accounting costs 17/18	\$3,080
Accounting and wind-up costs 18/19	\$3,080
<b><u>Sub-Total</u></b>	<b><u>\$152,933.31</u></b>
<b><u>TOTAL</u></b>	<b><u>\$322,697.03</u></b>

All these amounts and how they have been determined have been exchanged with the parties prior to the determination, other than the involuntary employment cover award which is discussed below. The “relative loss SMSF v Fund M/ Fund C” item includes actual losses on the Yarrabilba property purchased in the SMSF and considers the complainant’s position had he invested those funds in super. No losses were claimed in relation to the Avanti property because the complainant accepts that he, ultimately, chose that property.

I am satisfied however that losses arising from the sale of the Chamonix property are compensable. Had he not received the inappropriate advice, he would not have needed to sell it.

### **The tax penalties incurred by the complainant should not be reimbursed**

The complainant also accessed his superannuation to pay down the loan taken out to fund the agribusiness investment. He says that he may incur penalties due to this, although at this stage he is not sure if this will be the case. He has claimed \$70,294.96 in relation to this aspect of the claim.

I am only able to award the complainant direct loss arising from the breach. The test for determining whether any claimed amount is direct loss is ultimately determined by whether the loss was reasonably foreseeable at the time of the breach.

While setting up an SMSF did make it possible for the complainant to unauthorisedly access his super, it was not reasonably foreseeable that he would breach the superannuation preservation rules to do so.

In any event, there are financial hardship rules in place which allow early release of super in certain circumstances. If his financial position was so untenable such that he was required to access his super, this was the appropriate course of action for him. For the same reason, the accounting and legal costs he has claimed of \$5,500 to rectify the non-compliant withdrawal are not compensable.

### **The complainant's costs to bring this complaint should also be reimbursed**

The complainant was represented in this complaint and he has claimed \$3,000 costs. I am permitted under the Terms of Reference to award such costs. While AFCA does not require parties to be represented, I accept this complaint was sufficiently complex to justify such an award, particularly in light of the complainant's mental health condition.

### **Interest should be paid on all compensation from 30 June 2018 to the present**

While the purpose of interest is to maintain the real value of compensation and costs were incurred at different times, it is fair in all the circumstances that interest be paid at the rate of 1.5% per annum compounding annually from the 30 June 2018 to the date of payment on all amounts awarded, other than the \$3,000 professional costs. No interests is payable on this amount.



### 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