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Ms Toni Matulick  
Committee Secretary  
Parliamentary Joint Committee on Corporations and Financial Services  
PO Box 6100  
Parliament House  
CANBERRA ACT 2600  
[corporations.joint@aph.gov.au](mailto:corporations.joint@aph.gov.au)

Dear Ms Matulick,

## **Professional standards**

The Australian Bankers' Association (ABA) appreciates the opportunity to provide further comments to the Parliamentary Joint Committee on Corporations and Financial Services inquiry into proposals to lift the professional, ethical and education standards in the financial services industry.

### **1. Questions on notice**

The ABA received additional questions on notice from the Committee dated 29 October 2014. Our responses to those questions are set out in the table attached as *Appendix A*.

### **2. Further comments**

#### **2.1. AFS licensing for individual advisers**

There are currently three options for financial advisers to be authorised to provide financial advice. The financial adviser may elect to apply for an Australian Financial Services License (AFS Licence); elect to become an Authorised Representative of an AFS Licensee; or become a Representative of an AFS Licensee as an employee of that AFS Licensee.

Regardless of the source of the financial adviser's authorisation, the risk management, conflicts management and compliance arrangements that apply to providing financial advice do not change. A move to 'individual adviser licensing' will not introduce any additional consumer protections or lessen conflicts of interest, however, it is likely to result in additional compliance burden and costs, especially for some smaller financial adviser businesses, which would be required to establish their own internal compliance systems.

The personal liability of the financial adviser is different depending on the source of the authorisations, however, all financial advisers (Authorised Representatives and Representatives) have an individual obligation to comply with the requirements of the best interests duty and ASIC can take enforcement action against all financial advisers for breaching those obligations, including issuing banning orders.

Further, the introduction of the Financial Adviser Register will provide an appropriate mechanism to track all financial advisers. The Register will be funded by a registration fee paid to ASIC.

The introduction of individual licensing will have a substantial regulatory impact and add another layer of complexity and administration to the financial advice licensing regime. It is unclear the extent to which individual licensing would mirror the current AFS Licensing regime. Presumably the individual adviser licensing regime would carry with it the obligations of the current AFS Licensee, which will mean financial advisers will need to manage their own risk management, conflicts management and compliance arrangements. As well as introducing a substantial cost, there is potential for the development of inconsistent arrangements with associated poor consumer outcomes.

For these reasons, the ABA does not support a move to individual licensing.

The ABA would be pleased to discuss the contents of this letter in more detail.

Yours sincerely,

**Steven Münchenberg**

## Appendix A – ABA Response to Questions on Notice

Question on Notice		ABA Response
1. AFSL	a. How many licenses do each of your members have?	<p>Australian banks and banking groups maintain multiple AFS licences across a corporate group. Multiple licenses are held by the entity to support the delivery of a range of financial services, including providing retail banking and lending products and services; issuing financial products; providing custodial services; operating managed investment schemes; conducting market operations; and providing financial advice (including retail, corporate advisory, etc).</p> <p>For example, one large banking group operates 26 AFS licences, 12 of which have personal advice authorisations.</p> <p>Some organisations elect to operate a Corporate Authorised Representative model whereby a central AFSL is held and businesses or brands that require the same AFS Licence authorisations are authorised by the AFS Licensee as a Corporate Authorised Representative. The AFS Licensee has the same responsibility to ensure that compliance of the Corporate Authorised Representative as a natural Authorised Representative. The number of Corporate Authorised Representatives contributes to the scale of the financial services business and expands compliance and risk management arrangements required to satisfy the conditions of the AFS Licence.</p>
	b. What is the cost of each license for your members? Please include license fees and some information on costs to prepare applications and maintain licenses.	<p>AFS licensing costs vary depending on the scale, nature and complexity of the financial services business. The extent of the application, the compliance arrangements that underpin the AFS Licence and the ongoing audit and professional services requirements will be tailored to the requirements of the financial services and the risks associated with providing those financial services.</p> <p><b>Licence Application</b></p> <p>An AFS Licence application for a personal advice authorisation will require the development of a series of 'proofs' which require the applicant to describe the business, the competency of managers, risk management and compliance arrangements. Professional services fees for the</p>

		<p>preparation of an application can range up to \$150 000, in addition to internal resources and management time.</p> <p><b>Risk Management and Compliance</b></p> <p>The risk management and compliance arrangements that underpin the AFS Licence include employed risk and compliance professionals, IT systems to manage risk and control frameworks, breach and incident management systems, advice monitoring and supervision programs and corresponding reporting and governance processes. The nature, scale and complexity of the financial services business will determine the operational and organisational capacities needed. For example, a AFS Licence would operate the following for a large advice business:</p> <ul style="list-style-type: none"><li>• Risk and compliance function staffed with an appropriate number of risk and compliance professionals.</li><li>• Financial adviser monitoring and audit program with an appropriate number of audit professionals.</li><li>• Complaints management team.</li><li>• Investigations and incident management team.</li><li>• Advice vetting program (noting that the number of pieces of advice vetted is generally determined based on the adviser's experience, the risk associated with the advice (e.g. type of advice, type of product recommended, etc) and the complaints and compliance history of the adviser and AFS Licensee).</li><li>• Adviser training program, including RG 146 compliant training courses, additional educational qualifications, induction training, ongoing customer service and compliance training, continuing professional development (CPD), etc.</li><li>• Professional Indemnity (PI) Insurance or other compensation arrangements.</li><li>• Legal and professional fees to support the interpretation of AFS Licensing requirements,</li></ul>
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		<p>implementation of regulatory change, and the diligent management of breaches and incidents.</p> <p>The full-time employee (FTE) requirements and associated costs will differ across financial services businesses, however, the average FTE costs for the above employee functions ranges from \$115,000 pa - \$165,000. This does not include management costs.</p> <p><b>External Audit</b></p> <p>AFS Licensees are required to obtain an annual external audit opinion regarding compliance with the conditions of the AFS Licence. This opinion is prepared and lodged with ASIC as Form FS71.</p> <p>The audit fees vary considerably depending on the nature, scale and complexity of the financial services business. We have been provided with examples of AFSL audits costing approximately \$25,000 for each report.</p>
	c. What is the total fee payment for the licenses for each of your members?	Members have advised that they pay an annual licence fee of \$579 per AFS Licence.
2. Tier 1 financial products available to retail customers	a. What Tier 1 financial products are provided by your members?	Across the ABA membership, the full range of Tier 1 financial products is offered. The product offering of each member bank varies depending on business, operational and commercial considerations as well as the needs of their clients and their target client segment.
	b. What fee structures do your members use for Tier 1 financial products?	<p>Fees for investment products – superannuation, managed investment schemes, margin loans – generally comprise an administration fee and an investment management fee.</p> <p>These fees must be disclosed in the Product Disclosure Statement (PDS)<sup>1</sup>.</p>
	c. How are the fees and	The disclosure requirements for Tier 1 investment products are set out in Part 7.9 of the

<sup>1</sup> s1013D, Corporations Act 2001 (Cth).

	<p>investment risks associated with Tier 1 financial products disclosed to retail customers?</p> <p>Where possible it would be helpful if some examples from real financial products addition to a general description.</p>	<p>Corporations Act. These provisions require that a Product Disclosure Statement (PDS) (or a Short-Form Product Disclosure Statement) containing prescribed information is given to retail clients at or before the time when a financial product is offered or issued. Certain ongoing disclosure may also be required if material changes or significant events subsequently take place.</p> <p>A PDS must disclose, amongst other things:</p> <ul style="list-style-type: none"> <li>• information about any significant benefits and risks associated with holding the product<sup>2</sup>;</li> <li>• information about any other significant characteristics or features of the product or of the rights, terms, conditions and obligations attaching to the product<sup>3</sup>;</li> <li>• information about any cooling-off regime that applies in respect of acquisitions of the product (whether the regime is provided for by a law or otherwise).<sup>4</sup></li> </ul> <p>There is also a general obligation to disclose any other information that might reasonably be expected to have a material influence on the decision of a reasonable person whether to acquire the product.<sup>5</sup></p> <p>Typically, a PDS will include a general description about investment risk, accompanied by more specific descriptions and categories of risks.</p> <p><i>Example</i> (general description): All investments carry risk. Investment risk can be managed and even minimised but it cannot be completely eliminated. It is important to understand that not all risks are foreseeable. The likely investment return and the risk of losing money is different for each managed investment scheme as different strategies carry different levels of risk depending on the underlying mix of assets that make up each investment option. Those assets with potentially the highest long-term return (such as shares) may also have the highest risk of losing money in the shorter term.</p> <p>Descriptions of risks include terms such as stable, conservative, moderate, dynamic and</p>
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<sup>2</sup> 1013D(c)

<sup>3</sup> s1013D(f), *Corporations Act 2001* (Cth).

<sup>44</sup> s1013D(i), *Corporations Act 2001* (Cth).

<sup>5</sup> s1013E, *Corporations Act 2001* (Cth).

		<p>aggressive. These categories provide a description of investor risk profile. Additionally, a PDS will include an explanation of investment risks, including market risk, interest rate risk, currency risk, asset specific risk, international investments risk, credit risk, alternative investment risk, derivative risk, gearing and leveraging risk, product risk and illiquidity risk.</p> <p>The risks associated with the financial product or associated investment strategy or recommended by a financial adviser must also be disclosed in the Statement of Advice (SOA). The SOA must disclose, among other things, a statement setting out the advice<sup>6</sup>; information about the basis on which the advice is or was given<sup>7</sup>; and as much detail about a matter as a person would reasonably require for the purpose of making a decision about whether to follow the advice as a retail client<sup>8</sup>.</p> <p>In practice, the SOA sets out the client's relevant personal circumstances, including the client's 'risk tolerance' and demonstrates how the advice is aligned with risk tolerance. The key risks associated with the product are also published in the SOA.</p> <p>AFS Licensees have implemented detailed processes, questionnaires and face to face conversations to establish the client's risk tolerance and explain to the client the impact or consequences of their nominated risk tolerance.</p>
Funds frozen during or following global financial crisis	a. How many investment funds operated by each of your members in Australia were frozen?	<p>The ABA has not been able to identify the frozen funds operated by our member banks. As indicated during the ABA appearance before the Committee, other industry associations may be able to provide this information, especially those representing the funds industry.</p> <p>Managed investment schemes (MISs) can be offered by banks and banking groups or other financial services businesses. There are approximately 4,100 MISs operating in Australia. Of these, approximately 170 are currently closed to redemptions or 'frozen'.</p> <p>Notwithstanding the potentially serious impacts for investors with interests in frozen funds, the number of frozen funds does not represent a material proportion of MISs in Australia. The context in which these funds closed to redemptions was a series of external shocks that had global</p>

<sup>6</sup> s947B(2)(a) and 947C(2)(a), *Corporations Act 2001* (Cth).

<sup>7</sup> s947B(2)(b) and 947C(2)(b), *Corporations Act 2001* (Cth) and ASIC RG 175 *Financial Product Advisers - Conduct and Disclosure*, RG.168–RG 175.171.

<sup>8</sup> s947B(3) and 947C(3) *Corporations Act 2001* (Cth)

	<p>implications. Broadly speaking, closing funds to redemptions was driven by extreme volatility in global markets and investor demands for redemptions, and the corresponding liquidity challenges that posed for the funds.</p> <p>In addition to volatility in global markets, MISs can be impacted by the performance of the underlying assets. Specifically, for example, mortgage funds are pooled investments with exposure to the underlying assets (portfolio of mortgages), typically in the form of mortgage-backed securities (securitisation). During the global financial crisis, not only was there extreme volatility in global markets, but the domestic securitisation market was significantly impacted, primarily due to a loss of investor confidence in securitisation markets globally.</p> <p>Together with AFS Licensing obligations, Chapter 6 of the Corporations Act sets out stringent and prescriptive compliance and governance processes for Responsible Entities to manage illiquid funds and the process of closing funds to redemption. An important principle is managing the interests of all investors. Steps such as realising assets of the funds to meet the redemption requests of some members, would not be in the interests of all members. Frozen funds and investment options may be re-opened to allow withdrawal windows and/or determined to terminate and redeem units. As noted above, a PDS will disclose information about investment risks. In addition to disclosures about illiquidity risk and product risk, a PDS will typically include additional information about restrictions.</p> <p><i>Example:</i> The [fund] is subject to investment risk, including possible delays in repayment of withdrawal proceeds and loss of income and principal invested. [Bank] does not guarantee the capital value or investment performance of the investment options.</p> <p><i>Example:</i> The [bank] can suspend the withdrawal of your money in the unusual circumstance where an investment option is illiquid (that is, when the investment option's assets cannot be sold for their market value within the time periods specified under the constitution). While an investment option is illiquid, different withdrawal procedures will apply as specified under the <i>Corporations Act 2001</i>.</p> <p>In addition to the compliance and governance obligations that apply to the management of</p>
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		<p>stressed MISs, the funds industry has worked with ASIC to develop hardship relief that allowed for certain payments to be made to investors in hardship<sup>9</sup> and relief to allow access to capital for investors in frozen mortgage funds.<sup>10</sup></p> <p>Importantly, enhanced financial adviser education and competency standards are essential to improving the understanding of the operation of managed investment schemes, the associated risks, the suitability of the products for clients and the processes relating to distressed funds – including closing to redemptions.</p>
	b. What was the total value of each fund when it was frozen?	<p>The ABA has not been able to quantify the value of frozen funds operated by our member banks. ASIC may be able to provide this information.</p>

<sup>9</sup> <http://www.asic.gov.au/about-asic/media-centre/find-a-media-release/2008-releases/08-214-asic-facilitates-withdrawals-from-frozen-funds/>

<sup>10</sup> <http://www.asic.gov.au/about-asic/media-centre/find-a-media-release/2009-releases/09-269mr-asic-grants-conditional-relief-to-improve-access-to-capital-for-investors-in-frozen-mortgage-funds/>