

The FOS Approach to Adequacy of Statements of Advice

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We have created a series of FOS Approach documents, such as this one, to help consumers and financial services providers better understand how we reach decisions about key issues.

These documents explain the way we approach some common issues and dispute types that we see at FOS. However, it is important to understand that each dispute that comes to us is unique, so this information is a guide only. No determination (decision) can be seen as a precedent for future cases, and no FOS Approach document can cover everything you might want to know about key issues.

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1 At a glance

1.1 Scope

The *Corporations Act 2001* (*Corporations Act*) generally requires financial services providers (FSPs) to give a Statement of Advice¹ (SOA) to retail clients who receive personal financial advice. This is to ensure that retail clients are given enough information for them to understand the personal advice given to them and decide whether or not to rely on it.² The statements and information in an SOA must be worded and presented in a 'clear, concise and effective' manner.³

We handle many financial advice disputes in which a retail client says they did not understand the advice they received from the FSP. In these disputes, the quality and clarity of the information in the SOA is a critical issue.

1.2 Summary

FSPs are required to provide an SOA to retail clients who receive personal financial advice. The SOA is a key document in assessing whether adequate disclosure has been provided to retail clients, to enable them to understand the advice provided to them and rely upon it.

FOS will analyse the SOA in all cases where this document has been provided to a retail client of an FSP with a view to determining if the FSP has complied with its obligations to the client under the *Corporations Act*.

¹ Section 946A of the *Corporations Act*. From 1 July 2013 FSPs must also comply with Section 961G of the *Corporations Act*

² ASIC *Regulatory Guide 175* at RG 175.151

³ Subsections 947B(6) and 947C(6) of the *Corporations Act*

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2 In detail

2.1 How FOS assesses the adequacy of SOAs in financial planning

The issue of informed consent

The question of whether a retail client has given their informed consent to take up the FSPs advice is a critical issue in the majority of financial advice disputes handled by FOS.

Where this issue is raised, we will look at all of the disclosures made by the FSP to the client. A key document is the SOA.

If the information in the SOA is not 'clear, concise and effective', then FOS might find that the client did not understand the advice and the FSP had failed to secure the client's informed consent to take up the advice.

What does 'clear, concise and effective' mean?

The phrase 'clear, concise and effective' is not defined in the *Corporations Act*. This means the words must be given their natural meaning.

According to the *Macquarie Concise Dictionary*:⁴

- 'clear' means 'free from obscurity ... confusion, uncertainty or doubt' and 'in plain language'
- 'concise' means 'brief and comprehensive; succinct; terse'
- 'effective' means 'producing the intended or expected result'.

When looking at whether information in an SOA is clear, concise and effective, we will consider whether the information:

- is expressed in plain language
- is brief yet comprehensive
- promotes understanding of the adviser's recommendations.

⁴ 3rd edition (2004), Macquarie Press

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This approach is consistent with:

- ASIC's guidance in Regulatory Guide 175: Financial Product Advisers – Conduct and Disclosure⁵
- the Financial Planning Association's Code of Professional Practice.⁶

2.2 What factors does FOS consider?

When we consider whether or not an FSP secured a client's informed consent to take up advice, we will examine the SOA provided to the client and consider the following questions:

1. Did the FSP consider the client's experience, language skills, literacy and numeracy?

FSPs that make a reasonable assessment of a client's experience, language skills, literacy and numeracy are much more likely to prepare an SOA that the client will understand and less likely to be found to have breached their duty to secure the client's informed consent to take up the advice.

Remember, each client is unique.

2. Did the SOA use language the client was likely to understand?

An SOA which does not use language the client is likely to understand cannot be effective.

It is important to note that the question is an objective one. In other words, we do not consider whether the client subjectively understood the information in the SOA. We only need to be satisfied that the client was likely to understand the language used in the SOA, assessed objectively, having regard to their experience, language skills, literacy and numeracy.

See the case study below for an example of how FOS objectively assesses a client's understanding of an SOA.

3. Did the SOA use legal, industry or technical language?

⁵ Published April 2011. See paragraphs RG175.188 to RG175.192 (inclusive)

⁶ See Rules 4.11 and 4.12

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This question is closely related to question 2.

SOAs that use legal, industry or technical language are less likely to be 'clear, concise and effective' if the client is unfamiliar with this language. If the use of legal, industry or technical language in an SOA is unavoidable, the concepts must also be accurately explained in plain English.

4. Was the information in the SOA in a logical sequence?

SOAs which are not logically set out are not clear or effective as they tend to confuse clients.

In broad terms, SOAs must have:

- a beginning – the client's objectives, available assets, timeframe and risk tolerance
- a middle – an analysis of strategies and/or products that are likely to meet the client's objectives given their available assets, timeframe and risk tolerance
- an end – an explanation of a recommended strategy and/or products that are likely to achieve the client's objectives given their available assets, timeframe and risk tolerance.

5. Did the SOA identify the client's objectives in quantitative terms and explain how the advice would achieve those objectives?

An SOA that identifies the client's objectives in quantitative terms (e.g. 'to retire at age 60 with sufficient savings to generate a retirement income of \$40,000 a year') is much more likely to be effective than an SOA that does not identify the client's objectives with such attention to detail (e.g. 'to retire at age 60').

The latter type of SOA is very unlikely to contain any meaningful analysis of, or conclusions about, the strategies and/or products that will achieve the client's objectives.

6. Does the SOA resolve any internal conflicts?

An SOA which is internally inconsistent is unlikely to be clear. If, for example, the client wants only a low level of risk but wants to retire with an income that may only be achieved by taking a greater risk the resolution of this conflict must be explained

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in the SOA. For example, the client may agree to take more risk, put more of their current income towards retirement or agree to the objective of retiring on a lesser income.

7. Did the SOA contain irrelevant information?

Clients are likely to be confused by SOAs that contain irrelevant information.

For example, if a client has only sought advice about investment products, and does not wish to borrow to fund the proposed investment, the SOA need not include information about margin loans and insurance products. If the SOA includes this information, it is less likely to be clear, concise and effective.

8. Is the SOA a template document?

In our experience, a template SOA is more likely to include:

- language the client will not understand (see question 2)
- legal, industry or technical language (see question 3)
- irrelevant information (see question 7).

Template documents can be helpful, but the FSP must take care to tailor the language used in the template to the client and delete irrelevant information.

3 Context

3.1 Case study

Unclear and inappropriate financial advice

The Applicant was a very elderly war widow and had exceeded the life expectancy of an Australian female. Her financial situation was uncomplicated. She received more than enough income from her pension and from a small annuity to meet her needs.

The Applicant received a significant legacy from her sister's estate. This was the first time she had received a large sum of money. She had previously obtained financial advice about her annuity from a financial adviser, but she was otherwise inexperienced in financial matters.

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The Applicant sought financial advice from her regular adviser. She told the adviser that she wanted to top up her annuity with \$100,000 and sought her advice about how to invest the balance of the inheritance.

During her discussions with her adviser, the Applicant said she wanted to invest a small amount in her granddaughter's name, but later she changed her mind because she was concerned about how other family members would view the investment when she passed away and they were dealing with her estate.

The adviser recommended that the Applicant invest the balance of the inheritance in a managed growth fund. The SOA prepared by the adviser stated the investment in the managed growth fund was "not capital guaranteed", "the balance may fluctuate daily due to changes in unit prices" and there was a risk of capital loss if the Applicant withdrew from the investment early.

The Applicant accepted the advice and made the recommended investment. The investment performed badly and suffered significant losses. The Applicant lodged a dispute with FOS, claiming she did not understand the advice provided to her and the managed growth fund was not an appropriate investment in her circumstances.

We noted that an SOA is a disclosure document that is intended to help a retail client understand advice and decide whether to rely on it. Client understanding of the advice is a critical part of the advice process.

After investigating the case, we drew the following conclusions:

- The Applicant was inexperienced in financial matters and had very limited knowledge of financial markets and products (as shown by her uncomplicated financial arrangements prior to receiving the inheritance).
- The Applicant's primary objective was to leave a legacy for her sons and grandchildren and therefore she wanted to place the money into a secure, capital-protected investment (as shown by her concern about how a proposed investment in a granddaughter's name would be perceived).
- The information in the SOA about capital volatility associated with the managed growth fund was generic in nature and was not likely to alert the Applicant to the potential for capital loss. It would have been prudent to put these warnings in language the Applicant was likely to understand.

We found that if the SOA had been expressed in language the Applicant was likely to understand, she would not have made the investment. We ordered the adviser to pay compensation to her.

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3.2 References

Definitions

Term	Definition
applicant	individual or small business that has lodged a dispute with FOS
FSP	financial services provider, a business that has chosen FOS as its external dispute resolution scheme and provides a financial service
SOA	Statement of Advice

Useful links

Document	Title / Link
Terms of Reference	Financial Ombudsman Terms of Reference www.fos.org.au/tor
Corporations Act	Corporations Act 2001 https://www.legislation.gov.au/Series/C2004A00818