Appendix 3

Answers to questions taken on notice

ASIC (Canberra hearing, 24 June 2009)

ASIC 1 - Hansard p. 13

Senator MASON—I accept that. The Chairman also mentioned that there are certain training obligations. Could you outline what the training obligations are.

Ms Bird—Once you have got through the gate you have to comply with certain obligations. One of those is—

Senator MASON—Sorry to interrupt. 'Through the gate': so you have been given a licence.

Ms Bird—Then there are a whole lot of obligations that are imposed upon you. The licensee has to have the resources to do its job, it has to be competent and it has to ensure that its representatives are competent. For most licensees that is quite a general obligation; it is really up to the licensee to take the responsibility to ensure that the people performing the role are competent. However, in the advice area ASIC does set down minimum standards of training.

Senator MASON—What are they?

Ms Bird—I can tell you what the policy guide is. Essentially they are for financial advisers. I would have to take it on notice because there is a diploma level—we have divided it up between two sorts of products: there are simple products and there are more complex products.

Senator WILLIAMS—Can you do that course online over a period of six weeks or so?

Ms Bird—There are different forms of courses. There are two ways to comply. The main way that people comply is by doing a course that is on what is called the ASIC training register.

Senator WILLIAMS—Can you do that online?

Ms Bird—I cannot answer whether any of the courses can be done entirely online, but there is an ASIC register that sets out all the courses that you have to do. They are approved courses.

Mr PEARCE—It is all outlined under PS146.

Ms Bird—Yes, 146 has got the lot of it.

Mr D'Aloisio—We will check the online issue.

Senator MASON—That is fine, if you could take that on notice.

Mr D'Aloisio—We will take it on notice.

Answer: ASIC 1 - Hansard p. 13

Training obligations

Under the Corporations Act, AFS licensees need to ensure that their representatives are adequately trained and competent (s912A(1)(f)). ASIC has imposed licence conditions which require AFS licensees to ensure that any person who provides financial product advice to retail clients on behalf of the licensee:

(a) has completed appropriate training courses approved in accordance with Regulatory Guide 146 *Licensing: Training of financial product advisers* (RG 146); or

(b) has been individually assessed as competent by an assessor approved by ASIC; or

(c) in respect of financial product advice on basic deposit products, facilities for making non-cash payments that are related to basic deposit products or First Home Saver Accounts issued by an authorised deposit-taking institution (i.e. FHSA deposit accounts), has completed training courses that are or have been assessed by the AFS licensee as meeting the appropriate level.

Minimum standards for financial advisers

Minimum training standards for financial product advisers are set out in RG 146. The standards comprise sets of knowledge and skill requirements that must be satisfied at either Tier 1 or Tier 2 education level. The Tier 1 education level is broadly equivalent to the 'Diploma' level under the Australian Qualifications Framework and the Tier 2 education level is broadly equivalent to the 'Certificate III' level under the Australian Qualifications Framework.

The requisite knowledge and skill requirements and the education level is dependent upon whether the adviser gives general or personal advice and what products the adviser gives advice on. Tier 2 is the lower education standard and applies to a specified list of basic products being: general insurance products except for personal sickness and accident; consumer credit insurance; basic deposit products; non-cash payment products; and FHSA deposit accounts. The higher Tier 1 standard applies to all other products.

Whilst it is possible to complete a course online over a period of six weeks, this diploma level course provides only the basics to be able to provide advice in the industry and many licensees prefer that advisers complete higher levels of training.

Not all courses are online and approved courses typically use a variety of teaching methods including face-to-face teaching in conjunction with online components.

As outlined in ASIC's submission to the PJC Inquiry on Financial Services and Products (ASIC's submission) at [133]-[134], ASIC is reviewing RG 146 with a view to improving training standards and will consult on proposals for change with industry and other stakeholders.

ASIC 2 – Hansard p. 18

Mr PEARCE—I have one last question on the licensing issue. Have you any idea of the proportion of AFSL holders who have an affiliation with an FPA, for example, or an AFA or something else that imposes further qualification requirements?

M D'Aloisio—I would like to take that question on notice because it is a significant question and I am aware we have actually looked at that. Rather than try to recollect, I would like to take it on notice, because there are a substantial number of individual licensees, for example, who would be members of the FPA. The corporates are also members of FPA and IFSA and so on. So we can actually get you that information.

Answer: ASIC 2 – Hansard p. 18

Membership

There are various industry associations that offer membership and professional development services to participants in the financial advice industry. ASIC has been provided with membership data from four key industry associations:

(a) Financial Planning Association (FPA): 7939 practitioner members and 480 member firms;

(b) Association of Financial Advisers (AFA): 1300 members;[1]

(c) Investment and Financial Services Association (IFSA): 90 full member firms;[2] and

(d) National Insurance Brokers Association (NIBA): 476 member firms.

1 According to the AFA's corporate profile, 26% of members hold an AFSL. 74% of members are part of a larger AFSL and include individual members.

2 IFSA also offers supporting membership to companies involved in the retail funds management and life industry in a service capacity, e.g. legal and accounting firms, asset consultants and information technology providers.

In terms of the proportion of AFSL holders that are affiliated with an industry association, the FPA have advised ASIC that the 480 member firms that are members of the FPA represent nearly 90% of the advice industry. Where a licensee is a member of the FPA, the obligations associated with membership extend to all advice personnel, including authorised representatives who are not individual members of the FPA.[3]

Further qualification requirements

All members of the FPA are subject to continuing professional development (CPD) requirements. Member firms are required to ensure that their practitioners adhere to the FPA's CPD policy. Of the 7939 practitioner members, 5693 are qualified as certified financial planners (CFPs) and 2246 are associate members. The CFP program consists of five units of study with an underpinning bachelor degree. Associate members may be studying toward their CFP qualification. All CFP members must undertake 120 points (approximately 40 hours) of CPD per triennium (minimum 35 point per financial year) to retain the qualification. Associate members are required to undertake 90 points per triennium (minimum 25 points per financial year). All members must undertake 3 points on ethics and 3 points on compliance.

Individual members of the AFA have ongoing education requirements as a condition of membership. The AFA reports that its members undertake a range of education through professional associations (including the AFA and FPA), their licensees and public education providers. The AFA itself offers the Fellow Chartered Financial Planner qualification, which consists of four units each taking 12 weeks to complete. The current courses offered for this qualification are fully subscribed. It also offers courses via alliances with training organisations and universities, as well as national roadshows and conferences.

IFSA does not require that its members undertake ongoing professional development in order to maintain membership. However, it does offer a range of voluntary education options.

While NIBA membership is held at the licensee level, NIBA also operates an educational facility called the NIBA College. There are 2477 individual members of the NIBA College. Members may be either affiliate members (members that do not hold a formal broking or risk qualification) or practitioner members (members that hold formal broking or risk qualifications). There are five classes of practitioner members depending on the particular level of qualification. The vast majority of the members (2072) hold the Qualified Practising Insurance Broker qualification, requiring completion of a Diploma of Financial Services undertaken over 12-24 months as well as practical broking experience of at least four years. All members

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[3] The FPA also provided some membership data to the PJC at the hearing of the Inquiry into Agribusiness Managed Investment Schemes on 15 July 2009. See pp 38 and 45 of the transcript of the hearing: http://www.aph.gov.au/ hansard/joint/commttee/J12132.pdf.

must undertake 25 hours of CPD annually. The education options offered by the College are also open to non-members.

ASIC 3 – Hansard p. 19-20

Senator MASON—I want to talk about monitoring activities. An option the committee will be considering is whether, if ASIC were to upgrade and make more comprehensive their monitoring activities that would lead to better advice and companies acting more honestly and appropriately. That is the policy decision we have to come to. Are you happy that your monitoring activities are sufficient?

M D'Aloisio—You are never happy that your monitoring activities are sufficient, because if there are problems in the market you always worry about them. It is not a system that we have an approach where, for example, if there are 4,800 licensees, over a three-year period we would have carried out a surveillance on each of them. So you necessarily have to be selective in what you do. In being selective you are necessarily making judgments about risk and so on.

I come back to your question about whether we can do more than we are doing. At the moment, in the way we have restructured ASIC and the resources we have put in in terms of stakeholder teams, specifically in the case of financial advisers—leaving other AFSL licence holders out for the moment—we have a dedicated team of about 30 people now that is concentrating on that industry. One of the key priorities of that group, headed by Deborah Koromilas, whom I think you have met, is essentially around surveillance, compliance, quality of advice and so on. They have programs that they will run over each year to carry out that work.

We are always glad to receive more resources and to expand, and clearly we are pleased to look at that.

The other side of these surveillances and how you do them is that you do not want to do them for the sake of it, because they are extremely costly to ASIC and they are costly to the organisation that is involved. So you really want to be quite focused and achieve a result. I do not know at this stage—and we can take the question on notice and look at it further. If we are carrying out whatever number of surveillances in this area and we double or triple them, what do we think the net gain will be? I am happy to think about that. Off the top of my head it is hard to give you an answer, because I think that is where you are headed.

Answer: ASIC 3 – Hansard p. 19-20

It is very difficult to categorically state the beneficial effect of increasing surveillance activity. The effectiveness of surveillance activities is limited by resources and

ASIC's powers to take action based on the intelligence gained through the surveillance activity.

While we would always want to improve and increase ASIC's monitoring of the market, given that at 3 August 2009 there were 4,797 AFS licensees and 52,814 authorised representatives, there is a limit to how many people ASIC can have contact with and how many documents we can review. We also devote substantial surveillance resources to the illegal and unregulated area. We do not have sufficient resources to meet with every licensee (let alone every financial services provider) nor can we review every disclosure document. Therefore we have conducted targeted surveillances aimed at higher risk activities or issues we have already identified so that our surveillance activities can have greater impact.

Often contacting or meeting with a licensee or authorised representative will lead to a regulatory outcome in itself, such as where the licensee improves its compliance processes or rectifies a breach. However, in some cases, surveillance activities of themselves do not bring about a regulatory result and in those cases the impact of the activity will be limited by the action that ASIC is able to take based on the intelligence gained from the surveillance. If the intelligence is that the licensee is charging high fees, for example, then there is no breach of the Act for ASIC to take action.

Further information on ASIC's forward program in respect of surveillance activity can be found in Appendix 3 to ASIC's submission at [566] – [584].

ASIC 4 - Hansard p. 22

Senator BOYCE—Are there any comparisons you could make between those groups of people you are talking about—the ones who might use financial advisers versus stockbrokers et cetera? Are they different in any way?

Mr D'Aloisio—Well, they should not be, in terms of advice and their obligations.

Senator BOYCE—No, I am talking about the individuals, the investors. I am trying to get a sense of who investors are and if there is anything distinctive we can be saying about retail investors.

Mr D'Aloisio—We can take that on notice and give you a break-up as best we can. But generally speaking people might go to a stockbroker because they feel they want to invest in shares and get advice on funds management and so on, so it will vary, but we will see if we can get you that information, if it is available.

Senator BOYCE—I am just wondering if they are perhaps a less wealthy group, a less sophisticated group—well, I know sophisticated has an actual meaning, but perhaps it is a less sophisticated demographic that we are talking about here.

CHAIR—You will take that on notice, Mr D'Aloisio?

Mr D'Aloisio—Yes, we will.

Answer: ASIC 4 - Hansard p. 22

In answering this question, ASIC has relied on data from the ANZ Survey of Adult Financial Literacy in Australia ('the survey') published in October 2008.

Generally, the available data does not indicate that there is a relevant marked difference in the levels of sophistication of investors consulting financial advisers versus investors consulting stockbrokers. The data collected on both relative disadvantage and financial literacy of respondents, two measures that may be considered to be indicative of the sophistication of an investor, was largely consistent between investors consulting stockbrokers and those consulting financial advisers.

The survey did indicate that respondents who had consulted stockbrokers were more likely to own their home outright (57%) than respondents who had consulted a financial adviser (45%). Users of stockbrokers had an average household income of approximately $94,000 compared to users of financial advisers who had an average household income of approximately $82,000. These figures are, however, possibly influenced by factors other than the sophistication of the particular respondent and it is not necessarily accurate to equate wealth with sophistication in this context.

ASIC 5 – Hansard p. 22

Senator BOYCE—I have just one other question in that area. Is there anything specific that you might be able to tell us about ethnic or geographic groupings of investors?

Mr D'Aloisio—It will be hard, but we will try. We may be able to with Indigenous Australians. It will be a lot harder for ethnic communities and so on in Australia, but we will have a look and see what is available.

Senator BOYCE—Thank you.

Ms Rickard—There are some gender issues there, too.

Senator BOYCE—And gender, please.

Ms Rickard—It is more likely to be males than female who are using these advisers.

Mr D'Aloisio—Do you want to comment on that a bit more?

Ms Rickard—It is basically that more men will be using them than women. We have the stats, which we can provide you with.

Answer: ASIC 5 – Hansard p. 22

In answering this question, ASIC has relied on data from the ANZ Survey of Adult Financial Literacy in Australia ('the survey') published in October 2008.

It is difficult to draw specific conclusions from the data available on ethnic groupings of investors. 85% of respondents to the survey identified as only speaking English at home. The data available on investors speaking languages other than English is accordingly very limited. For example, the second highest single ethnic group[4] (by language spoken at home) was Italian, which constituted 2% of the total sample.

The data available on Indigenous investors is likewise limited. Only 2% of respondents were of Aboriginal or Torres Strait Islander descent.

In terms of gender, investors who had used a stockbroker were more likely to be male (59% of male respondents had consulted a stock broker, versus 41% of female respondents.) Users of financial advisers were generally evenly split between male and female (49% of male respondents versus 51% of female respondents).

In terms of geographic distribution, users of financial advisers were more likely to live in capital cities (67% in capitals versus 33% in non-capitals) than users of stockbrokers (57% in capitals versus 43% in non-capitals).

ASIC 6 –Hansard p. 23-24

CHAIR—Can you tell the committee when was the first time that ASIC was made aware, through any means—complaints or otherwise—of problems with Storm Financial?

Mr D'Aloisio—I gave a statement to Senate estimates in February where we had initially gone through our files of where the contacts were, and I can refer to that. What we said we would do and are doing is having all our files looked at and assessed and, as I said earlier, we will provide you with that complete chronology, because we are as anxious as you are to get this off our plate.

CHAIR—Not a problem—that is fine. I accept that. That is why I said 'can you'. If you cannot, that is not a problem.

Mr D'Aloisio—Okay. You will have it. We will discuss the confidentiality issue around it.

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[4] 3% of respondents spoke an Asian language (other than Cantonese, Mandarin and Vietnamese) and 3% of respondents spoke a European language (other than Spanish, Greek, Italian and German).

CHAIR—Were the people who ran or operated Storm and other companies, people of interest or people who had previously come across your system or under your oversight at any other point in time? Had these people come onto your radar, as it were, previous to their incarnation as Storm, for example?

Mr D'Aloisio—Again, it is not a question that it is appropriate to go into, because we are investigating—

CHAIR—Not a problem. That is fine.

Mr D'Aloisio—I will take it on notice but I cannot answer that.

Answer: ASIC 6 –Hansard p. 23-24

ASIC has reviewed its interactions with Storm prior to commencement of its formal investigations, including a review of complaints received about Storm. The findings of this review are set out in Appendix 5 to ASIC's submission, which was provided to the PJC on a confidential basis to avoid prejudicing our ongoing investigations in relation to Storm. Further information is provided in the confidential letter sent by ASIC to the Secretariat of the PJC of 28 August 2009.

ASIC 7 – Hansard p. 29

Senator MASON—Did you ever monitor Storm Financial's advertising?

Mr D'Aloisio—We would have to take that on notice.

Answer: ASIC 7 – Hansard p. 29

ASIC has reviewed its interactions with Storm prior to commencement of its formal investigations, including a review of monitoring and surveillance activities conducted by ASIC in relation to Storm. The findings of this review are set out in Appendix 5 to ASIC's submission and, which was provided to the PJC on a confidential basis to avoid prejudicing our ongoing investigations in relation to Storm.

ASIC 8 –Hansard p. 30-31

Senator MASON—But I just want to make sure this is clear. You do not monitor all advertisements?

Ms Rickard—No, we don't.

Senator MASON—And that is a resource issue rather than an issue of integrity. So ASIC would not have asked Storm in that case to correct or rectify—you have the powers to do this with advertising. That clearly never happened?

Mr D'Aloisio—I am not aware that we have taken any—we have powers for corrective advertising.

Senator MASON—I know that, but did you use those?

Mr D'Aloisio—I am not aware. We will look at it, but I do not think so. I do not recollect that we took action—as I say, we are struggling here to actually remember whether there were any ads to start with.

Senator MASON—Sure. Can you take that on notice?

Answer: ASIC 8 –Hansard p. 30-31

ASIC has reviewed its interactions with Storm prior to commencement of its formal investigations. The findings of this review are set out in Appendix 5 to ASIC's submission, which was provided to the PJC on a confidential basis to avoid prejudicing our ongoing investigations in relation to Storm.

ASIC 9 – Hansard p. 33

Senator MASON—How many times in, let's say, the last 12 months have you used coercive powers to remedy misleading advertising?

Mr D'Aloisio—When you say coercive powers, are you saying—

Senator MASON—How many times have used your powers? There may just be a friendly reminder or they may be coercive.

Mr D'Aloisio—We will take that on notice and give you a list, from really tough down to just a warning or something.

Answer: ASIC 9 – Hansard p. 33

How ASIC deals with false, misleading or deceptive advertising and marketing material

Both the Corporations Act and the ASIC Act contain offence provisions in relation to advertising and marketing material. See Table 17 in Appendix 2 to ASIC's submission.

ASIC has a number of regulatory options for dealing with advertising and marketing material which breaches or potentially breaches these conduct provisions. For example, ASIC can:

(a) stop the advertisement by way of an injunction or stop order;

(b) enter into an enforceable undertaking with the offending party;

(c) initiate a claim for compensation e.g. compensation for any loss suffered by a consumer as a result of being misled;

(d) apply for punitive orders requiring the publication of corrections or adverse publicity about the offending promoter;

(e) apply for a community service order or probation order;

(f) apply criminal charges; and

(g) cancel a promoter's AFS licence or adding more licence conditions following a hearing.

The regulatory response that ASIC uses will depend on the particular provision that has been breached. Often we can reach a regulatory result without using our coercive powers, e.g. where the promoter agrees to change its advertising.

ASIC deterrence in relation to advertising or promotional material

Over the last year, ASIC's Deposit Takers and Insurers team (DTI) has taken action 15 times in relation to advertising and marketing material for financial products including bank accounts, insurance and credit. Outcomes from this action include entities withdrawing their advertising, changing their advertising to comply with the law or in some cases taking other steps to address ASIC's concerns. For example, in 2009, ASIC raised concerns with Westpac Banking Corporation that some advertising for the Westpac Choice account was misleading, or likely to mislead, because it gave the impression that the promoted offer of no monthly fees would apply to all customers. In fact, the offer only applied to new customers. Westpac took a number of steps to address ASIC's concerns including making their offer available to all customers.

Over the last 12 months, DTI has also undertaken targeted monitoring of advertising for financial products such as bank accounts. In one case, this monitoring identified advertising concerns that were widespread across industry and a broader approach was adopted by ASIC to address these concerns, including writing to relevant peak industry bodies to distribute our concerns to their members.

ASIC 10 – Hansard p. 34

CHAIR—No, I mean giving people specific verbal advertisements, verbal advice such as, 'Our fund does XYZ'—marketing promotion in a verbal sense. At a seminar, for

example, you do not provide advice through any written form but you say: 'Our product is 100 per cent safe. Our product is absolutely secure. Our product never loses.' All I am asking is: do you take that as seriously—

Mr D'Aloisio—Of course we take it seriously. The issue is: how do you come to know about it? For example, if you are playing golf—

CHAIR—I am not asking you how you come to know about it. I am saying: once you do know about it, lots of people already know about it. I know about it, others know about it and others go to seminars where they hear about it. Do you then take action against those people who provide that verbal promotion, advertising, marketing—whatever you want to call it?

Ms Rickard—I think the answer to that is yes. We would need to go back and check but I am fairly confident that there are a number of issues, particularly in the seminar area, where we have. But we would need to confirm that and provide you with details.

Answer: ASIC 10 – Hansard p. 34

ASIC monitors seminars as a part of its ongoing compliance and surveillance activities. Where ASIC becomes aware of a seminar that it considers warrants further investigation, e.g. following an advertising campaign or a complaint, it may decide to send a staff member to anonymously review the content of the seminar. Further information is available in Appendix 3 to ASIC's submission at [566] – [576].

The content of seminars may be analysed to determine, e.g.:

(a) whether advice is being given without a licence;

(b) if advice is being given, whether the advice is limited to general advice and the appropriate warning is given; and

(c) whether the information being delivered is false, misleading or deceptive.

There is unlikely to be any action ASIC can take immediately in relation to a seminar if personal advice is not given and participants are given a warning that they are only getting general advice.

ASIC does not have all the relevant information to comment on how many times it has informally engaged with entities to reform seminar content and promotional strategies. However, a number of examples are provided on formal proceedings in which ASIC has achieved an outcome for investors.

In 2005, ASIC successfully obtained court orders against 21st Century Academy Pty Ltd and Mr Jamie McIntyre requiring both parties to stop or change the way they arrange, promote and hold live seminars in Australia.

In 2004, ASIC took action in four separate cases against entities promoting and presenting seminars:

(a) ASIC obtained undertakings from Vision Pursuit Pty Ltd (Vision Pursuit), the promoter of American Robert Allen's "One Minute Millionaire" seminar in Sydney. Neither Vision Pursuit nor Mr Allen held an Australian financial services licence (AFSL). Vision Pursuit undertook not to provide financial product advice other than in accordance with the Corporations Act.

(b) ASIC obtained undertakings from Inguz Pty Ltd (Inguz), trading as Pow Wow Events, the promoter of American John Burley's "Winning the Money Game" and "Automatic Wealth" seminars in Sydney. Neither Inguz nor Mr Burley possessed an AFSL. Inguz undertook not to provide financial product advice other than in accordance with the Corporations Act.

(c) ASIC obtained orders against Jack C. Weavers, the promoter of wealth creation seminars, and his company Oneworld Seminars Pty Ltd (Oneworld). The orders prohibit Mr Weavers and his associates from providing financial advice and specialised courses in contravention of the Corporations Act.

(d) ASIC obtained orders against five parties involved in the promotion and presentation of wealth creation seminars. The parties included Giann & Giann Pty Ltd, trading as Break Free Events (BFE), CTC Professional Services Pty Ltd and JTC Group Pty Ltd. The seminars promoted investment strategies based on exchange traded options and options indices and were held in Melbourne, Sydney, Perth, Adelaide, Brisbane and the Gold Coast. The Federal Court declared that representations made by BFE were false and misleading. The Court also made orders for corrective advertising and restraining similar future conduct by the parties.

A recent example of ASIC's seminar surveillance activity occurred in April 2009. Two ASIC officers attended a promotional session held by a licensed operator following an internal complaint. The seminar concerned the promotion of an educational tool to assist investors in forecasting market movements up to a year in advance. While it was considered that the seminar involved puffery as to the profits that could be made, the sessions were education-based and did not involve provision of financial advice.

As a part of its forward program, detailed in ASIC's submission, ASIC is committed to thematic reviews of advertising, including reviewing seminars. The program includes a campaign targeted at CFD and other over-the-counter derivatives. ASIC officers will be attending CFD seminars as part of a project directed at reviewing the way CFDs are advertised and sold to retail investors and comparing this information with complaints data. ASIC also has several enforcement matters and compliance projects focused on unacceptable conduct in the promotion of various products and trading systems.

Financial Ombudsman Service (FOS) (Melbourne hearing, 26 August 2009)

FOS 1 - Hansard p. 25

Mr PEARCE—Senator Mason has just touched on one of the areas that I was going to talk about. I visited the UK funds when I went to the UK a number of years ago. You talked about the need for some initial government funding or seed funding to establish it. That is what happened in the UK, isn't it? Did the government set it up there and then the industry took it over progressively? Have you had a look at that structure and an application in Australia?

Ms Maynard—Yes, we have.

Mr PEARCE—What sort of funding would be required to establish that?

Ms Maynard—I cannot remember the figures off the top of my head. Can I just refer to my documents?

Mr PEARCE—Yes. You could take it on notice and come back to us.

Ms Maynard—Yes, I will take it on notice.

Answer: FOS 1 - Hansard p. 25

As indicated in your email, I took a question 'on notice' in relation to the costs of a financial services compensation scheme and wish to take this opportunity to answer that question.

Specifically, The Hon. Chris Pearce MP asked, 'Have you had a look at that [United Kingdom Financial Services Compensation Scheme] structure and an application in Australia?...What sort of funding would be required to establish [a scheme]?'.

FOS's proposed financial services compensation scheme to assist vulnerable retail clients falls squarely within the Committee's Terms of Reference, having particular relevance to:

• Term of Reference 2 - the general regulatory environment for these products and services;

• Term of Reference 5 - the adequacy of licensing arrangements for those who sold the products and services;

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

• Term of Reference 9 - the need for any legislative or regulatory change. In answer to the question taken on notice:

• a short summary of our research into the costs of establishing, operating the fund, and compensating retail clients is set out in this letter;

• a comparison between the UK compensation scheme and proposed Australian compensation scheme forms Annexure A to this letter;

• a detailed Proposal to establish the Financial Services Compensation Scheme (October 2009) forms Annexure B to this letter; and

• research into Australian, United Kingdom and other compensation arrangements in the report entitled Retail Client Compensation for Financial Services Licensees (July 2007) forms Annexure C to this letter.

2. Failure of AFS licensees to compensate retail clients

(a) Enhancing consumer protection and restoring consumer confidence

In 2006, it became increasingly apparent to FOS (then the Financial Industry Complaints Service) whilst receiving complaints against licensees arising after the collapse of Westpoint, that consumers require particular protection where a licensee has become insolvent.

As FOS has stated in its first submission to the Inquiry, the current professional indemnity insurance arrangements for those who sell financial products and is not designed to provide full compensation. The Westpoint and Storm Financial collapses provide ample evidence of the severity of the impact of inadequate compensation arrangements on consumers.

FOS recommends that a compensation scheme be introduced to ensure that retail clients are compensated in the event that the AFS licensee from whom they purchased a product or service has become insolvent or disappears.

(b) Development of the proposed compensation scheme

In 2007 we commissioned an extensive research report into:

• Limitations of Professional Indemnity insurance as a consumer protection mechanism;

• Alternative compensation arrangements such as compensation schemes and mutual funds that are in place in Australia and in other countries;

• A compensation scheme that could be implemented to build upon PI, and to better protect consumers.

Over 2008 and 2009, we have continued to undertake extensive research to refine the design of the Compensation Scheme, including:

• Economic modelling on funding of a Compensation Scheme through a levy on licensees;

• Meeting with and collecting detailed data from the United Kingdom Financial Services Compensation Scheme;

• Cost estimates for the compensation and operating costs that the Compensation Scheme would be required to meet.

3. Outline of the proposed compensation scheme

FOS proposes a compensation scheme that would protect consumers and enhance their confidence. It would be:

• An industry-based scheme operated by an entity governed by the key stakeholders: industry and consumers;

• Funded by licensees through regular levies;

• Subject to approval by the Australian Securities and Investments Commission;

• Supported by the Government through the passage of legislation to require all AFS licensees to become members of the compensation scheme; and

• A scheme that covers gaps left by the reliance of the current protection regime on PI insurance by compensating retail clients in the event that a licensee becomes insolvent up to a level that reflects the financial jurisdiction of EDR schemes.

Further details of the proposed compensation scheme are included in Annexure B to this letter.

FOS believes that such a compensation scheme would help restore consumer confidence in the financial services sector, and would provide a fundamental plank in the consumer protection mechanisms afforded by financial services regulation.

4. Estimated costs of the compensation scheme

(a) Estimated 'average' annual compensation costs

It is estimated that compensation claims during an 'average' year would be in the order of $12 million.

This estimate is based on an analysis of our data on successful claims against Australian Financial Services (AFS) licensees that were not paid because the AFS licensees became insolvent. This assumes that in an 'average' year the compensation

scheme would be required to pay about 180 compensation claims of an average of about $65,000 each.[5]

(b) Estimated costs of establishing and operating a compensation scheme

It is estimated that the total costs of establishing and operating a scheme to the end of Year 1 would be $2.3m. This comprises $1.1m estimated establishment costs and $1.2m operating costs to the end of Year 1.

This estimate assumes that significant leverage would be achieved from the relationship between the compensation scheme and FOS[6] and that the compensation scheme would operate, with a core staff, for six months of Year 1.[7]

If claims were to continue to stay steady at about $12million, it would [be] reasonable to assume that operating costs for the full 12 months of Year 2 would be in the order of $2.4.

5. Funding of the compensation scheme

(a) Levy on industry

It is intended that the compensation scheme would be funded by industry through the following mix of pre-funding and post-funding:

• Operational costs and 'average' compensation costs would be pre-funded; and

• Exceptional compensation costs would be post-funded through a special compensation levy.

An economic model has been developed which demonstrates the way in which the levy would be distributed across AFS licensees.

This economic model shows that the levy can be carefully managed through various 'levers': the proportion of the total levy that is pre-funded and post-funded, the proportion of the levy that is imposed on those licensees that provide the same financial service as the licensee that is insolvent, the number of years over which the levy is struck; and the 'floor' and 'ceiling' levies.

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5 These assumptions are based on an analysis of our data over the past 2½ years. This data indicates that we made 78 awards which were not paid to the client due to the insolvency of the licensee. Based on anecdotal evidence there were a further 70 unpaid claims, and the FOS receives only about one third of the total claims.

6 It assumes that we would provide, at a fee, space within the existing FOS premises and essential support services.

7 For the first six months of the compensation scheme's operation, it is assumed that the compensation scheme would employ a Chief Executive Officer and a core staff of six, and includes the Board expenses.

For example, using the estimated Compensation Costs and Year 1 Costs set out above, industry would fund $12 million in claim payments and a further $2.3 in establishment and operational costs of the compensation scheme, that is, $14.3 million in total.

The parameter values used to calculate a levy of $14.3 million are:

• The levy applies to the whole industry;

• $250 minimum levy per annum;

• a $150,000 maximum per annum; and

• A single levy applies for one year.

The calculated levy, as a percentage of the 2007 revenue of AFS licensees is 0.023% of revenue per annum.

(b) 'Stress testing' of large claims

In addition to estimating the claims for compensation that the compensation scheme would receive in an 'average' year we have also 'stress tested' various other scenarios to establish how affordable a larger levy would be for AFS licensees.

For example, our economic modelling indicates that if the compensation scheme received notice of $200m in claims in Year A required to be funded over three years, and a further $100m in Year B which was also required to be funded over three years, then this would give rise to a levy just over 1% of AFS licensee revenue in each of the three funding years.6

(c) Other sources of funding

Eventually, the compensation scheme could recover some funds as a creditor in the winding up of AFS licensees. In order to do this the compensation scheme would make the payment of compensation to a retail client conditional upon an assignment of rights to pursue a recovery against the AFS licensee. If a claim under the AFS licensee's Professional Indemnity policy were successful, then this sum could become available to the compensation scheme in the usual course of the winding up.

In order to maximise the compensation scheme's flexibility to manage its cashflow, it would also have the power to borrow where necessary.

CPA (Melbourne hearing, 26 August 2009)

CPA Australia 1 – Hansard p. 67

Senator MASON—Tier two would not be subject to fiduciary duty, but it would still be subject to 945A.

Mr Davison—Yes. The tier one advisers may very well become quite a niche market. The question then is whether the public, as a whole, is going to have access to affordable advice.

Senator MASON—You are right. That is right for a policy issue. I just want to scheme out in my own mind how we are going to go. You can see where the evidence this morning has led us. You can see that you have two tiers, one with a fiduciary duty—fee for service—and then the other one. Do you follow this?

Mr Davison—You are going to have a full independent financial adviser who gives you financial advice independent of product and the second group will be product advisers that will sell you a product for your need.

Senator MASON—Without a fiduciary duty that still would meet the current Corporations Act.

Mr Drum—We are happy to have a look at the Hansard regarding what was said this morning and follow up with some written comments. We can take it as a question on notice if you like because it is from the hip, off-the-cuff remarks at the moment in understanding the detail.

Answer: CPA Australia 1 – Hansard p. 67

CPA Australia is supportive of the principle behind the tiered advice concept, that is, ensuring that the consumer understands the service they are being offered and that the advice is in the best interests of the consumer. However we believe that consumers are confused about who can provide them with financial planning advice. Introducing a new tiered advice model that would include further industry specific terminology and concepts will only add to this confusion. Therefore pursuing this option would need to be given careful consideration. It would also need to take into account any added cost, as this will ultimately be borne by the consumer.

A more appropriate option in our view would be to introduce a clear and concise disclosure statement similar to that currently under consideration by the Financial Services Authority in the UK. We believe this may offer a simpler and more cost effective alternative.

Under this proposal a financial planner who is restricted on what products they can recommend to a consumer would be required to provide a disclosure statement verbally to the client prior to any engagement.

The disclosure statement could simply be:

I am a [Firm X] adviser. The advice I can provide will be based on an assessment of your needs, however as part of that advice should I need to recommend a product, I am restricted to only recommending products from [name of provider].

It is important to note that financial planning requires the financial adviser to consider the client's objectives and take into account their client's specific circumstances in order to be confident that any advice they provide is in the best interests of the client, and will effectively aid the client in achieving their goals.

Product recommendations will form part of this advice process, but only after suitable investment vehicles and asset mixes have been identified and discussed. While the financial adviser may be restricted in the products that they can recommend to the consumer (for example limited to recommend products from a limited number of companies only), the restriction should not affect or influence the advice and strategy developed for the consumer.

This is an important and necessary distinction to demonstrate the value of the advice and show that the advice is independent from the recommendation of product.

For consistency and to avoid any possible confusion, CPA Australia would be supportive of prescribing a mandatory form of words for firms to use when they are explaining the restrictions in what products they are able to recommend.

Treasury (Canberra hearing, 28 August 2009)

Treasury 1, Hansard p. 14

Topic: STORM FINANCIAL

Senator McLucas asked:

Senator McLUCAS—I know you are not the compliance unit, in terms of ensuring that licensing regulations are there, but can you tell me when Treasury became aware that there was a problem with Storm?

Mr Miller—If you want an exact date we will have to take that on notice because we do not have the information with us.

Senator McLUCAS—I understand that. Also, can you tell me about the nature of the information that you received at that time?

Mr Miller—We will take that on notice as well.

Answer: Treasury 1, Hansard p. 14

Treasury became aware there was a problem with Storm on the morning of 17 December 2008 when the Office of the Minister for Superannuation and Corporate Law drew our attention to an article in the Townsville Bulletin of that date.

FPA (Canberra hearing, 28 August 2009)

FPA 1 – Hansard p. 39

Senator McLUCAS—How many members have you expelled from the FPA since its inception?

Mr Sanders—I can certainly attest to the fact that, in the last quarter alone, we have expelled five members. We have somewhere between 21 and 50 investigations that have progressed over the quarter. We have a range of sanctions and penalties available, of which expulsion is obviously the ultimate impact. We have had terminations of a further eight members, as I recall—and I think that data it is in our submission. We have an active investigations portfolio now. It is perhaps one of the busier aspects of the FPA's activity.

Senator McLUCAS—I make no judgment on that. It is just interesting to note the quantum of membership closures.

Ms Bloch—We certainly provided those statistics in relation to Westpoint, and our investigation process there has been completed. For the last two years we have been publicly publishing information on our complaints and disciplinary process. I am happy to provide the committee with the results for the last quarter or the last year if that would be of interest.

Answer: FPA 1 – Hansard p. 39

Thank you for giving us the opportunity to respond to Sen. McLucas's question on notice (FPA1 – Hansard p. 39). The Senator asked about the FPA's disciplinary statistics, with particular regard to expulsions. In response, we offered to provide the statistics on our complaints and disciplinary process, which we make available publicly in Financial Planning magazine.

Each quarter, the FPA publishes statistics and information on investigations and discipline for the preceding quarter. Statistics on investigations include the number of ongoing investigations as at the beginning of the quarter, the number of new investigations initiated during the quarter, the number of investigations closed during the quarter, and the number of investigations ongoing as at the end of the quarter. Information on discipline includes the number of members suspended, the number of members expelled, and the number of members subject to other sanctions, as well as the names of members subject to each form of discipline.

Information is also provided on the general nature of some particular breaches under investigation and/or for which a member is subject to discipline. We have attached excerpts from Financial Planning magazine, which contain discipline statistics for periods covering the financial year ending June 2009. In summary, fourteen (14) members were expelled over the course of the year, with five (5) expelled in the most recent quarter prior to the hearing in August.

Gus Dalle Cort (Cairns hearing, 1 September 2009)

Dalle Cort 1 – Hansard p. 13

Senator McLUCAS—So when your business was purchased by Storm, did all your clients move from your business?

Mr Dalle Cort—No.

Senator McLUCAS—What proportion didn't?

Mr Dalle Cort—Ninety-eight per cent of them.

Senator McLUCAS—So how many clients moved from MLC to Storm in that transition? I am just trying to get an understanding of the growth of the business over time from the point where the business was re-badged as Storm.

Mr Dalle Cort—I do not know. I would have to check the actual numbers.

Answer: Dalle Cort 1 – Hansard p. 13

It is not possible for me to answer this question as I do not have access to any information from Strom Nine that operated the Cairns Business.

I answered the question as if I had access to the available data.

I am sorry I was unable to assist any further.

Commonwealth Bank of Australia (Sydney hearing, 4 September 2009)

CBA 1 – Hansard p. 93

Senator WILLIAMS—Did you lend Storm $10 million in October just prior to that?

Mr Cohen—There was a drawdown of an existing facility in, I believe, September or October.

Senator WILLIAMS—To pay out a facility they had with Macquarie Bank?

Mr Cohen—I am not aware of the reason.

Senator WILLIAMS—Macquarie says in their submission that in October a facility was paid out to Macquarie. I believe it was a $10 million facility that you lent Storm in October 2008. You might be able to check on that for us.

Mr Cohen—We can certainly take that on notice.

Answer: CBA 1 – Hansard p. 93

During CBA's appearance at the Sydney hearing on Friday 4 September, Senator Williams raised a question (p CFS 93) about a $10M loan facility that CBA provided to Storm.

I can confirm the loan facility to Storm was approved by CBA to payout Macquarie Bank and provide funding for future acquisitions. The loan amount of $10.165m was funded on 29th October 2008.

Professional Investment Services (Sydney hearing, 4 September 2009)

PIS 1 – Hansard p. 118

Senator McLUCAS—What happened between the lender, yourself as the adviser and the client in terms of advising of the margin call?

Mr Evans—From my understanding, this was a situation where the lender advised both the client and the adviser. The reason the adviser likes to know is if there is a requirement to sell an asset people need to actually understand which asset they should be selling particularly around tax considerations and the type of investment. My understanding—and this may be wrong; I am not working day-to-day next to them—from the advisers I have spoken to is that the provider has actually contacted both the client and the adviser so they could then talk to them about which asset they would have to actually sell to prop up their current loan.

Senator McLUCAS—This is interesting. I wonder if you could do us a favour and confirm with the committee that that is accurate, because that would be very useful information.

Mr Evans—We will.

Senator McLUCAS—When you say the lender contacts the adviser and the borrower, how do they contact them? Is it a telephone call? Is it an email? Is it a letter in the mail?

Mr Evans—I would have to check on that. I remember being in a taxi coming back to an airport and actually having an adviser ring me about a particular issue. The phone call had been made to the client directly from the lender on that issue. But I would like to check to see whether that is actually common practice or whether that is just one instance where it actually happened that way.

Answer: PIS 1 – Hansard p. 118

Further to the committees request during Professional Investment Services' appearance at the Inquiry into financial products and services on Friday, 4th of September 2009 please find enclosed a sample of our margin lending experiences shared by members of the advisory network. The experiences have generally been quite inconsistent across the margin lenders with BT generally being the only margin lender to consistently contact clients (by way of mail, whilst also contacting advisers), whilst St George generally only contacted clients via phone in the instances in which they were unable to reach the adviser.

Colonial Geared Investments and Macquarie Leveraged Equities did not contact the client, only the adviser.

Margin Lender	Client Contacted by Margin Lender?	Adviser contacted by Margin Lender?
Macquarie/Leveraged Equities	No	Yes, via email
BT Margin Lending	yes via mail	Generally No
St George	Generally no, unless St George was unable to contact the adviser (in that instance they would contact the client)	Yes
Colonial Geared Investments	No	yes

ASIC (Canberra hearing, 16 September 2009)

ASIC 1 – Hansard p. 20

Ms GRIERSON—If there is a tighter regulatory regime, and if people breach that regime, what do you envisage would be the action, enforcement measure or penalty that might flow from that?

Ms Rickard—In terms of reverse mortgages—

Ms GRIERSON—I just mean generally in terms of the recommendations before us. I am talking about if they do not meet the provisions for mandatory advertising, if they do not have a disclaimer on their advice or if they do not meet the disclosure provisions.

Ms Bird—The details I will have to take on notice. The new credit bill which is before the parliament involves licensing and special obligations such as responsible lending. It is a licensing regime so it would give ASIC all the administrative powers that come with a licensing regime as well as other enforcement remedies. I am not familiar enough with the bill to be able to tell you what all the remedies are for the various forms of breaches of the legislation.

Answer: ASIC 1 – Hansard p. 20

ASIC's recommendations in its submission to the PJC Inquiry on Financial Services and Products (ASIC's submission) are not intended to increase the penalties for breach, but rather to strengthen the underlying regime. For example, ASIC has recommended that ASIC's powers to act against individuals be enhanced by amending the banning power in s 920A of the Corporations Act (see ASIC's submission at [91] – [98]).These recommendations, if implemented, would strengthen the regime by enhancing ASIC's ability to identify and ban individuals who are likely to cause investor losses and would result in ASIC's banning power being more like a 'negative licensing' power. They do not seek to change the form or substance of the penalty imposed i.e. the banning order.

There are already a range of penalties under the Corporations Act. Broadly, the penalties fall into one of three categories: criminal, civil or administrative.

(a) Criminal actions: criminal penalties can range from a fine to a period of imprisonment, or both.

(b) Civil actions: civil remedies include the imposition of civil penalties for serious contraventions of specific provisions (e.g. breach of director's duties), injunctive relief to restrain specific conduct or compel compliance with the law, corrective action to address misleading information and compensatory action to recover damages or property.

(c) Administrative actions: ASIC may undertake a range of administrative actions, including action to: disqualify or ban a person (after a hearing); issue a stop order notice for defective disclosure documents; or enter into an enforceable undertaking with a person.

Further information on ASIC's deterrence activities is available in Appendix 3 to ASIC's submission at [587] – [588].

The new credit regime will also implement a range of new penalties for which ASIC may take action within these broad categories. For example, ASIC may take:

(a) civil penalty proceedings in relation to a number of specific obligations on credit licensees including: failure to make reasonable inquiries about, and take reasonable steps to verify where appropriate, a consumer's requirements and objectives in relation to a credit contract and their financial situation before providing credit assistance; and failure to assess whether a credit contract will be unsuitable in light of particular circumstances, including the consumer's ability to service their obligations under the contract; and
(b) administrative action to ban a person from engaging in credit activities if they have contravened any credit legislation or been involved in such a contravention.

There is also a significant range of criminal penalty provisions that ASIC may refer to the Commonwealth Director of Public Prosecution for action.

Bank of Queensland (Canberra hearing, 16 September 2009)

BOQ 1 – Hansard p. 48

Mr Liddy—Initially in a loan application process there would be a statement of assets and liabilities given and a statement of income and outgoings as part of the normal loan process.

Mr ROBERT—Does any of that documentation require me, using that same hypothetical situation, to keep you abreast if my assets and liabilities fundamentally change?

Mr Liddy—To be honest, Mr Robert, I am not sure. I will take that question on notice and come back to you.

Answer: BOQ 1 – Hansard p. 48

Refer to the attached excerpt from our standard loan contract terms and conditions - Section 14, paragraph (k). In summary, the customer may commit an act of default but there is no positive obligation for them to advise the Bank if their circumstances materially change.

BOQ 2 – Hansard p. 55

Senator McLUCAS—Thank you for your earlier comments about how you deem who is going to be banker of the year. You indicated that it was on the range of sales of different products and deposits and the five elements of the bank's principles. Could you take on notice for me and provide me in writing how that is applied. How much is around—

Mr Liddy—The weightings?

Senator McLUCAS—The weighting on deposits, the weighting on integrity and how you measure those five separate elements.

Mr Liddy—We will provide that information to you.

Senator McLUCAS—Thank you.

Mr Liddy—There are certain gate openers. If you fail your audit or you fail your credit risk review, you do not get considered, regardless of what your sales performance is.

Senator McLUCAS—I do not know that we have time to go through it now, so if you can provide it on notice that would be great.

Mr Liddy—Certainly.

Answer: BOQ 2 – Hansard p. 55

The 'Branch of the Year' award is one of the sales and performance awards given as part of the Bank's annual recognition program. There are a number of awards as part of this program, which can be separated into two "buckets" - leadership and excellence awards, and sales and performance awards.

In line with the Bank's Code of Conduct, sales and performance awards are not considered in isolation from regulatory compliance requirements. There is no strict weighting on these criteria, except for the requirement that audit and compliance requirements must be passed for the year in question.

Sales awards in general are awarded to individual and team performers in Retail and Business Banking who have reached "Star" status through:

- their achievement of key performance indicators
- continuously 'living' the Bank's core values
- achievement of the core criteria of the award

These are assessed by the Executive team of the Bank, based on the year in question's sales results, any criteria such as the audit and compliance results for the year, and the Executive and senior management's personal knowledge of staff and their subjective view of their performance with respect to the Bank's values (passion, achievement, courage, integrity and teamwork). Given the small size of our organisation and the subsequent very high levels of personal interaction between Executives and senior management with all staff, this approach has been appropriate.

The specific criteria for the 'Branch of the Year' award is that it is given to the No. 1 branch for branch sales performance (as per the internally published leaderboard), that has also passed audit and compliance requirements. Assessment of the audit and compliance requirements are any branch audit reports for the year in question, and the regular branch "health checks" undertaken by the Regional Management teams.

"Sales performance" takes into account performance in the following areas: personal lending, home lending, business lending, equipment finance, deposit growth, insurance product sales, credit card sales, merchant facility sales and net customer number growth.

North Ward was awarded the "Branch of the Year" award in 2008. Declan Carnes has separately been awarded the "Branch Manager of the Year" in 2006 and 2007.

Macquarie Bank (Canberra hearing, 28 October 2009)

Macquarie Bank 1 – Hansard p. 9

Mr van der Westhuyzen—Our Ts and Cs say that we will seek to contact you or your nominated representative.

Mr ROBERT—Are those the exact words?

Mr van der Westhuyzen—They are not the exact words but that is the general thrust of the statement.

Mr ROBERT—Could you provide a copy of the exact words?

Mr van der Westhuyzen—Sure.

Answer: Macquarie Bank 1 – Hansard p. 9

Clause 5 of the Macquarie Investment Lending (MIL) Loan and Security Agreement deals with margin calls. Clause 5 does not, however, specify who will be contacted in the event of a margin call although it does make it clear that a borrower is liable to pay a margin call irrespective of whether or not any notice to pay is given by the Bank (clause 5.8). Clause 5 can be found at pages 24 and 25 of the attached brochure.

While the issue of contact in the event of a margin call was not specified in the Loan and Security Agreement, the following form of words does appear on page 15 of the attached brochure:

"A margin call requires prompt action. Macquarie will seek to contact you in the case of a margin call, but may take the action described below if we are unable to contact you. You can also nominate a Secondary Contact in case you are not contactable when a margin call occurs."

In addition, Section 11 of the application form ("Your Authorised Representative") says:

"The Bank will contact this person for instructions in relation to your Margin

Loan facility in the event that you are uncontactable, including if a margin call

is made and dealing instructions are required".

Macquarie Bank 2 – Hansard p. 13

Senator MASON—You notified Storm. How many clients directly?

Mr van der Westhuyzen—From the end of October we started to notify Storm clients directly. From that point through to the end of November, to give you a comparative period, there were 359 notifications directly to Storm clients.

Senator MASON—And of those margin calls how many were satisfied within 10 days?

Mr van der Westhuyzen—I could not tell you off the top of my head here but we can take that on notice.

Senator MASON—The committee would like to know that. Can you find that out and let the committee know.

Mr van der Westhuyzen—Yes.

Answer: Macquarie Bank 2 – Hansard p. 13

Of the 359 margin call notifications to Storm advised clients made between the end of

October 2008 through to the end of November 2008, 348 margin calls were satisfied

within the 10 day period.

Macquarie Bank 3 – Hansard p. 21

Senator BOYCE—I just have one question that you may have to take on notice. You mentioned earlier, Mr van der Westhuyzen, that there had been margin calls throughout 2008 on Storm client accounts. Could you just give us a list, month by month, of how many there were each month for 2008?

Mr van der Westhuyzen—I can either take that on notice or provide that information to the committee.

Senator BOYCE—I think that would be best on notice, thank you.

Answer: Macquarie Bank 3 – Hansard p. 21

Below is a table setting out month by month margin calls for Storm advised clients versus the total margin calls for Macquarie Investment Lending clients for the calendar year 2008:

Month	Storm	Total	Storm as % of Total
Jan-08	12	4,054	0.3%
Feb-08	0	1,728	0.0%
Mar-08	14	3,288	0.4%
Apr-08	1	724	0.1%
May-08	1	685	0.1%
Jun-08	3	2,708	0.1%
Jul-08	342	4,170	8.2%
Aug-08	81	1,738	4.7%
Sep-08	134	3,678	3.6%
Oct-08	921	11,133	8.3%
Nov-08	355	8,153	4.4%
Dec-08	47	1,894	2.5%
Total	**1,911**	**43,953**	**4.3%**

As confirmed to the Committee, at the end of October 2008, Macquarie had approximately 1,050 margin lending clients who were advised by Storm out of a total of approximately 22,000 margin loan clients.

Commonwealth Bank of Australia (Canberra hearing, 28 October 2009)

Commonwealth Bank 1 – Hansard p. 30

Senator MASON—Particularly in the period September through to October—I do not know if you can answer this, but we have got 2,600 all up between the beginning of October and the end of December—how many were addressed within the five-day limit response time?

Mr Cohen—I do not have the answer to that, and I am not too sure if any of my colleagues do?

Mr Comyn—No.

Mr Cohen—Perhaps we can take that on notice?

Answer: Commonwealth Bank 1 – Hansard p. 30

1) Of the clients who went into margin call between 1 October 2008 and 31 December 2008, what proportion were actioned within 5 business days?

In our submission of 31 July 2009, we acknowledged that we over relied on Storm to do the right thing. However, in respect of margin loans we do not believe it is reasonable to suggest that we sat idle for 11 weeks between October and December 2008.

We believe the following factors are relevant:
Ø As at 3rd October 2008, only 48 clients were in margin call with the average Storm LVR being approximately 71%.

Ø During the period 1 October 2008 to 31 December 2008 our records indicate that Storm would have received margin calls for almost all of their clients who had a margin loan with us and whose loans passed the margin call trigger point

Ø Storm wrote to its clients on 8 October 2008 advising them that it 'may be necessary to recommend that you switch up to 100% of your portfolio to cash.' Further, 'Should you go into margin call, the margin lender is likely to sell you down completely and pay down debt. This removes the ability of the portfolio to recover whilst you are still in buffer. The losses then are very real'

This communication by Storm to its clients was, in any reasonable view, a tangible indication that it was going to manage a measured sell down, as it had in the past, to the potential margin calls.

Ø While it will be the task of our Resolution Scheme to review the data on a case-by-case basis, our initial investigations indicate that most margin calls were responded to by Storm within 5 business days. Storm was initially very active, arranging two major tranches of redemptions in October 2008 totalling more than $700 million. This represented approximately 65% of all Storm funds under advice. We believe the redemptions could have been sufficient to clear the margin calls had the market not continued to deteriorate.

Ø Of those which were not actioned within 5 business days a significant proportion were delayed due to the freezing of the managed index funds in which the loans were invested.

Ø These funds were managed by a range of financial services organisations, including Colonial First State. The freezing of redemptions was considered necessary by the responsible entities of the relevant funds to ensure that all investors were treated equally.

Ø From September to November 2008, we and Storm remained in constant communication on the status of the outstanding margin calls. We were assured by Storm that they were taking appropriate steps to manage the margin call process.

Ø In November 2008, Storm was sending us daily resolutions for margin calls. They were addressing clients in negative equity as a priority and promising to address any residual margin calls. Storm provided further resolutions totalling more than $13 million in the first two weeks of November, and promised a further $8 million.

Ø When it became apparent that the action taken by Storm was insufficient, and, despite Storm's requests to the contrary and advising their clients not to cooperate with us, we commenced the unusual step of calling clients directly in December 2008.

Ø Consistent with the fact that clients dealt almost exclusively with Storm, further delays were encountered when numerous clients, verbally and in writing, advised they would not deal with us until they had consulted with Storm.

Our initial investigation concluded that the historic market volatility during this same period necessitates a case-by-case approach to assessing each customer’s situation. For example, in many cases a delay in actioning redemptions resulted in investors actually receiving a higher price than if they had been redeemed within 5 business days.

As we stated before the Committee, to the extent to which our customers’ hardship is a result of our shortcomings, they will be fairly recompensed via our Resolution Scheme.

Commonwealth Bank 2 – Hansard p. 33

Senator McLUCAS—Can you help the committee by providing us with some advice about when that change of policy was communicated, and how, to Storm Financial?

Mr Narev—I cannot give you any details. I would have to take that question on notice. I have not been able in my inquiry to determine exactly when the policy was changed.

Answer: Commonwealth Bank 2 – Hansard p. 33

2) When did we alter our policy of not notifying clients directly of a margin call? How was this change in policy notified to Storm?

During our 10 year association we were advising Storm directly if their clients entered margin call. Operational staff from both the Bank and Storm interacted on a daily basis in monitoring customer positions and dealing with margin calls, when they arose. Storm was in fact reticent for us to contact their clients directly as they wanted to control the relationship. They were also best placed to advise their clients on what was the appropriate action to take as they were the only party who had complete visibility of their client's financial situation and who was licensed to provide financial advice.

We advised Storm, as opposed to the customer, which is consistent with industry practice, the law and our terms and conditions that every customer is required to sign when applying for a margin loan. Our practice was to offer to the adviser that we also send written confirmation direct to their client, however this offer was rarely accepted.

Clarity around Storm's responsibility to contact their clients in relation to margin calls is supported by the submission to the Committee of a former Storm adviser and shareholder, Mr John Fuller. Mr Fuller provides evidence that, 'I was educated from the outset within Storm Financial that no client would ever receive a margin call direct from their margin lender. If maximum LVR's were breached or threatened, the margin lender would direct the call through Storm Financial.'

Commonwealth Bank 3 – Hansard p. 48

Mr Narev—In terms of how much of this was germane to Storm, in the period that we spoke about when we made just over 2,500 margin calls between October and December to Storm customers, we made over 16,000 through the same business to clients through other dealers.

Senator BOYCE—Are they proportionate? Are those 16,000 customers the same percentage as the 2,500 is of the Storm customers?

Mr Narev—I would have to take that on notice.

Answer: Commonwealth Bank 3 – Hansard p. 48

3) For other third party advisers which CGI also dealt, did the same proportion of their clients enter into margin call during the period 1 October 2008 and 31 December 2008?

As stated before the Committee, CGI deals with approximately 7,000 third parties. In the historic volatility of last year we had an issue with only one party. Further, we also understand that during this time there was only one financial planning group which had a catastrophic failure across its client portfolio. In both cases it was Storm. We believe that this is clear evidence that the problem lies with Storm, not the industry generally or us specifically.

Our customers who were advised by Storm went into margin call in proportionately far higher numbers than the approximately 40,000 other financially advised clients within CGI.