



**ASIC**

Australian Securities & Investments Commission

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29 February 2008

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General Manager, Wealth Management  
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Mr Sean Graham  
Head of Professional Standards  
Commonwealth Financial Planning Limited and Financial Wisdom Limited  
Level 17, 175 Pitt Street  
SYDNEY NSW 2000

Dear Sir,

**COMMONWEALTH FINANCIAL PLANNING PTY LIMITED AND FINANCIAL WISDOM LIMITED – Surveillance Findings**

I refer to your conversation with Darren Williams on 29 February 2008 and to ASIC's surveillance ("**Surveillance**") conducted in 2007 in relation to the provision of financial product advice by Commonwealth Financial Planning Pty Limited ("**CFP**") and Financial Wisdom Limited ("**FWL**") (**collectively referred in this letter as CBA**). CFP and FWL are each holders of Australian Financial Services Licences that authorises them to provide both personal and general financial product advice.

During the course of this Surveillance, we reviewed a range of CBA's processes and interviewed numerous senior staff in relation to CBA's provision of personal financial product advice. We also reviewed 496 examples of advice selected at random from CBA's answer to our notices, given by 51 representatives between 1 July 2006 and 16 January 2007.

**1. Surveillance Findings**

**1.1 Compliance Framework**

As a result of our Surveillance, we identified the following key concerns with the CBA's compliance framework that we do not consider to be adequate to discharge its obligation to take reasonable steps to ensure its representatives comply with financial services law under s912A(1)(ca) of the *Corporations Act* 2001 ("**the Act**"):

- the use of the risk matrix does not address whether representative's advice is compliant with all of your legislative obligations;
- the number of representatives CBA has rated as Negligible or Low and subsequently revoked or cancelled the representative's authorisation is significant; and
- representatives who have been rated Critical as a result of serious misconduct are not effectively addressed within the current framework.

(a) Ratings in the Risk Matrix

The CBA compliance team monitors representatives, after they have been given post-vet status, by conducting reviews of client files for the purpose of ensuring representatives are providing advice that is reasonable and appropriate to the needs of the client, and to confirm that the representatives are complying with internal policies as well as their legislative obligations. In their monitoring procedure, the compliance staff use a risk matrix, which compares representative's activity levels with their risk rating (which range from Negligible, Low, Moderate, High to Critical). The risk matrix determines the frequency (minimum two/maximum three) of reviews per annum and whether the review will take place from a centralised or on-site location. Compliance staff review at least 4 client files per representative as part of their review process.

CBA has informed us that risk ratings within the risk matrix are intended as an objective metric system to assess the quality of advice and the supporting documentation, against the representatives legal and professional obligations.

The CBA risk matrix categorises representatives with Negligible risk to CBA and its licence, as exhibiting the lowest level examples of misconduct, using benchmark examples such as:

- minimal inconvenience to client;
- isolated incidences where representatives have failed to address some aspect of the clients needs and objective;
- isolated incident of representatives providing poor quality advice; and
- delays and reluctance to clients queries.

Notwithstanding the above definition, our review of advice given by representatives that were rated as Negligible identified significant issues that we would not consider negligible. Given that approximately half of CBA's representatives were rated as Negligible risk between July 2006 and January 2007, we are therefore particularly concerned with how your policy is implemented and accordingly, your ability to ensure your representatives are complying with the law.

Please see "Annexure A" for an example of the advice we reviewed where issues were identified.

As we have stated, we reviewed 496 examples of randomly selected advice during this Surveillance from 51 representatives. Our concern about the effectiveness of the risk categories within the risk matrix broadened to other risk categories when we found that:

- 60% of switching advice contained switching tables that did not have all the information required under s947D of the Act;
- 48% of the advice had insufficient records of inquiries about the client's personal circumstances in the Financial Needs Analysis ("FNA"). Specifically, we found that many representatives did not fully complete the FNA and there was also generally no notation to the effect, as required by CBA's policy, to document that the client did not wish to disclose the information.

It is not clear whether the widespread failure to document this information is indicative of a failure to obtain the information. We seek further clarification from CBA regarding the practices their compliance team employ to satisfy the

licensee that s947D and s945A of the Act have been met, without the above documentation.

Given the above findings, we are concerned that the use of the risk matrix does not lead the CBA compliance team to consider whether the representative's advice is compliant with their legislative obligations under the Act.

(b) Authorisation Revocation

Between 1 July 2006 and 16 January 2007, 41 representatives who had their authorisation cancelled, for the period immediately prior had been rated as Negligible or Low risk. Given that Negligible rated representatives are bi-annually reviewed by CBA, we are concerned that your own data suggests that your compliance framework is not adequately detecting serious misconduct. We are therefore concerned that you are not adequately using your framework to continuously ensure you are meeting your licence obligations.

Please see "Annexure B" for an example of this issue.

(c) Addressing Serious Misconduct

CBA's policies denote Critical risk as the highest rating in the risk matrix and is intended to encompass serious representative misconduct which may include the following:

- fraud and dishonest conduct;
- clear mismatch of risk profile;
- inappropriate product selection ;
- deliberate or reckless failure to address known needs and objectives;
- consistent and deliberate or reckless failure to disclose fees, costs, charges, relationship and warnings;
- no evidence of appropriate advice; and
- remediation of more than \$10,000.

We note that CBA's procedures seek to consequence manage Critical risk representatives by:

- Heightened supervision in the form of an additional compliance audit per annum which may be on-site;
- Impacting representative's bonus as Critical representatives are not entitled to a 6% component of their yearly bonus and may, on a discretionary basis, not be entitled to other parts of their bonus; and/or
- Revocation of representative's authorisation.

For representatives who are rated Critical but continue to provide advice, the heightened supervision, in the form of an additional review per annum, is inadequate to properly discharge CBA's obligation to supervise representatives. Where representatives continue to provide advice, the benchmarks you have identified for this misconduct would at a minimum require more monitored supervision on a regular basis and further training.

We reviewed a random sample of Critical rated representatives and found serious deficiencies in their advice. Consequently, we are concerned that those current representatives rated Critical and continue to provide advice have not been adequately consequence managed.

Please see "Annexure C" for an example of this issue.

Furthermore we do not see a strong correlation between the severity of the misconduct required to achieve a Critical rating and the potential impact upon the representative's bonus. We are concerned that this may not provide an adequate deterrent to serious misconduct and is therefore not appropriate.

As part of our Surveillance, we requested CBA provide us with the bonuses received by the selected representatives so we could ascertain whether compliance ratings in fact impact bonuses in accordance with CBA policy. CBA has not provided that information due to IT system limitations. Therefore, apart from the additional review per annum, we are unaware of what, if any, action CBA has taken to sanction the conduct of the remaining representative who continue to give advice.

We observed that of the 38 representatives who were rated Critical, CBA revoked the authorisation of only 12 representatives. We do not know why the remaining representatives continue to retain their authorisations. There appears to be some correlation between the amount of revenue generated by the representative and CBA not revoking an authorisation. As an indicator, the 20 CFP representatives generated aggregate revenue of \$121 million in gross sales during the six month period.

Only 7 of the 38 representatives were reported to ASIC under s912D of the Act, one of which was after the Surveillance had commenced. Given the seriousness of the conduct, we have concerns about CBA's ability to discharge their obligation to report significant breaches under s912D of the Act.

## **1.2 Statement of Advice ("SoA") template**

The SoAs prepared by CFP representatives identified a widespread use of generic information in certain sections, rather than the advice being tailored to the personal circumstances of the client, particularly in relation to investments onto the CFS First Choice platform. The sections that appeared generic and not personalised were the:

- needs and objectives of the client; and
- advantages and disadvantages of investment in a product.

ASIC is concerned this trend may suggest that there is too heavy reliance on the SoA template, particularly the pre-formatted advantages and disadvantages of investing in CFS First Choice and pre-populated generic needs and objectives of the client.

We made a further observation that the SoA template contained two tables that were inconsistent with each other i.e. one cost table was inclusive of GST whilst another cost table was exclusive of GST notwithstanding that both cost tables record some costs which are the same quantity.

## **1.3 Record Keeping**

ASIC observed in their review of 496 pieces of advice that there were several areas that representative's demonstrated extensive poor record keeping practices in the provision of their advice, which consequently compromises the CBA's compliance team ability to assess whether representatives are compliant with their legislative obligations.

We also found that SoAs containing switching advice generally had inferior documentation practices than non-switching advice. Areas that demonstrated failure to

disclose entirely or correctly were fees and commissions, the significant consequences (particularly benefits lost) of replacing the existing product with the recommended product and the different value of ongoing costs between the existing product and the recommended product.

As stated previously in this letter, significant numbers of the advice we reviewed had insufficient records of inquiries about the client's personal circumstances in the FNA. Specifically, we found that many representatives did not fully complete the FNA and there was also generally no notation to the effect, as required by CBA's policy, to document that the client did not wish to disclose the information.

## **2. Previous Findings**

ASIC is particularly concerned about the findings from this Surveillance, given that many of them were put to CBA in 2006, after a smaller surveillance was undertaken of CFP's Bankstown branch and FWL's Cairns branches. The concerns that appear to be reoccurring are the:

- failure by representatives to complete FNAs or reliance on outdated FNA when providing advice;
- provision of SoAs relating to switching advice, that do not identify or adequately disclose all components of the management expense ratio and any Performance Based Fees payable to the fund manager; and the significant consequences of replacing the existing product with the recommended product, including the different value of ongoing costs between the existing product and the recommended product;
- lengthy and generic SoAs that were not tailored to the client; and
- failure to report significant breaches to ASIC as required by section 912D of the Act.

Despite assurances from CBA in May 2006 that CBA had overhauled its compliance arrangements and the suggestion that many of ASIC's concerns were historical, we have reason to believe, on the basis of our findings in this Surveillance, that our concerns are ongoing.

## **3. Conclusion**

We are considering what action to take in relation to the issues we have identified. The purpose of this letter is to give CBA an opportunity to put to ASIC a proposal that will satisfactorily address these issues.

## **4. Next Steps**

We think it would be appropriate to meet with you to hear from you about the steps CBA will take to address our concerns. We suggest an appropriate time for that meeting will be in the week commencing 17 March 2008 at ASIC's office, Level 18, 1 Martin Place, Sydney.

If you have any questions, please contact me on [REDACTED]

Yours faithfully

**Darren Williams**  
**Director, Compliance**  
**Financial Services**

**"Annexure A"**

Licensee: *FWL*  
Representative: [REDACTED]  
Client Name: [REDACTED]  
Compliance rating: *Rated Negligible in September 2006*

**Facts:**

[REDACTED] year old client seeking advice about his 3 existing superannuation accounts and was recommended to roll all 3 existing accounts into CFS First Choice product. The CBA compliance team when reviewing the advice noted that the FNA had one client objective prioritised while the SOA highlighted more options and rated the advice the highest ranking of "First Class".

However, our review noted that:

- One of the superannuation accounts did not have a member statement so it was not clear whether the representative made inquiries into that superannuation account. The file notes and member statements accompanying the FNA only showed account balances for the superannuation funds. There was limited evidence of research into the fees or features (such as insurance) of the existing superannuation funds.
- The client goals appear non-specific, non-measurable and generic on page 6 of the SoA. As a result it would be difficult to test the advice against any specific benchmarks on satisfying the client's goals or objectives.
- The SoA did not compare the advantages and disadvantages (including benefits lost and dollar values comparison of fees and charges between the "to" and "from" products) and the consequences of following the advice to switch products.
- The consequences section of the recommendations table on page 11 of the SoA did not deal with lost features of the existing funds except general statements about costs (lower/higher). The consequences mainly detailed features of the new fund and the table did not address lost benefits of the "from" funds or discuss if the benefits listed were already available in the "from" funds. Given the lack of documentation it was not possible to determine if any insurance was lost as a result of the transfers.
- The advantages and disadvantages of taking up the recommendation appeared generic and pre-formatted.
- The product recommended was more expensive than the clients existing product.
- The FNA was contradictory in that it stated that advice was limited and later not limited.
- There was a retirement planning goal listed in the FNA (\$40,000 pa at age 65) but it was unclear if this was within scope of the advice. There was no ongoing retirement savings advice in the SoA as part of the superannuation switch advice.

Representative: [REDACTED]  
Client Name: [REDACTED]  
Date of advice: *September 2006*  
Compliance rating: *Rated Negligible in October 2006*

The CBA compliance team when reviewing the file noted that one section was left blank, and rated the advice as "First Class".

However, our review noted the following concerns:

- The Ongoing Fee Table showed commissions receivable from insurance premiums (Life Insurance/Critical Illness Plus- Licensee 14.50% with representative receiving 13.78%). It was unclear why this was being charged because the SoA did not make insurance recommendations.
- A \$60 exit free was detailed on page 21 of the SoA when discussing the implication of the recommendation, however the exit free was shown a nil in later discussion about the cost of implementing the advice.



**"Annexure B"***CFP Representative:**Compliance rating:*  
*Negligible*

The representative was rated as Negligible in November 2006 even though a complaint was made against the representative for misleading and deceptive conduct a month earlier (September 2006) and CFP found in favour of the client resulting in a remediation payment offer of \$9,222.56. We are concerned that this representative achieved the minimal risk rating in these circumstances.

*FWL Representative:**Compliance rating:*  
*Critical (undated), Negligible (April and Feb 2006, August 2005)*

This representative was rated Critical by the CBA compliance team (document undated) after an entry was made in the Issues Register on 1 September 2006 noting that SoAs has not been given to 26 of the representative's clients. The breach notification letter relayed that the representative's misconduct commenced as early as August 2005. In the circumstances, ASIC is concerned about the minimal risk rating given to the representative in August 2005, February 2006 and April 2006 despite the serious and longstanding nature of the representative's misconduct. It should also be noted that ASIC did not receive a breach notification until 6 weeks later on 18 October 2006 and has concerns about the length of time CBA takes to notify of a reportable breach.



### "Annexure C"

Representative: [REDACTED]

Compliance rating:

Critical (December 2006)

CBA's Issues Register noted deficiencies in the representative's advice in November 2006. The representative was subsequently rated Critical by the compliance team one month later (December 2006) as a result of a review of 4 of his client files. Another entry was made in the Issues Register in January 2006 recording that a client was not given a regulated document.

Below are 2 examples of the 8 pieces of advice ASIC reviewed, all of which raised concerns.

Client Name: [REDACTED]

Date of advice:

July 2006

#### Facts:

In January 2006, following the recommendation of the representative, the client invested \$237,890.74 into a CFS First Choice Allocated Pension "AP". The first SoA was not on the file.

Six months later (July 2006) the client attended a meeting to discuss his ability to pay on-going fees for service. A 'Transaction History' printout of [REDACTED] CFP First Choice AP showed that a monthly representative service fee was being deducted from his account.

In a meeting a few days later, the representative indicated that if the client rolled the current AP into the ING One-Answer Nil Entry Fee AP and invested for at least 4 years the representative would waive all future fees after the 3% initial commission and ongoing trail commission of 0.6%. The representative prepared an SOA to the above effect, the client signed an Agreement to Proceed, and made the switch to the ING product.

We have the following concerns about the advice:

- Of the 8 examples of advice we reviewed for this representative, 6 recommended switches to the ING One Answer mastertrust platform. (The conflict presented by this remuneration was removed in October 2006). The SoA also disclosed that FWL would receive additional commission up to a maximum of 0.2% per annum of the average monthly funds under management for ING OneAnswer retail products and pay some or all of this commission to the representative if he met certain quality and earnings ratings.
- The client's request for a review of his AP was based on a concern about his ability to pay ongoing fees for service in the future yet the representative recommended a roll-over into a new product, the ING OneAnswer AP.
- The representative had previously recommended that the client purchase a CFS First Choice AP only 7 months before this and there was no documentation of the reason the representative recommended moving out of this product.
- Although the representative told the client that he would waive the ongoing representative service fee if the client paid the initial and ongoing trail for the new product, the representative did not disclose to the client in the Fees Section of the SoA (nor in any documentation contained on file) that the representative Service Fee for the CFS and ING products was negotiable. The PDS for both products disclosed that the representative Service Fee was negotiable.
- The SoA did not mention that initial and ongoing commissions can be rebated although the SoA refers the client to the PDS for further detail on commissions. In this case the representative charged the client the maximum initial and ongoing commissions.
- The SoA did not comply with s947D because it does not contain a cost comparison between the "from" and the "to" product. However, 5 months after the advice (9 March 2007), after being selected as part of this Surveillance, the representative sent the client a letter setting out a cost comparison between the "from" and "to" product for the first 4 years of the investment. The letter showed that the total fees for the "to" product were 43% more than the client's

"from" product. The recommended product will cost the client \$6,820 more than if he had remained in the existing product.

- As the features of the ING One Answer product and the CFS Allocated Product are similar, it was not clear why the switching advice was appropriate and the file notes and SoA did not document the reasons for the advice.

Client Name: [REDACTED]

Date of advice: 19 October 2006

Facts:

The SoA recommended a switch from the Colonial First State Rollover & Superannuation Fund to ING OneAnswer Personal Super.

In file notes attached to the FNA dated 16 October 2006, the representative stated that he contacted the client on 12 October 2006 "...and advised that he wanted to do a review of the client's 'super position'". The representative met with clients and discussed the lack of investment choice in the client's current CFS Fund and suggested that a platform would be more effective. File notes dated 20 October 2006 indicated that the representative recommended rolling the client's funds into the ING O/A Platform (Nil Entry Fee) because the platform:

- had a greater range of investment options;
- had the potential to provide higher returns over time; and
- the M.E.R of 2.73% compared to the CFS Fund of 2.0% would be higher for the first 4 years, but at the 4 year point would reduce to 1.67%".

The representative also told the client that:

- an exit fee of 3% would apply for the first 3 years and the representative would receive an initial commission of 3.3% of assets with an ongoing trail commission of 0.6%;
- they would be subject to an exit fee of 1.5% of the account balance on the CFS Fund but the representative "...agreed to rebate \$300.00 of this amount by the 25 Feb 2007".

The client made the switch to the ING One-Answer Personal Super - Nil Entry Fee option on 20 October 2007.

We had the following concerns about this advice:

- The SoA notes that the advice was limited to a "review (of) the superannuation fund to roll over the CFS Rollover and Superannuation Fund" which does not explain why the client was seeking to rollover his current super fund or the circumstances justifying this advice (particularly given that the representative initiated the review). The representative in this case encouraged the client to switch funds by offering to rebate a portion of the exit fee payable on the client's current CFS fund.
- The Switching Table in the SoA did not contain the information required under s947D and did not disclose the overall cost of switching products.
- The representative wrote to the client on 9 March 2007, almost five months after the provision of advice (and after the Representative has been selected as part of this Surveillance) because the representative thought it prudent to include a comparison of fees between the existing product and the recommended product over the first 4 yrs. The table showed that the total fees for the recommended product was 25% more expensive than the fees for the existing product. The analysis of the difference between the "to" and the "from" funds' fee structures should have been included in the SoA to allow the client to make an informed decision at the time of the recommendation. In any event, the representative made an error in the calculations in the letter to the client and the table showed that the total fees for the recommended product would be 45% more expensive than the fees that were being charged for the existing product. The error was caused by the exit fee of \$279 including representative rebate being applied to the recommended product instead of the current product.
- A further letter to the client noted that the initial commission applicable in this case was \$1,273 (3.3% based on the initial investment and any subsequent regular investments) whereas there was no commission payable if the client remained with his current CFS fund. The letter did not reiterate the ongoing commission payable for the recommended product, which was \$517.00 (0.6% based on the initial switch amount but also applying to the portfolio balance). In comparison, the ongoing trail payable for the CFS product was 0.44%. Based on the commissions earned

following the switching of funds the representative gained significant benefits from this recommendation.

- The SoA did not state that initial and ongoing commissions could be partially or fully rebated (as noted in the recommended product's PDS) as negotiated with the representative although the SoA referred the client to the PDS for further details on commissions. In this case the maximum initial and ongoing commissions have been charged to the client.
- One of the representative's reasons for recommending a switch was that the ongoing MERs averaging 2.73% for the "to" fund would reduce to 1.67% after 4 years. However, the PDS said "For the Nil Entry Fee Option, a rebate of 0.75% would be credited as additional units to (a client's) account on an ongoing basis after four years of each investment". In calculating the rebate that would equate to the ongoing MERs averaging 1.98% after four years and not the 1.67% the representative notes in the FNA file notes, SoA and further correspondence to the client dated 9 March 2007.