

**ABSA PRIVATE BANK : WEALTH
MANAGEMENT CONVENTION
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THE "VICE" IN ADVICE

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OMBUDSMAN FOR

LONG-TERM INSURANCE

THE OFFICE OF THE OMBUDSMAN

- Functioning since 1985.
- Established by Long-term Insurance Industry.
- A voluntary scheme.
- Every ombudsman yet: A retired judge.
- A service to both consumers and insurers.
- To investigate and resolve enquiries, complaints, disputes.
- Free of charge to consumers.
- Funded by a fixed levy and a variable charge per complaint payable by insurers.
- Consumers not bound by rulings, insurers are.



A NOT UNFAMILIAR MISSELLING COMPLAINT

- Time frame: 2000.
- Mr A is a 70 year old retired farmer.
- He has R400 000 from a maturing non-guaranteed local investment in company X.
- This amount is available for further investment.
- Mr B (a broker in the employ of company X) approaches Mr A.
- Mr B recommends: that the R400 000 be invested for five years in company X's overseas Equity Fund.
- At first the investment does well.
- As a result of 9/11 in 2001 and the strengthening of the Rand it deteriorates rapidly.

MR A's STATED COMPLAINT

- He signed the application form in blank; it was completed by Mr B.
- He never instructed or intended an overseas investment.
- His distinct instructions were: no risk; capital to be preserved and guaranteed.
- When, in March 2002, he discovered the reduced value of his investment, he complained to Mr B.
- Mr B advised him not to withdraw the investment.
- The investment continued to deteriorate.
- Mr A lodges a complaint with the Ombudsman.

MR B's RESPONSE

- Mr B denies Mr A's version.
- Mr B states that, on the information then commonplace in the industry, he recommended an investment overseas.
- They discussed the prospects and Mr A accepted his advice.
- He agrees that (when Mr A complained to him in March 2002) he recommended that Mr A should not withdraw the investment, in the hope that it would recover and improve.
- How do we resolve this conflict?

A HEARING

Rule 5.1

"The Ombudsman shall resolve material disputes of fact on a balance of probabilities and with due regard to the incidence of the onus."

Rule 5.2

"If the Ombudsman is of the opinion that a material and conclusive dispute of fact cannot be resolved on a balance of probabilities and with due regard to the incidence of the onus, the parties concerned shall be advised that a determination in favour of the one or the other party cannot be made."

Rule 5.3

"Notwithstanding Rule 5.2, if the Ombudsman and all the parties concerned are in agreement that a complaint or a material and conclusive dispute of fact can best be determined by the hearing of evidence, it may be so determined."

- Hearing held.
- Mr A disbelieved.
- What now?

THE MANDATE

- Two agreements between Mr A and company X:
 - (i) Mr A's mandate to Mr B;
 - (ii) the actual investment.

- The mandate:
 - express/implied/tacit terms;
 - to duly inform Mr B of all the available products and options, to give him guidance and to make recommendations.

- Advice furnished at different levels:
 - a fee for introducing the customer to the product;
 - a monitoring or reviewing fee;
 - a fee for on-going advice on whether to move the investment:
 - issue: who is to take the initiative to furnish such advice e.g. in the case of a living annuity?
 - e.g. in the case of a living annuity when making the annual election as to income % and portfolio choice;
 - The answer is to be found in the tacit terms of the contract
- At every level: an implied or tacit term of mandate: advice must be honest and appropriate.
- If neither, it amounts to a breach of mandate giving rise to consequential relief

HONEST AND APPROPRIATE ADVICE.

Not honest: if the advice is commission-driven.

- Not appropriate:

- if not properly researched (e.g. no risk profile or needs analysis done).
- if not properly conceived:
 - if the advisor is ignorant of current market trends;
 - if wrong factors are taken into account;
 - if correct factors are ignored.
- If advice is not properly explained to the customer.

THE CRITERIA FOR APPROPRIATE ADVICE

- The appropriateness of advice is determined ex post facto but with reference to the circumstances existing at the time the advice was given
- Not: the “very best” advice imaginable.
- Not inappropriate simply because it can be shown that there could have been a better product or combination of products or better terms or prospects.
- Not necessarily “successful” advice:
 - the advice is not inappropriate because the recommended investment performed poorly thereafter ;
 - hence: the advice need not imply a guarantee that the investor would *not* lose in the long run.

THE NORM

- Advice that, in retrospect, would generally be recognised to have been balanced and appropriate for an adviser in the position of the adviser in question.
- Good advice at the time that turns out poorly is still good advice; conversely, bad advice at the time that turns out well in the end is brilliant advice.
- If the above norm is consistently applied it would mean that every adviser would give more or less the same advice in the same circumstances.
- "Text book advice" must be regarded as the lowest common denominator or the threshold requirement.
- That does not restrict the "super adviser" with above average research, experience and insight from striking out in a different direction from all the others, even if, in the result, the investment proved to be less than successful.

- To protect himself, the adviser must ensure that the customer:
 - is fully informed;
 - is properly primed about all the odds and all the options;
 - fully understands the thinking and the risks.

- If he is fully informed the decision to invest is his decision and not that of the adviser.

- The adviser must not impose his recommendation on the customer.

- The adviser is not liable if the customer, duly informed, chooses the adviser's least favoured option or insists on following his own hunch.

APPLYING THE TEST TO THE HYPOTHETICAL FACTS

- Mr A, elderly and retired, was in a safe investment that could have been prolonged for another five years.
- No needs analysis was done.
- He was not told that he could continue with his current investment.
- He was not warned of the risks of an overseas investment.
- Mr B, in effect made up Mr A's mind for him.
- That was because Mr B, based on statistics and analyses at the time, genuinely believed that there were no risks.

Conclusion:

- Because the advice was not appropriate, Mr B, and through Mr B, company X, committed a breach of mandate.

THE RELIEF

- In principle: The customer is to be placed in the position he would have been in had the advice not been inappropriate.
- Causation: no relief will be granted if the customer was determined and insisted on a particular investment. In such circumstances it was not poor advice but the customer's own obstinacy that caused the loss.
- Loss: if the investment, notwithstanding the bad advice, prospers, the loss would be erased or reduced accordingly.
- In our case: the loss increased.

MITIGATION OF DAMAGES

“In mitigating his loss a contractant is expected to take the steps that a reasonable person in his position would have taken. The doctrine of mitigation therefore relates to conduct of the plaintiff after breach of contract has been committed, namely his failure to act. The reasonableness of conduct in mitigation will be considered with reference to all the circumstances of a case. (Van der Merwe et al: Contract: General Principles: (2nd ed p 397).

WHAT WAS REASONABLE?

- What should Mr A have done when he realised he was in the wrong product?
- Mr B advised Mr A to stay in the investment in the hope that it would eventually improve.
- Such advice cannot per se be said to be wrong.
- Mr A accepts the advice.
- If the investment improves it would wipe out or reduce the loss and thus Mr B's liability.
- To that extent Mr B's advice is really in his own interests.
- But what if the investment continues to deteriorate?
- Who must assume the responsibility for the further loss: Mr A or Mr B?

TWO POSSIBLE APPROACHES

One view:

The further loss was a direct and foreseeable consequence of the initial inappropriate advice given to Mr A; hence the additional loss is for the account of company X.

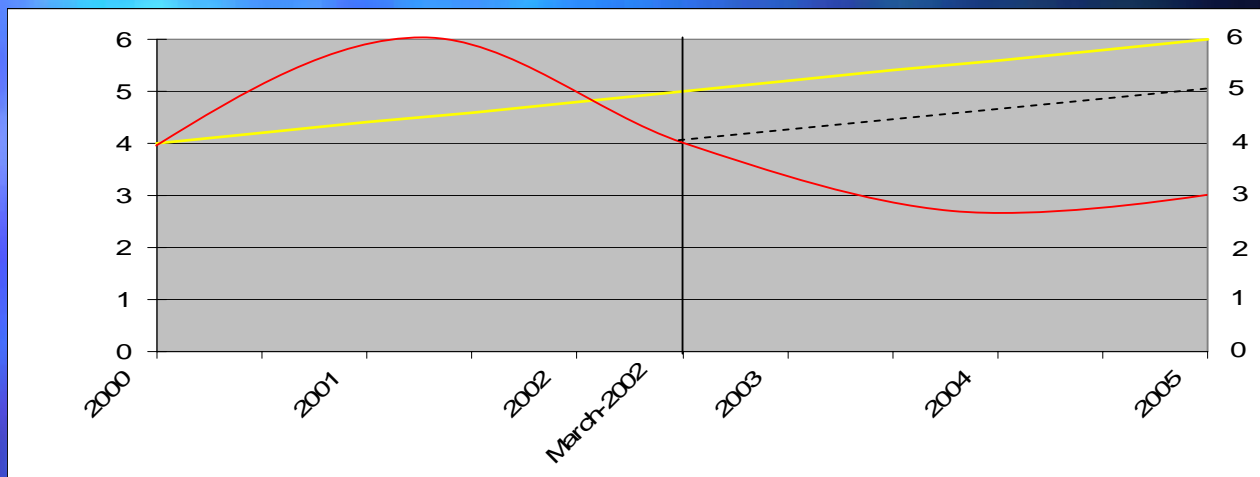
or

Second view:

Mr A, in March 2002, made an informed decision to stay in the "wrong" investment.

- he was no longer ignorant of the risks and the options;
- he should have switched to the investment in which, if properly advised, he would have been in from the outset;
- it is not reasonable, on that view, to hold Mr B and company X liable for the consequence of Mr A's own informed decision;
- hence Mr A's loss is to be predicated on the hypothesis that he should have shifted at that point to the investment in which he initially was.

THE REGRESSION OF THE INVESTMENT



Legend :



The actual investment



The notional continuation of the matured investment



Notional switch in March 2002.

- **What is the answer as to what is reasonable?**

THE ANSWER:

- Don't ask me:

The Ombudsman's office never volunteers free advice.

- Alternatively (the answer all lawyers give when they don't know the answer):

it all depends on the circumstances and on what was reasonable at the time.

- e.g. no switch was factually or legally possible; or the original "right" investment is doing even worse than the "wrong" one; or the prospects for an improvement in the "wrong" investment was generally accepted to be exceedingly good, etc.

A GENERAL REMARK

- Professional financial advisers practise a profession that is hugely responsible and fraught with pitfalls.
- If you are in a challenging profession: expect to be challenged.
- The consequences of poor advice can be calamitous.
- The adviser needs to have the qualifications, skills and experience to be a true master of his craft.
- Ironically: he has to advise on yesterday's and today's data but is often judged on tomorrow's results which he could not foresee and over which he has no control.

- He is constantly under scrutiny – from his clients, his employer, his peers and, finally, the Ombudsman.
- The Ombudsman, at least, understands that the adviser is only to be held liable if he is truly to be blamed.
- But there are rewards:
 - a nice fat juicy commission or, maybe, fee;
 - the satisfaction of providing guidance for the uninitiated and, if all goes according to plan, of enhancing the peace of mind and the standard of living of someone who reposed trust in him.

END - NOTE

To return to the title of my talk:

The Poet:

“Vice is nice
but a little virtue
won’t hurt you.”

The Ombudsman’s office:

“Advice is nice
but a bit of misselling
makes us the hell-in.”