CPA Australia Ltd
ABN 64 008 392 452

CPA Centre
Level 28, 385 Bourke Street
Melbourne VIC 3000 Australia
GPO Box 2820AA
Melbourne VIC 3001 Australia

T +61 3 9606 9606
F +61 3 9670 8901
E vic@cpaaustralia.com.au
W www.cpaaustralia.com.au

31 July 2009

Parliamentary Joint Committee on Corporations and Financial Services
PO Box 6100
Parliament House
Canberra ACT 2600
Australia

By email: corporations.joint@aph.gov.au

Dear Sir

INQUIRY INTO FINANCIAL PRODUCTS AND SERVICES IN AUSTRAIA

CPA Australia represents the diverse interests of more than 122,000 members in finance, accounting and business in 100 countries throughout the world. Our mission is to make CPA Australia the global professional accountancy designation for strategic business leaders. We make this submission not only on behalf of our members, but also the accounting profession generally, taking into account the broader public interest.

The key recommendations raised in our submission are as follows:

1. ASIC utilise the 'Business Description core proof' provided when applying for, or varying, an AFS licence to evaluate the risk that an applicant may breach their obligations once granted an AFS licence

2. Focus must now be turned to ASIC implementing new measures to increase the effectiveness of the existing regulation, rather than increasing the regulation of financial services.

3. All AFS licensees complete an AFSL annual return as part of maintaining their compliance requirements to hold their licence

4. ASIC consult industry to develop the annual return to ensure that it adequately and comprehensively covers key information and statistics required, to ensure ASIC can make an informed judgment of whether further action is required to ensure compliance is maintained

5. Generally it is not the role of government to set markets, therefore the level of financial adviser remuneration should be left as a matter for industry to determine within the current legislative and regulatory parameters

6. Remuneration should be calculated on a fee for service basis. However, the client should be the one empowered to choose the method of payment to pay for the agreed fee for service

7. Specific soft dollar benefits from third parties that place the interests of the financial adviser in significant conflict with those of the client, such as volume based bonuses, should be banned

8. Existing regulation and guidance for the production of marketing and advertising material is effective, provided it continues to be supported by the monitoring surveillance of ASIC

9. ASIC provides specific guidance on what level of client inquiries are expected to be conducted by a providing entity and to what extent the providing entity must consider and investigate the subject matter of the advice, where the providing entity's licence authorisation conditions are limited to one or a few financial products

10. Industry and regulators continue their efforts to produce simple and effective disclosure documents

11. Independent legal advice is sought by the Financial Services Working Group to ensure any short form PDS produced complies with the relevant regulation, to ensure that it will be readily adopted by industry

12. ASIC undertake a marketing campaign promoting FIDO as the first stop for investors and potential investors for information and resources to ensure they are informed, educated and active, in accordance with ASIC's approach to consumer education

13. An annual benchmarking process be implemented to track the success of raising the awareness of FIDO

14. The current requirements regulating the level of professional indemnity insurance required to be held by an AFSL are adequate and do not require review at this time

15. ASIC reactivate the Financial Services Consultative Committee with meetings on a bi-annual basis

16. ASIC must again establish an open dialogue with industry associations and also a panel of AFSL holders who collectively represent the industry, and

17. ASIC adopt a proactive and positive approach to compliance, working with both industry and industry associations to in turn promote the confident and informed participation of investors and consumers in the financial system.

Should you have any questions regarding this submission, please do not hesitate to contact Paul Drum, General Manager – Policy and Research, on 03 9606 9701 or paul.drum@cpaaustralia.com.au.

Yours sincerely

Geoff Rankin FCPA
Chief Executive Officer

INQUIRY INTO FINANCIAL PRODUCTS AND SERVICES IN AUSTRALIA

TERMS OF REFERENCE

1. The role of financial advisers

Financial planning is a holistic approach to planning for an individual's financial future.

The role of the financial adviser is to explore the individual's current financial position, their future financial goals and their options to achieve them. This requires developing a tailored financial plan which will enable management of future events, both positive and negative, pay debts, grow wealth and protect wealth with the intention to provide the best opportunity for the client to achieve their goals.

The client is at the centre of this process and their tailored financial plan will include independent advice which covers budgeting/cash flow planning, wealth protection, retirement planning, investment planning and estate planning.

It requires the financial adviser to ensure that they have considered not only the client's objectives, but taken into account their client's specific circumstances in order to be confident that any advice provided is in the best interest of the client, and will effectively aid the client in achieving their goals.

Investment advice will form part of a complete plan, but only after suitable investment vehicles and asset mixes have been identified and discussed.

Elements of the financial planning process are enforced by both the *Corporations Act 2001* and policy documents issued by the Australian Securities and Investments Commission (ASIC). For example, *Regulatory Guide 175 Licensing: Financial product advisers – conduct and disclosure* (RG 175) details ASIC's policy for administering the law on:

- Providing financial product advice; and
- Preparing and providing suitable personal advice.

Table 1 in RG 175.6 defines what is considered to be personal advice:

> *Financial product advice given or directed to a person (including by electronic means) in circumstances where:*
>
> > *(a) the provider of the advice has considered one or more of the client's objectives, financial situation and needs; or*
> >
> > *(b) a reasonable person might expect the provider of the advice to have considered one or more of those matters (s766B(3)).*

The *Corporations Act 2001* (*the Act*) states in section 945A that there must be a reasonable basis for this advice ('reasonable basis for advice rule' or the 'suitability rule'):

> *(1) The providing entity must only provide the advice to the client if:*
>
> *(a) the providing entity:*
>
> > *(i) determines the relevant personal circumstances in relation to giving the advice; and*
> >
> > *(ii) makes reasonable inquiries in relation to those personal circumstances; and*
>
> *(b) having regard to information obtained from the client in relation to those personal circumstances, the providing entity has given such consideration to, and conducted such investigation of, the subject matter of the advice as is reasonable in all of the circumstances; and*
>
> *(c) the advice is appropriate to the client, having regard to that consideration and investigation.*

A providing entity as defined in RG 175.26 may be a holder of an Australian Financial Services Licence (AFSL) or authorised representative. Representatives that are not authorised representatives are not providing entities. Where a licensee provides financial product advice (e.g. through one of its employees), the licensee is the providing entity.

This is then supported by RG 175, section 106 which states:

> *All personal advice must comply with the 'suitability rule' (or 'reasonable basis for advice rule'): s945A. Under this rule, where a providing entity provides personal advice to a retail client, each of the following three elements must be satisfied:*
>
> > *(a) the providing entity must make reasonable inquiries about the client's relevant personal circumstances;*
> >
> > *(b) the providing entity must consider and investigate the subject matter of the advice as is reasonable in all the circumstances; and*
> >
> > *(c) the advice must be 'appropriate' for the client.*

Through RG 175, ASIC provide also guidance on what is 'appropriate advice' (RG 175.132):

> > *Personal advice must be 'appropriate' for the client: s945A(1)(c). Advice is appropriate if it is fit for its purpose—i.e. if it satisfies the client's relevant personal circumstances. Personal advice does not need to be ideal, perfect, or the best to comply with the Corporations Act.*

There are also specific obligations applying to the provision of advice including the obligations imposed by the *Australian Securities and Investments Commission Act 2001* (the ASIC Act), which are explained in RG 175.47:

> *Where financial services (including financial product advice) are provided to retail clients, there is an implied warranty under the ASIC Act that:*
>
> *(a) the financial services will be rendered with due care and skill; and*
>
> *(b) where the purpose for which the financial services are being obtained is made known, the financial services will be reasonably fit for that purpose (s12ED, ASIC Act).*

The financial adviser therefore has a responsibility to ensure that the financial services they provide are provided with due care and skill, that reasonable inquiries about the client's relevant personal circumstances are made, and that any advice or recommendations provided are appropriate or fit for that purpose.

Considering the role of a financial adviser, the regulatory obligations that they must comply with and the ethical responsibility to always act in the best interests of the client, it is evident that a 'one size fits all' approach cannot be adopted when providing financial planning advice. It could be strongly argued that any business model that perpetuated this approach would in fact fail to adhere to both legislative and common law obligations.

In this regard however, it appears that Storm Financial Limited (Storm) may have taken this approach, through regularly recommending high levels of gearing with the client borrowing against their family home to invest in shares and then borrowing against the shares to invest in Storm badged products.

We understand Storm had complied with their disclosure obligations and ensuring all relevant systems, procedures were documented and in place, evidenced by the fact that they passed an ASIC audit shortly before their collapse. The issues that appear not to have been addressed however are:

- whether Storm as the providing entity made reasonable inquiries about each of the client's relevant personal circumstances
- whether they considered and investigated the subject matter of the advice 'as is reasonable' in all the circumstances, and
- whether the advice 'appropriate' for each client.

Without having specific knowledge of each of the client circumstances we are not in a position to make this judgment. However ASIC as the sole regulator for the industry should consider these questions[1]. It is also clear that ASIC has the power to investigate and enforce these obligations, as through previous investigations ASIC has banned a number of individuals for failure to comply with s945A of *the Act*. Examples include:

- November 2008, an individual was banned from providing financial services for six years after an ASIC investigation found between 2003 and 2007 the individual failed to conduct adequate due diligence investigations into the products recommended to clients. It was also found the individual provided inappropriate advice to clients on products, thereby breaching his duty to ensure that the investment recommendations were appropriate for his clients[2]

- July 2008, an individual was banned from providing financial services after an ASIC investigation found between 2003 and 2005 the individual failed to provide appropriate advice in relation to the products, thereby breaching his duty to ensure that investments were appropriate for his clients[3].

- February 2009, Father and son advisers were banned after an investigation found that between October 2003 and November 2005 they did not undertake sufficient investigations, including failing to perform a full analysis of the client's financial circumstances, nor consider the risks associated with the products, prior to making recommendations to their clients[4], and

Interestingly all of the above investigations related to Westpoint investments and were conducted after Westpoint's collapse. This perhaps indicates that ASIC currently appears to employ a reactive rather than a proactive approach to enforcing the regulation. It is possible however, that ASIC could use information that they receive as part of an application for an AFSL to take a more proactive approach to their surveillance.

ASIC provided evidence in their public hearing with the Joint Committee on Corporations and Financial Services on the 24 June that they request a statement of what the applicant is going to do, in order to know exactly what their business is[5]. This statement is known as the 'Business Description core proof' and must

[1] This is supported by the then Government's Statement of Expectations, provided to ASIC in 2007. It states that through ASIC performing its functions and exercising its powers as set out in the *ASIC Act*, ASIC must strive to 'take whatever action it can take, and is necessary, in order to enforce and give effect to the laws of the of the Commonwealth that confer functions and powers on it', and, 'a key role for ASIC is to ensure the integrity of the market'. Given the statement of expectations has not been revoked, we assume it is still current.
[2] AD08-61 ASIC bans Perth financial adviser
[3] 08-155 ASIC bans former Victorian financial adviser
[4] AD09-17 ASIC bans Brisbane father and son advisers
[5] Hansard, Reference: Financial, Financial products and services in Australia. Wednesday 24 June 2009. Joint Committee on Corporations and Financial Services. CFS15.

be supplied when applying for or varying an AFSL. *Regulatory Guide 2 AFS Licensing Kit: Part 2 – Preparing your AFS licence or variation application* states why ASIC requires this information:

> *RG 2.244 We need this information so that we can understand how your business will work and the relevance of the licence authorisations you have selected (including any new ones).*
>
> *RG 2.245 This core proof includes an overview of your business and an organisational chart.*

Whilst it is not ASIC's role or responsibility to approve a business model in order to approve an application for an AFSL, ASIC could use the Business Description core proof to evaluate the risk that an applicant may breach their obligations once licensed. Any applicant who was deemed to be at risk could be reviewed by ASIC within a 12 month period of being granted an AFSL. The review should include ensuring all relevant processes and licence requirements are still in place and a review of random selection of Statements of Advice (SOA). This will aid in identifying if the providing entity is making reasonable client inquires, if they are considering and investigating the subject matter of the advice as is reasonable in all the circumstances and if the advice is 'appropriate' for the client.

If the review revealed that the majority of clients were being recommended the same investment strategy and financial products, this would be cause for further investigation.

Recommendation:

1. **ASIC utilise the 'Business Description core proof' provided when applying for, or varying, an AFS licence, to evaluate the risk that an applicant may breach their obligations once granted an AFS licence.**

2. The general regulatory environment for these products and services

Australia's financial planning industry is currently one of the most highly regulated in the world. The *Corporations Act 2001* as amended by the *Financial Services Reform Act 2001* (FSR Act) significantly changed the way in which the public interacts with providers of financial services and products. Essentially, the *FSR Act*:

- bought various financial services and products under one licensing regime;
- introduced a new disclosure regime for most financial products; and
- established a standard of conduct for financial service providers dealing with retail customers.

ASIC, being responsible for market integrity and consumer protection in the financial services sector, administers the *FSR Act* as well as the:

- *Australian Securities and Investments Commission Act 2001* (the *ASIC Act*);
- *Insurance Contracts Act 1984; and*
- *Superannuation (Resolution of Complaints) Act 1983.*

ASIC also exercises functions related to consumer protection and administers various regulations under the following legislation:

- *Superannuation Industry (Supervision) Act 1993;*
- *Retirement Savings Accounts Act 1997; and*
- *Life Insurance Act 1995.*

In addition to this, financial advisers must also be aware of legislative and common law principles which are relevant when providing advice to clients:

- Financial advisers have a contractual obligation with their clients to provide their services in a professional and timely manner, and if those services are performed in an unsatisfactory or negligent manner the client can seek redress under common law for breach of contract.
- The law of tort can impose a civil liability, even where the advice is given without fee.

- Section 52 of the *Trade Practices Act* prohibits corporations in trade or practice from engaging in conduct that is misleading or deceptive or is likely to mislead or deceive.

It is clearly evident that there is significant and stringent regulation for the financial planning industry. Referring again to the Statement of Expectations for ASIC, it notes under the heading of financial products and services:

> *It is important that this regime be administered with due regard to minimising costs to business and without compromising commercial certainty.*

It has been recognised that one of the biggest barriers to accessing financial planning advice is cost. Response from the industry is that the cost is largely driven by the level of compliance which they must adhere to in order to provide the advice. This is especially true for small financial planning practices where trying to manage the complexity of the current compliance requirements takes the financial adviser away from their clients, often forcing them to outsource these requirements to external companies. The cost of outsourcing compliance requirements can be as high as $20,000 annually. This is coupled with research, software and professional indemnity insurances costs, which may be the same for a sole-practitioner or small sized practice.

We are currently bordering on a regulatory environment which is repressing competition, rather than fostering it. While the focus should be on reducing unnecessary complexity, enhancing competition and educating consumers so they benefit from competitive markets, we are instead facing the genuine risk that small independent financial planning practices may be forced out of the industry no longer be able to compete with the large scale institutionally owned financial planning practices. This will be a great loss to the financial services industry and ultimately the consumer.

Given this level of current regulation, the fact that this regulation appears to be effective for the vast majority of the industry and the goal to minimum costs to business without compromising commercial certainty and improving accessibility of financial planning advice, we do not believe that further regulation is the answer.

So how do we prevent further instances like the recent collapse of Storm from occurring?

CPA Australia believe that any financial planning practice that relies on a 'one size fits all' approach to providing financial planning advice to their clients must be eliminated from the industry, as it fails to act in the best interest of the client. We believe this to be an inappropriate business model and question how such a practice can comply with the many obligations that a financial adviser must adhere to, including the requirement to ensure that advice is appropriate.

Should ASIC be aware of such practices, the onus is on ASIC as the regulator to ensure that the providing entity is complying with s945A of *the Act* and that the integrity of the market is maintained.

It is of concern that there is anecdotal evidence that many licensees who have been in practice for many years have had little or not contact with ASIC since being granted an AFSL. It is unrealistic for ASIC to audit each AFSL on an annual basis, however CPA Australia believe that there is still a need for ASIC to have regular contact with all AFS licensees.

A more efficient and far-reaching solution would be for every licensee to complete an AFSL annual return. The annual return should cover key information and statistics, which ASIC would review and use to compare against industry averages and best practice. It would be an efficient method to identify an AFSL who may be at risk of breaching their obligations due to their business practices. For example, if there was a disproportionately high number of clients in one product type, this could be seen as a result to investigate further.

The questionnaire should cover:

- Clients: number of clients and other basic data such as age, employment status and income range.
- Product: a breakdown of the type of products held by % of clients.
- Fees: average fees charged and as a percentage of clients. Whilst there is no industry average for the level of fees being charged, if the questionnaire showed that the AFS licensees fees were disproportionate to the majority of the industry, it may again warrant further investigation.

We recommend that ASIC consult with both industry associations and a focus group of licensees to ensure that it adequately and comprehensively covers all relevant information that ASIC would require to make an informed judgement whether further action is necessary.

AFS licensees are currently required to annually lodge with ASIC their profit and loss statement, balance sheet and audit report. The AFSL annual report could be incorporated into this existing reporting process.

Recommendations:

2. **Focus must now be turned to ASIC implementing new measures to increase the effectiveness of the existing regulation, rather than increasing the regulation of financial services.**

3. **All AFS licensees complete an AFSL annual return as part of maintaining their compliance requirements to hold their licence.**

4. **ASIC consult industry to develop the annual return to ensure that it adequately and comprehensively covers key information and statistics required, to ensure ASIC can make an informed judgement of whether further action is required to ensure compliance is maintained.**

3. The role played by commission arrangements relating to product sales and advice including the potential for conflicts of interest, the need for appropriate disclosure, and remuneration models for financial advisers

The issue of commissions, fees and remuneration is a constant and often negative focus for the financial services industry.

It is compounded by the fact that many of the large institutions who are licensed, also have their own products or have close alliances with product providers. For compliance purposes, including to ensure the validity of their professional indemnity cover, the majority of AFS licensees also have specific approved product lists, essentially restricting the products that can be recommended to clients to those on the list.

CPA Australia has been a strong advocate of fee-based remuneration for many years and this is reflected in accounting professional statement APS 12 – Statement of Financial Advisory Services[6] released in 2005. We believe that a fee for service approach should be adopted as this is considered to be more consistent with the principles of professional independence. This applies to both initial and ongoing remuneration.

A straight hourly rate is also too simplistic as other factors also need to be taken into account and include:

- the skill and knowledge required for the type of work
- the level of training and experience of the person necessarily engaged in the work, and
- the degree of responsibility applicable to the work, such as risk.

We believe that before agreeing to the terms of engagement it is essential that the client understands how the total fee is determined and how the fee will be paid. APS 12 also prohibits the practice of discounting fees for initial engagements where the intention is to recover such fees through higher costs at a later stage.

Once the amount of the fee is established, a secondary issue is the way by which the fee will be paid. We consider the client is entitled to choose the payment method for the advice, whether by direct billing of the client, automatic debit from a financial product, commission payments where they are offset against fees payable by the client or converting an agreed fee for service into a percentage amount for the purpose of debiting against a financial product, platform or service. Where such a commission is greater than the agreed fee however, a rebate should be provided to the client.

As stated in APS 12, we do not believe that financial advisers should be restricted in how fees for service are received as professional independence comes from how fees for service are determined, not how he fee is received.

We are however most supportive of prohibiting the receipt of specific soft dollar benefits from third parties

[6] A copy of APS 12 – Statement of Financial Advisory Services can be viewed at http://www.cpaaustralia.com.au/2372_16404

that place the interests of the member in significant conflict with those of the client. These include:

- additional commissions or benefits based on sales volumes – unless they are rebated in full to the client
- preferential commission or benefits received for the sale of in-house financial products
- free or subsidised office rental or equipment
- free or subsidised computer hardware
- free or subsidised computer software that is commercially available
- free or subsidised attendance (including travel and accommodation), or sponsorship of, conferences of functions of one or more days duration, conducted by a third party, where the principal eligibility is based on or related to business volumes written or held
- cash payments not directly attributable to a direct client action of sales volumes.

Adopting this approach would ensure that financial advisers can maintain their professional independence, as they would retain control of how they determine the appropriate fee to reflect the work being performed. It would also empower the client to choose the most appropriate method in which to pay for the fees for service determined for the specific circumstance.

Furthermore, under this approach any obvious or potential conflicts of interest would also be removed or significantly reduced as the remuneration is no longer tied to the specific sale of product, whether in-house or other, as any commissions received above the agreed fee would be rebated to the client in full.

Recommendations:

5. **Generally it is not the role of government to set markets, therefore financial adviser remuneration should be left as a matter for industry to determine within the current legislative and regulatory parameters.**

6. **Remuneration should be calculated on a fee for service basis. However, the client should be the one empowered to choose the method of payment to pay for the agreed fee for service.**

7. **Specific soft dollar benefits from third parties that place the interests of the financial adviser in significant conflict with those of the client, such as volume based bonuses, should be banned.**

4. The role played by marketing and advertising campaigns.

For a number of years ASIC has undertaken research in this area to try and identify the role that marketing and advertising campaigns play in influencing a consumer to invest in a specific financial product or make certain financial decisions.

In April 2008 ASIC Report 121 – *Australian investors: at a glance*[7] found that of the consumers interviewed:

- 44% of investors did or would use the media for both investment information and to seek opportunities and advertisements
- 38% use or would use only the media for the investment information.

Further to this ASIC Report 126 - *Understanding investors in the unlisted, unrated debenture (UUD) market*[8] found that:

- two types of investors were identified, with over 53% of the investors falling into Type 1
- Type 1 had a mean age of 64, more likely to be female, divorced, widowed and retired/receiving some form of government support
- they relied heavily on advertising
- they were attracted to and influenced by the advertising for that product

[7] ASIC Report 121 *Australian investors: at a glance* April 2008, pg. 31
[8] ASIC Report 126 *Understanding investors in the unlisted, unrated debenture (UUD) market* April 2008, pg. 12

- they perceived the frequency of the advertising as a measure of quality.

The same report found that over 85% of the consumers who invested in ACR or Fincorp could recall where they either saw or heard the advertising for the product.

From reading the research that ASIC has completed to date in this area, it is clear that there is a strong nexus between advertising and the consumer making the decision to investment in a specific product. It would also appear that there are certain demographics of investors who are more attracted and influenced by product advertising.

Following the collapse of Westpoint and others, ASIC released Regulatory Guide 156 Debenture Advertising. This provides specific standards that must be adhered to when advertising debentures. It places restrictions on the wording that can be used and ensures specific information is contained within any marketing material. For example, it states that words such as 'secure', 'safe' or 'guaranteed' should be avoided. This will no doubt have had some impact on the influence of marketing material for these products, since introduction, as Report 126 found that the use of these phrases was one of the factors that attracted the Type 1 investors.

It is difficult to comment on the role that marketing and advertising played in the case of Storm. It would appear it was the clients themselves may have been the biggest promoters of the group and being based in smaller communities, word of mouth quickly spread. This identifies that efforts must be continued and possibly increased to educate the consumer on how to find the right financial adviser for them and what the role of the financial adviser entails. This will be discussed further in point 7 of the terms of reference.

Recommendation:

8. Existing regulation and guidance for the production of marketing material is effective, provided it continues to be supporting by the monitoring surveillance of ASIC.

5. The adequacy of licensing arrangements for those who sold the products and services

As previously stated, Australia's financial planning industry is currently one of the most highly regulated in the world, however the recent events of Storm and Opes Prime have bought into question the effectiveness of this system. Specifically, are the current licensing arrangements for those who recommend the products and services still adequate and effective, as on face value it would appear that the law has failed the consumer it was trying to protect.

Generally *the Act* requires individuals who provide financial services to hold an AFSL (or become a representative of an AFSL). Providing financial services includes:

(a) provide financial product advice;

(b) deal in a financial product;

(c) make a market for a financial product;

(d) operate a registered scheme; and

(e) provide a custodial or depository service.

The requirements that must be satisfied before ASIC can issue an AFSL are set out in s913B of *the Act*:

(1) ASIC must grant an applicant an Australian financial services licence if (and must not grant such a licence unless):

(a) the application was made in accordance with section 913A; and

(b) ASIC has no reason to believe that the applicant will not comply with the obligations that will apply under section 912A if the licence is granted; and

(c) the requirement in whichever of subsection (2) or (3) of this section applies is satisfied; and

(ca) the applicant has provided ASIC with any additional information requested by ASIC in relation to matters that, under this section, can be taken into account in deciding whether to grant the licence; and

(d) the applicant meets any other requirements prescribed by regulations made for the purposes of this paragraph.

Note: ASIC must not grant an Australian financial services licence to a person contrary to a banning order or disqualification order (see Division 8).

(2) If the applicant is a natural person, ASIC must be satisfied that there is no reason to believe that the applicant is not of good fame or character.

(3) If the applicant is not a single natural person, ASIC must be satisfied:

(a) that:

(i) if the applicant is a body corporate—there is no reason to believe that any of the applicant's responsible officers are not of good fame or character; or

(ii) if the applicant is a partnership or the trustees of a trust—there is no reason to believe that any of the partners or trustees who would perform duties in connection with the holding of the licence are not of good fame or character; or

(b) if ASIC is not satisfied of the matter in paragraph (a)—that the applicant's ability to provide the financial services covered by the licence would nevertheless not be significantly impaired.

The *Corporations Regulations 2001* (*the Regulations*) then details in 7.6.03 the information that must be provided to ASIC as part of an application for an AFSL:

For paragraph 913A (a) of the Act, the following information is required as part of an application by person for an Australian financial services licence:

(a) if the person is a body corporate:

(i) the person's name (including the person's principal business name, if any); and

(ii) the name and address of each director; and

(iii) the name and address of each secretary;

(b) if the person is applying on behalf of a partnership — the partnership's name and address, and the name of each partner;

(c) if paragraphs (a) and (b) do not apply — the person's name (including the person's principal business name, if any);

(d) the person's principal business address;

(e) if the person has an ABN — the ABN;

(f) a description of the financial services that the person proposes to provide;

(g) the arrangements (including a description of systems) by which the person will comply with its general obligations set out in section 912A of the Act;

(h) any other information that ASIC requires for the purpose of considering the application.

At their first public hearing with the Joint Committee on Corporations and Financial Services, ASIC made the following statement regarding requirements that must be met by an applicant in order for ASIC to grant an application for an AFSL:

'The main ones are if ASIC has no reason not to believe that the applicant is of good character or has no reason to believe that the applicant will not comply going forward. We cannot refuse a licence on any other grounds than those'.[9]

CPA Australia were surprised by these comments, as we do not believe they provide an true account of the actual requirements an applicant must demonstrate and comply with in, order to be granted and continue to hold an AFSL. These comments paint a picture of a low or almost non-existent entry threshold, when in fact an applicant must prove they comply with a series of robust and comprehensive requirements which include:

[9] Hansard, Reference: Financial, Financial products and services in Australia. Wednesday 24 June 2009. Joint Committee on Corporations and Financial Services. CFS7.

- Compliance Arrangements

Processes must be in place that will adequately monitor compliance with the AFSL conditions and the law, as detailed in *Regulatory Guide 104 Licensing: Meeting the general obligation*s (RG 104):

RG 104.1 If you are an AFS licensee, you have general obligations under s912A(1) of the Corporations Act 2001 (Corporations Act) to:

(a) do all things necessary to ensure that the financial services covered by your licence are provided efficiently, honestly and fairly (s912A(1)(a));

(b) have adequate arrangements in place for managing conflicts of interest (s912A(1)(aa));

(c) comply with the conditions on your licence (s912A(1)(b));

(d) comply with the financial services laws (s912A(1)(c));

(e) take reasonable steps to ensure that your representatives comply with the financial services laws (s912A(1)(ca));

(f) unless you are regulated by APRA, have adequate financial, technological and human resources to provide the financial services covered by your licence and to carry out supervisory arrangements (s912A(1)(d));

(g) maintain the competence to provide the financial services covered by your licence (s912A(1)(e));

(h) ensure that your representatives are adequately trained and competent provide those financial services (s912A(1)(f));

(i) if you provide financial services to retail clients, have a dispute resolution system (s912A(1)(g)); and

(j) unless you are regulated by APRA, establish and maintain adequate risk management systems (s912A(1)(h)).

The applicant must be able to demonstrate that they will be able to comply with their general obligations from when they are first granted the licence

- Organisational Competence – Responsible Managers

One or more 'responsible managers' must be able to provide all of the financial services and products covered by the licence through meeting one of the following five options:

Table 1: The five options

Option	Knowledge component (qualifications, training etc)	Skills component (experience)
Option 1 (see RG 105.50–RG 105.52)	Meet widely adopted and relevant industry standard or relevant standard set by APRA	3 years relevant experience over past 5 years
Option 2 (see RG 105.53–RG 105.55)	Be individually assessed by an authorised assessor as having relevant knowledge equivalent to a diploma	5 years relevant experience over past 8 years
Option 3 (see RG 105.56–RG 105.60)	Hold a university degree in a relevant discipline **and** complete a relevant short industry course	3 years relevant experience over past 5 years
Option 4 (see RG 105.61–RG 105.65)	Hold a relevant industry- or product-specific qualification equivalent to a diploma or higher	3 years relevant experience over past 5 years
Option 5 (see RG 105.66)	If not relying on Options 1–4, you need to provide a written submission that satisfies us that your responsible manager has appropriate knowledge and skills for their role. Your submission must cover all of the information in RG 105.66	

- Representatives

  The licensee is also responsible or monitoring, supervising and training their representatives

  The representative should be trained and competent to provide the financial services the applicant is applying for. The training undertaken should be commensurate with the level of advice. For example, a financial adviser providing detailed business insurance advice will normally require training beyond an introductory RG 146 course.

  Representatives must also undertake ongoing training to maintain, update and deepened their knowledge on an ongoing basis, known as continuing professional development (CPD). Each representative must have their own annual training plan that details who this requirement will be met.

A full summary of the requirements have been provided as an appendix.

In reviewing the requirements it is evident there are in fact comprehensive and extensive requirements that an applicant must satisfy before ASIC will grant an application for an AFS licence. These conditions and obligations must continue to be met once the licence has been granted. If a licensee fails to comply or breaches their obligations, ASIC have the power to take action, including the power to cancel the licence under Division 4, Subdivision C of *the Act.*

The global financial crisis has resulted in two high profile collapses of financial services businesses in the past financial year, however it would appear that this existing level of regulation is effective and adequate for the vast majority of the industry. ASIC stated in their public hearing with the Joint Committee on Corporations and Financial Services[10] that in the past financial year they had cancelled only 21 licenses and in the 2007/2008 financial year they had cancelled 20. This equates to less than 0.5% licenses issued being cancelled on average over the past two years.

It should also be noted that regardless of the level and extent of regulation imposed on the industry, there will always be an element who will try and exploit the system or attempt to profit from operating 'outside' the system. Increasing legislation in attempt to capture this group will only result in further cost to the greater majority of the industry who will always ensure they comply with the system, a cost which will ultimately be borne by the consumer.

While CPA Australia believes that there is no need for further regulation, the current regime requires that applicants elect to provide different financial services for each financial product and are encouraged by ASIC to only select the financial services they will need. ASIC illustrate this point by advising that the applicant may choose to provide advice relating to superannuation, securities and derivatives but only provide dealing services for superannuation. This will result in an applicant being granted an AFSL with limited authorisation conditions, such as in the case of Great Southern and Timbercorp. They both hold (or held at the relevant time) an AFSL(s) with limited authorisations conditions for the financial services they can provide advice on and/or deal in as part of their licence conditions. Any individuals who then become an authorised representative of their licence, are subject to the same limited authorisation conditions.

CPA Australia again queries whether financial planning advice given by a providing entity licensed to provide financial planning advice and/or deal in only one or a limited number of financial products is appropriate, in the context of our view that a holistic approach is required when providing financial planning advice as discussed in section 1 of this submission.

The question really is how a providing entity who is licensed to only provide advice on interests in MIS, securities and superannuation can then advise a client that investing in an agribusiness MIS is an appropriate strategy to ensure the right mix of diversification for the client's investment portfolio, when the providing entity itself is unable to provide advice on all financial products? The risk is that a recommendations by a providing entity, licensed to only recommend investment in limited classes of financial products, may in fact result in their client being under or over exposed in one or more classes of financial products.

Further it is unclear what level of client inquiries and to what extent must the providing entity, licensed to only provide advice for a limited classes of financial products, consider and investigate the subject matter of the advice in order to satisfy the suitability rule and this should be clarified.

To mitigate risk and possibly ensure commercial gain in some situations, it is also common practice for a licensee to operate using an approved product list. This further limits what end product a providing entity may

[10] Hansard, Reference: Financial, Financial products and services in Australia. Wednesday 24 June 2009. Joint Committee on Corporations and Financial Services. CFS17

be able to recommend to their client, which in some situations may only be limited to financial products offered by the same providing entity.

As RG 175.32 states that personal advice does not need to be ideal, perfect or the best to comply with the *Corporations Act*, it would appear that a recommendation to invest (and possibly borrow to further the investment) in a MIS offered by the providing entity, with limited licence authorisation conditions, based on limited client inquiries will currently comply with both the requirements of the *Corporations Act* and also the guidance provided by ASIC.

CPA Australia is concerned that providing entities who hold limited authorisation as part of their licence conditions may be providing financial planning product advice that may meet the requirements of the *Corporations Act* and guidance provided by ASIC, but that in the long term will not continue to promote confident and informed participation by investors and consumers in the financial system.

We therefore recommend that ASIC undertake a review of these situations and provide specific guidance to the industry on what level of client inquiries are expected in these circumstances and to what extent must the providing entity consider and investigate the subject matter of the advice.

Recommendation:

9. **ASIC provides specific guidance on what level of client inquiries are expected to be conducted by a providing entity and to what extent the providing entity must consider and investigate the subject matter of the advice, where the providing entity's licence authorisation conditions are limited to one or a few financial products.**

6. The appropriateness of information and advice provided to consumers considering investing in those products and services, and how the interests of consumers can best be served

A Product Disclosure Statement (PDS) is one of three disclosure statements commonly given to retail clients. Essentially it outlines details about the financial product being recommended. In s1012a(3) of *the Act* , it states that a regulated person must provide a PDS to a consumer when:

> *(a) the regulated person provides financial product advice to the person that consists of, or includes, a recommendation that the person acquire the financial product; and*
>
> *(b) the person would acquire the financial product by way of:*
>
> > *(i) the issue of the product to the person (rather than the transfer of the product to the person); or*
> >
> > *(ii) the transfer of the product to the person in circumstances described in subsection 1012C(5), (6) or (8) (secondary sales that require a Product Disclosure Statement); and*
>
> *(c) the financial product advice is provided to the client as a retail client; and*
>
> *(d) the financial product advice is personal advice to the client.*
>
> *The Product Disclosure Statement must be given at or before the time when the regulated person provides the advice and must be given in accordance with this Division.*

The Act also stipulates who must prepare a PDS and the content that must be included. It must also be worded and presented in a clear, concise and effective manner (s1013c(3)) and prohibits misleading or deceptive conduct or statements from being included (s1041E and 1041H).

Despite these requirements, there are two issues that must be addressed in order to ensure the appropriateness of this information and how the interests of consumers can best be served.

The first issue is that despite the best intentions that the PDS will be an educational informative document to assist the consumer to make an informed decision on whether to invest in a financial product, the average PDS is between 50 to 100 pages in length and often includes industry jargon and/or complex information.

This creates the second issue, in that investors are then overwhelmed with the amount and complexity of information presented to them, especially when also combined with their statement of advice which may also be of a similar length. In ASIC's *Report 121 Australian investors: at a glance (April 2008)* it was reported that

> *Investors were often overwhelmed by the volume and complexity of the investment information available to them, including disclosure material such as Product Disclosure Statements (PDS), prospectuses and annual reports*[11].

The report also noted that majority of investors in the qualitative stage of their research either glanced over or partly read the disclosure documents when making investment decisions, citing length and complexity of the barriers to reading the documents.

The issue remains that these documents will not reduce in size or complexity, due to concerns by the product managers that if this level of information and detail is not provided, they may breach mandated disclosure requirements. Still, a balance must be found to ensure the investor is provided with enough valuable and meaningful information to enable them to be confident when making investment decisions, without being overwhelmed.

Work has began to address this issue by both the industry and regulators. The Financial Services Working Group (FSWG) released a four page 'short form' PDS for the first home saver account in July 2008 and are reportedly working on further examples.

CPA Australia supports this initiative and recommends that these efforts continue. We would however also encourage the FSWG to seek independent legal advice which would provide certainty that any example short form PDS they produce, complies with all legal obligations. While it is clear that any examples would be deemed by the regulator to comply with all legal obligations, there still may be a reluctance by industry to adopt these examples for fear of being open to a possible civil action by a client. Independent legal advice may address this issue and ensure ready take up of such examples, which will in turn benefit the consumer.

Efforts must also be made by ASIC and the industry to encourage consumers to take responsibility for their investment decisions. They must take an active role in planning for their financial future and while it is the role of the financial adviser to provide the expertise to enable this process, the investor ultimately makes all final financial decisions. This sentiment is also echoed in the Government's Statement of Expectations to ASIC which states:

> *Consumers and investors must be encouraged to take an active role in seeking information about products and should also take ultimate responsibility for their financial decisions*[12].

Consumers need to understand the potential consequences this may carry if they do not actively make an informed decision. It is the responsibility of ASIC to promote this message and while ASIC have produced extensive educational material and resources for the consumer, the message to date does not appear to have hit the mark. This is discussed further in point 7 of the terms of reference.

Recommendations:

10. **Industry and regulators continue their efforts to produce simple and effective disclosure documents.**

11. **Independent legal advice is sought by the Financial Services Working Group to ensure any short form PDS produced complies with the relevant regulation, to ensure that it will be readily adopted by industry.**

[11] Report 121 Australian investors: at a glance April 2008, p26
[12] Government's Statement of Expectations for the Australian Securities and Investments Commission, 20/2/07 2007, p3

7. Consumer education and understanding of these financial products and services

There are many sources of research and information investigating the level of consumer understanding of financial products and services. ASIC's *Report 121 Australian investors: at a glance* (April 2008), is one such example. The purpose of this research project was to gain an understanding of the Australian investor population, including who invests and what motivates or influences them when they are considering investing[13].
Some key findings from that report include:

> *Most investors had heard of the term diversification (78%). However, some had difficulty applying the concept (e.g. 36% said investing 100% of your money in Government bonds was good diversification), and very few stated it as a reason for making an investment decision or as a potential protection against fraud and scams.*
>
> *Half (51%) of the investors using media (i.e. the internet, magazines, newspapers, TV or radio) as an information source when investing have used or would use media to identify investment opportunities.*
>
> *Almost half of investors showed interest in a hypothetical investment advertisement offering 'Fixed returns of 9.75% p.a. All loans are secured by registered mortgages over real property…' and 21% of them were interested because they believed it 'sounds safe'.*
>
> *15% of actual investors used a professional financial adviser as a main source of information the last time they made an investment decision*

Interestingly, the report also found that only 28% of investors were able to name ASIC as the 'corporate watchdog'.

As previously mentioned, it appears it was the clients themselves who were strong promoters of Storm and being based in smaller communities, word of mouth quickly spread. This in itself highlights the need for further education and consumer messaging to ensure that investors understand:

- who can provide financial planning advice
- why use a financial adviser
- financial planning advice should be tailored to the individual, not a one size fits all approach, for example what is right for you may not be right for your friend
- how to choose a financial adviser
- what is involved in the financial planning process
- the risks involved in investing in different types of financial products

CPA Australia is not advocating that the consumer themselves become experts in financial planning products, or that they need to understand extensively the risks and features of different financial planning products. Rather, we are strongly recommending that efforts must be continued to educate and inform investors on how to find the right financial adviser for them, the benefits of using a financial adviser and some basic understanding around the products they are being recommended to ensure that they are making an informed choice that is right for their individual situation. This is akin to Energy Safe Victoria providing information for consumers to educate them on how to engage a registered electrical contractor and ensuring they ask for a certificate of electrical safety for work completed.

FIDO (the consumer website of ASIC) already provides detailed information on choosing a financial adviser and basic information about different financial planning products, the question is – is this information reaching the investor? *Report 126 Understanding investors in the unlisted, unrated debenture (UUD) market*, released by ASIC in April 2008, showed less than 10% of the general investors[14] surveyed used the FIDO website as an information source.

[13] ASIC's Report 121 Australian investors: at a glance April 2008, p8
[14] The report defined this group as either those with general fixed interest investments or those with any type of investment (e.g. shares, investment property) and over $50,000 to invest

This would indicate that efforts made to date have not been far reaching enough. A stronger more targeted approach is needed in order to ensure the message reaches as many individuals as possible. This must then be monitored to progress the success of raising the awareness of FIDO.

Recommendations:

12. **ASIC undertake a marketing campaign promoting FIDO as the first stop for investors and potential investors for information and resources to ensure they are informed, educated and active, in accordance with ASIC's approach to consumer education.**

13. **An annual benchmarking process be implemented to track the success of raising the awareness of FIDO.**

8. The adequacy of professional indemnity insurance arrangements for those who sold the products and services, and the impact on consumers

Under s912B of *the Act*, a financial services licensee who is providing financial services to retail clients must have arrangements for compensating those persons for loss or damage suffered because of breaches of the relevant obligations under Chapter 7 of the Act by either the licensee of its representatives.

ASIC have published *Regulatory Guide 126 Compensation and insurance arrangements for AFS licensees* (RG 126) which details how ASIC administers the requirements under s912B of *the Act.* They note that the primary way in which to comply with this obligation is through professional indemnity insurance.

From 1 January 2010, all AFSLs will be required to have in place a higher level of cover that will meet the requirements of RG 126.

Existing requirements for the level of PI cover to be held by an AFSL and the new requirements being enforced by ASIC, which will commence on 1 January 2010, are adequate and do not require further review or amendment at this time.

Recommendation:

14. **The current requirements regulating the level of professional indemnity insurance required to be held by an AFSL is adequate and do not require review at this time.**

9. The need for any legislative change

There is no doubt that the global financial crisis has had a devastating and far reaching impact on global economies and that this has hit individuals hard, especially those who are nearing retirement or have in fact retired. It has also resulted in the collapse of two high profile financial services businesses in Australia, whose former clients are now left in terrible financial situations.

The extent and impact of these collapses have been devastating and the temptation is to respond with further regulation, however we must remember that Storm and Opes Prime represent only two AFSLs out of approximately 4800 currently issued. While this is of little comfort to their former clients, it does demonstrate that the existing legislation is effective and is adequate for the vast majority of the industry.

We must also be mindful that irrespective of the level and extent of regulation imposed on the industry, there will always be an element who will try and exploit the system or attempt to profit from operating 'outside' the system. Increasing legislation in attempt to capture this group will only result in further costs on the greater majority of the industry who will always ensure they comply with the system, which will ultimately be borne by the consumer.

The focus must now be turned to implementing new measures to increase the effectiveness of the existing regulation and encourage market participants to comply with corporate law on a voluntary basis.

CPA Australia feels that it is imperative that ASIC again establish a closer working relationship with the industry it regulates.

Previously ASIC consulted regularly with financial services industry associations and representatives. This provided a forum for both parties to discuss issues, flag new concerns and seek clarification on specific topics. The model was then replaced with the Financial Services Consultative Committee, which provided an open forum for representatives of the financial services sector to discuss general financial services issues. According to the ASICs website:

> *The forum - effectively ASIC's primary platform for industry liaison - provides an opportunity to deal with general financial services issues that are not specific to a particular industry/association. We are taking this approach because many matters raised with us, and many of ASIC's activities, have broad relevance across the whole financial services sector*[15].

These forums have not been held in over 12 months. Currently these is no ongoing regular contact between ASIC and the financial planning industry.

CPA Australia recommends that ASIC reactivate these forums with meetings on a bi-annual basis. We also recommend that ASIC again initiate an open dialogue with both industry and industry associations.

ASIC should also separately establish a panel of AFSL holders who represent the diversity of the AFSLs held in the industry. This will enable a more proactive approach to monitoring and surveillance and provide a closer connection to what is happening in the industry. Such moves will only aid to ensure the integrity of the market, which is a key role of ASIC.

Another key role for ASIC is to strive to promote the confident and informed participation of investors and consumers in the financial system. ASIC must be mindful of this role when they undertake various monitoring and surveillance activities, such as their shadow shopper investigation. ASIC last completed a shadow shopper in 2005, with the purpose of assessing whether the advice given to consumers after the introduction of Super Choice complied with the law.

The report was report released in April 2006. The accompanying media release, provided a myriad of statistics and quotes detailing the problems the survey had found with only one positive comment. The same tone was also reflected in the report.

CPA Australia supports exercises such as the shadow shopper and believes that they can be an effective tool in monitoring and surveillance. We also appreciate that ASIC have a responsibility to ensure they take whatever action is necessary to enforce and give effect to the existing regulation. However, we feel that ASIC are still missing an enormous opportunity to work closely with the industry to improve the quality of advice it provides to consumers. Negative reinforcement will only be successful if it is complemented with positive messages and outcomes. Where it is used as the sole motivation to improve practices, it will ultimately fail leading to resentment of the process itself and a resistance to take heed of any outcomes.

We believe that these exercises should be used by ASIC, however they should be used as a learning experience and the focus must be changed from one of simply looking for the potential problems to also focusing on positive outcomes, improvements and what can be done to ensure quality advice is provided to consumers. This approach should flow through to all aspects of the shadow shopper or any other surveillance activity undertaken.

Where problems are identified, ASIC should proactively work with the industry to rectify them and implement measures to mitigate future risks that reoccur, rather than simply sending the survey results to each licensee whose advisers participated in the survey and expecting that these licensees will act quickly to fix any problems identified in the survey.

ASIC could also engage with industry associations to utilize their number of financial advisers they can reach to reinforce these messages and deliver resources to improve future outcomes.

---

[15] Liaison Arrangements - http://www.asic.gov.au/asic/asic.nsf/byheadline/FSR+Liaison+Group?openDocument

Another shadow shopping exercise has been tabled for this financial year. CPA Australia encourages ASIC to adopt this approach described above, which will aid to ensure a strong desire to continually work towards best practice in the industry which will in turn promote the confident and informed participation of investors and consumers in the financial system.

Recommendations:

15. **ASIC reactivate the Financial Services Consultative Committee with meetings on a bi-annual basis.**

16. **ASIC must again establish an open dialogue with industry associations and also a panel of AFSL holders who collectively represent the industry.**

17. **ASIC adopt a proactive and positive approach to compliance, working with both industry and industry associations to in turn promote the confident and informed participation of investors and consumers in the financial system.**

Additional matter - the involvement of the banking and finance industry in providing finance for investors in and through Storm Financial, Opes Prime and other similar businesses, and the practices of banks and other financial institutions in relation to margin lending associated with those businesses.

In respect of the additional terms of reference, CPA Australia notes that under the Government's current plan to implement national regulation for consumer credit, a 'margin lending facility' will be included as a financial product for the purposes of Chapter 7 of the *Corporations Act 2001*.

Services in relation to the product will therefore be subject to the licensing, conduct and disclosure requirements of Chapter 7 and will be under ASIC's supervision and enforcement powers.

The *Corporations Legislation Amendment (Financial Services Modernisation) Bill 2009* will

- Define a margin lending facility, which will extend to cover non-standard arrangements and any facility declared by ASIC to be a margin lending facility specifically designed to capture Opes Prime and Tricom style arrangements.

- Implement responsible lending provisions including a requirement that margin lenders make an assessment to determine whether the loan is unsuitable for a 'retail client', with a general position that clients should be able to meet their contractual obligations from income and available liquid assets, rather than from long-term savings or from equity in a fixed asset such as a residential home. The ability to service the loan should also not be dependent on potential returns from the portfolio financed by the loan. The responsible lending provisions will apply to both new loans and for an increase in the limit of an existing loan.

Regulations will also be made concurrently which are intended to include important considerations such as whether the client has taken out a second loan to finance their equity contribution for the margin loan and whether they have used their homes to secure this loan, otherwise known as double gearing.

As stated in our recent submission to Treasury on the draft National Consumer Credit Reform Legislation, we support national regulation of credit being implemented by the Federal Government. We feel that overall, these initiatives should provide further protection for investors by reducing inappropriate lending practices.

Appendix

The following is a summary of requirements an applicant must demonstrate and comply with in, order to be granted and continue to hold an AFSL:

- Applicant details including contact details
- AFS licence authorisations
  The applicant must identify the types of financial services they wish the AFS licence to authorise, for example provide financial product advice and/or deal in a financial product. They are also asked to select the financial products that they wish to advise on, which are grouped under 11 broad headings:

  (a) Deposit and payment products—this includes basic deposit, non-basic deposit and non-cash payment products;

  (b) Derivatives;

  (c) Foreign exchange contracts;

  (d) General insurance;

  (e) Government debentures, stocks or bonds;

  (f) Life products—this includes any products issued by a registered life insurance company that are backed by one or more of its statutory funds;

  (g) Managed investment schemes—this includes interests in both registered and unregistered schemes;

  (h) Retirement savings accounts;

  (i) Securities;

  (j) Superannuation; and

  (k) Miscellaneous financial facilities.

- Business Description
  This section covers the proposed business activities, to allow ASIC to understand how the business will work and the relevance of the licence authorisations selected. An A5 Business Description core proof must also be provided to support this section of the application, which must be specific to the business, providing an overview of the financial services business and including an organisational chart.

  Unless regulated by APRA, the AFS licence will also be required to adhere to specific minimum financial requirements, depending on the nature, scale and complexity of the business.

- Organisational Competence – Responsible Managers
  To obtain an AFS licence, the applicant must demonstrate that one or more 'responsible managers' can provide all of the financial services and products covered by the licence. *Regulatory Guide 105 Licensing: Organisation competence* details these requirements and in RG105.38 states:

  If you operate a large business, you will usually only need to nominate a subset of the people who can be responsible managers. If you are a smaller business, you may need to nominate everyone who can be a responsible manager. If you are an individual who holds or is applying for an AFS licence in your own name, you will need to nominate yourself as the responsible manager.

  It also details that there are five options for demonstrating the necessary knowledge and skills, which are summarised in Table 1 of RG 105.44 (copy below):

Table 1: The five options

Option	Knowledge component (qualifications, training etc)	Skills component (experience)
Option 1 (see RG 105.50–RG 105.52)	Meet widely adopted and relevant industry standard or relevant standard set by APRA	3 years relevant experience over past 5 years
Option 2 (see RG 105.53–RG 105.55)	Be individually assessed by an authorised assessor as having relevant knowledge equivalent to a diploma	5 years relevant experience over past 8 years
Option 3 (see RG 105.56–RG 105.60)	Hold a university degree in a relevant discipline **and** complete a relevant short industry course	3 years relevant experience over past 5 years
Option 4 (see RG 105.61–RG 105.65)	Hold a relevant industry- or product-specific qualification equivalent to a diploma or higher	3 years relevant experience over past 5 years
Option 5 (see RG 105.66)	If not relying on Options 1–4, you need to provide a written submission that satisfies us that your responsible manager has appropriate knowledge and skills for their role. Your submission must cover all of the information in RG 105.66	

The applicant must also provide People Proofs core proof for each responsible manager, which includes:

(a) a Statement of Personal Information

(b) certified copies of qualification certificates

(c) certified copy of a bankruptcy check

(d) certified copy of a criminal history check

(e) certified copies of two business references (at least one of these from an external person to the business).

- Organisational Competence – Processes
  The applicant must demonstrate that there are processed to ensure that all responsible managers maintain relevant competence to carry out their duties under the AFS licence, effectively, honestly and fairly.

- Compliance Arrangements
  Processes must be in place that will adequately monitor compliance with the AFSL conditions and the law, as detailed in *Regulatory Guide 104 Licensing: Meeting the general obligation*s (RG 104):

  RG 104.1 If you are an AFS licensee, you have general obligations under s912A(1) of the Corporations Act 2001 (Corporations Act) to:

  (a) do all things necessary to ensure that the financial services covered by your licence are provided efficiently, honestly and fairly (s912A(1)(a));

  (b) have adequate arrangements in place for managing conflicts of interest (s912A(1)(aa));

  (c) comply with the conditions on your licence (s912A(1)(b));

  (d) comply with the financial services laws (s912A(1)(c));

  (e) take reasonable steps to ensure that your representatives comply with the financial services laws (s912A(1)(ca));

(f) unless you are regulated by APRA, have adequate financial, technological and human resources to provide the financial services covered by your licence and to carry out supervisory arrangements (s912A(1)(d));

(g) maintain the competence to provide the financial services covered by your licence (s912A(1)(e));

(h) ensure that your representatives are adequately trained and competent provide those financial services (s912A(1)(f));

(i) if you provide financial services to retail clients, have a dispute resolution system (s912A(1)(g)); and

(j) unless you are regulated by APRA, establish and maintain adequate risk management systems (s912A(1)(h)).

The applicant must be able to demonstrate that they will be able to comply with their general obligations from when they are first granted the licence.

- Representatives
  The licensee is also responsible or monitoring, supervising and training their representatives. It also serves to ensure any breaches are identified and remedied.

  The representative should be trained and competent to provide the financial services the applicant is applying for. The training undertaken should be commensurate with the level of advice. For example, a financial adviser providing detailed business insurance advice will normally require training beyond an introductory RG 146 course.

  Representatives must also undertake ongoing training to maintain, update and deepened their knowledge on an ongoing basis, known as continuing professional development (CPD). Each representative must have their own annual training plan that details who this requirement will be met.

- Adequacy of Resources
  Applicants who are not regulated by APRA must show they have access to sufficient financial, human and information technology resources to properly carry out the responsibilities under the AFS licence and the law. This will include a Financial Statements and Financial Resources core proof.

- Dispute Resolution
  This consists of both an internal dispute resolution procedure (IDR) that complies with *Regulatory Guide 165 Licensing: Internal and external dispute resolution* and membership of an ASIC–approved external dispute resolution (EDR) scheme or schemes that will cover all possible complaints about the financial services that will be provided by the AFSL.

- Risk Management
  Demonstration of adequate processes tailored to the business for managing risks associated with the business. This may also require an additional proof – Risk Management System Statement.

- Compensation and Insurance Arrangements
  If the applicant has applied to provide financial services to retail clients, they will need to have arrangements for the compensation of those clients for loss they suffer if the applicant breaches their obligations under *the Act*. This is met through professional indemnity insurance.

- Research and Benefits
  This section asks questions around the nature of product research and the applicants approved or recommended product list, if they provide financial product advice to retail clients.

There are also additional requirements if the applicant selects certain complex financial services or products as part of their licence application.

ASIC have also issued the following Regulatory Guides which provide guidance on the obligations that apply to all providers of financial services required by *the Act* and *the Regulations*:

RG 36 Licensing: Financial product advice and dealing

RG 104 Licensing: Meeting the general obligations

RG 105 Licensing: Organisational competence

RG 126 Compensation and insurance arrangements for AFS licensees

RG 146 Licensing: Training of financial product advisers

RG 165 Licensing: Internal and external dispute resolution

RG 166 Licensing: Financial requirements

RG 167 Licensing: Discretionary powers

RG 175 Licensing: Financial product advisers — Conduct and disclosure

RG 181 Licensing: Managing conflicts of interest

Appendix 2

Inquiry into financial products and services: terms of reference[16]
On 25 February 2009 the Parliamentary Joint Committee on Corporations and Financial Services resolved to inquire into and report by 23 November 2009 on the issues associated with recent financial product and services provider collapses, such as Storm Financial, Opes Prime and other similar collapses, with particular reference to:

1. the role of financial advisers;

2. the general regulatory environment for these products and services;

3. the role played by commission arrangements relating to product sales and advice, including the potential for conflicts of interest, the need for appropriate disclosure, and remuneration models for financial advisers;

4. the role played by marketing and advertising campaigns;

5. the adequacy of licensing arrangements for those who sold the products and services;

6. the appropriateness of information and advice provided to consumers considering investing in those products and services, and how the interests of consumers can best be served;

7. consumer education and understanding of these financial products and services;

8. the adequacy of professional indemnity insurance arrangements for those who sold the products and services, and the impact on consumers; and

9. the need for any legislative or regulatory change.

On 16 March 2009 the Senate agreed that the following additional matter be referred to the Parliamentary Joint Committee on Corporations and Financial Services as part of that committee's inquiry into financial products and services in Australia, adopted by the committee on 25 February 2009 for inquiry and report by 23 November 2009: The committee will investigate the involvement of the banking and finance industry in providing finance for investors in and through Storm Financial, Opes Prime and other similar businesses, and the practices of banks and other financial institutions in relation to margin lending associated with those businesses.

[16] http://www.aph.gov.au/senate/committee/corporations_ctte/fps/tor.pdf