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A Tale of Two 'Citi's — Is this the final leg of the conflicts journey?

Zein El Hassan CLAYTON UTZ

Main points

- As an investment bank, Citigroup argued that its contract with Toll stated that it was an independent contractor and not a fiduciary. Accordingly, it was not subject to the conflicts rules.
- Trustees of super funds and managed investment schemes are an established category of fiduciary relationship and cannot contract out of the conflicts rules.
- Financial planners, dealer groups and investment managers have the option to contract out. However, they have all undertaken to act on behalf of their clients and will be found to be fiduciaries on the facts. If so, they will be subject to the conflicts rules.
- Even so, the law permits each of those regulated entities to engage in related-party dealings, provided they can rely on one of three exceptions to the conflicts rules.
- Now is the time to test and strengthen your reliance on these exceptions. If you get it wrong, you risk reputation damage, statutory penalties and an account of profits.

Make no mistake, conflicts are inherent in the dealings within financial institutions, whether they are investment banks or wealth management businesses. Despite the conflicts, these dealings are permitted by law if the institution can rely on one of three exceptions to the conflicts rules, or contract out altogether.

However, there are many related-party dealings which have been structured without a proper appreciation of the exceptions to the conflicts rules. If you get it wrong, you may be exposed to reputation damage, statutory penalties and you may also be liable to account for profits.

That was the potential reality facing Citigroup when the Australian Securities and Investments Commission (ASIC) challenged the foundations of the investment bank: Australian Securities and Investments Commission v Citigroup Global Markets Australia Pty Ltd (No 4) (2007) 160 FCR 35; [2007] FCA 963; BC200704944.

Those foundations withstood regulatory and judicial pressure, as Citigroup was able to prove that it had contracted out of the conflicts rules altogether. This article considers whether the decision in the Citigroup case provides an answer for wealth management.

What are the conflicts rules?

There is a general principle of law that requires an account of profits where a fiduciary engages in certain conduct. While difficult to define, a person is a fiduciary where the law determines (using a number of different tests) that they are required, or have undertaken, to act on behalf of another person (called a duty of loyalty).

A fiduciary will be liable to account for profits where:

- they have placed themselves in a a position where their duty of loyalty conflicts with their personal interest or duty to someone else (no conflict rule); or
- they make an unauthorised profit from their fiduciary position (no profit rule).

For convenience, these two rules are referred to as the 'conflicts rules' in this article. These rules have found their way into a number of statutory provisions, all of which use different language and

have different consequences. The provision which found centre-stage in the Citigroup case was the conflicts management obligation for holders of an Australian financial services licence (AFSL) under Chapter 7 of the Corporations Act 2001 (Cth).

How do investment banks manage their conflicts?

ASIC shook the foundations of the investment banking community when it took on Citigroup, a global giant, and alleged that its conflicts were managed contrary to law. It alleged a breach of the AFSL conflicts management obligation, misleading and unconscionable conduct and insider trading under the Corporations Act.

However, all the allegations (except insider trading) required a finding that Citigroup was a fiduciary and breached the conflicts rules under the general law. The facts and the decision in favour of Citigroup are as follows.

Citigroup was an investment bank with many divisions. One of those divisions advised Toll Holdings on its proposed takeover of Patrick Corporation. On the other side of its Chinese wall, another Citigroup division was trading in Patrick shares for the benefit of Citigroup.

During a break in trading, the wall was breached and it was suggested to the share trader that it wouldn't look good for Citigroup to continue buying Patrick shares. The trader subsequently sold 20 per cent of those shares.

ASIC pleaded that Citigroup was a fiduciary. The share trading gave rise to a conflict between Citigroup's commercial interests in profiting from the share trading and its duty to act in Toll's interests in keeping the bid price down for the takeover. ASIC alleged that Citigroup needed to get Toll's fully informed consent (one of the exceptions to the conflicts rules) in order to trade in Patrick shares. As it didn't, ASIC pleaded that Citigroup was in breach of its conflicts management obligation under its AFSL and engaged in misleading and unconscionable conduct.

If Citigroup was a fiduciary, and ASIC was right, Citigroup would also be potentially liable to account to Toll for the profits made on the trading in Patrick shares. However, Toll did not complain nor seek an account of profits. Rather, it was ASIC who took offence to Citigroup's conduct.

Citigroup argued that its contract with Toll stated that it was an independent contractor, and not a fiduciary. Accordingly, it was not subject to the conflicts rules and did not need Toll's informed consent to the share trading.

The court agreed with Citigroup. As it had contracted out of being a fiduciary, the conflicts rules under the general law and under the Corporations Act did not apply to Citigroup. The case confirms that investment banks can simply contract out of the conflicts rules altogether. The contract is king!

Is Citigroup the answer for wealth management?

Wealth management businesses also breathed a sigh of relief following Citigroup's win. However, query whether they can adopt the same approach as the investment banks regarding the conflicts rules.

The regulated entities within wealth management businesses include trustees, financial planners, dealer groups, investment managers and life insurance companies. These entities either cannot contract out of the conflicts rules or have chosen to act on behalf of their clients and, accordingly, are subject to the conflicts rules as fiduciaries.

Trustees are in an established category of fiduciary relationship and cannot contract out of the conflicts rules. This applies to trustees of super funds and managed investment schemes.

Financial planners and investment managers are not an established category of fiduciary relationship. Accordingly, they have the option to contract with their prospective clients as independent contractors and not as fiduciaries, in the same way as investment banks deal with their corporate advisory clients. If they take this approach, they will not be subject to the conflicts rules under the general law. However, financial planners and investment managers continue to undertake to act on behalf of their clients and, accordingly, will be found by the courts to be fiduciaries on the facts and subject to the conflicts rules.

Life companies have a contractual relationship with their policyholders which are subject to certain statutory protections, but they are not fiduciaries. However, that should give little comfort if the life company is dealing with another related entity that is a fiduciary, such as a related trustee, financial planner, dealer group or investment manager. It is a commercial reality that various forms of remuneration are earned from services, investments and products provided by these related entities to each other.

If one of the entities is a fiduciary, their dealing with another group entity that derives remuneration from the dealing will be subject to the conflicts rules, and the entities will be liable to account for the profits arising from the dealing.

Exceptions to the conflicts rules

Even though the regulated entities within wealth management businesses are subject to the conflicts rules, the law permits them to engage in related-party dealings and keep the resulting remuneration if they can come within one of three available exceptions.

The first exception is that the conflict is expressly authorised by the trust deed or the contract that governs the relationship with the client. This exception is the foundation on which many products and services were built and offered by financial institutions. Its proper use permits related-party dealings and resulting remuneration. The attraction of this exception is that its use does not require the fully informed consent of the client. Rather, it just requires that the dealings are built into the trust or contract from the start.

Examples include where trust deeds lock in the use of related life companies as life insurers and investment managers. Financial planners can come within this exception if the contract with their prospective client discloses their related-party dealings and expressly authorises their resulting remuneration. Likewise for investment managers, the IFSA template investment management agreement expressly authorises related-party dealings and the receipt of remuneration from them.

The second exception is that the conflict is inherent in the circumstances

of appointment of the fiduciary from the start. This exception requires a finding on the facts and may not always be available, depending on the circumstances and, accordingly, is less certain in its application.

An example where the exception may apply is where the trust deed confers a discretion on the trustee, but the trust was built from the start as an investment with a related-party and offered as such to investors. Where the trustee is appointed to such a trust, the law will permit it to continue to act despite the conflict on the basis that the conflict was inherent in the circumstances of its appointment. This exception is likely to be a fall-back position for many related-party dealings within wealth management businesses.

The third exception is that the fiduciary has disclosed the conflict and obtained the fully informed consent of the client to act, despite the conflict. Given the need to obtain the consent of all beneficiaries, this exception is impractical for trusts with a large number of beneficiaries, and is rarely relied on by trustees. However, it may find some application with wholesale trusts with a small number of beneficiaries.

If an exception is available, the law permits the fiduciary to act despite the conflict. However, it does not end there for the fiduciary. The law still requires the fiduciary to properly discharge their duty of loyalty to the client in circumstances where the conflict still exists and may influence the fiduciary's actions. A breach of the duty of loyalty may give rise to a liability to the client for any resulting loss.

How effective is reliance on these exceptions?

If products and services are built and offered properly in reliance on one of the above exceptions, they are an effective answer to the conflicts rules. However, we have seen trusts and contracts where the effectiveness of their reliance on an exception is questionable.

There are trust deeds that use loose and generic language or retain some element of discretion for the trustee, rather than locking them into using a related party.

Some funds have replaced lock-in provisions with wide investment discretions, then invested through a related life company, which involves a conflict. Many funds contain open-ended discretions regarding administration and custody, and then appoint related parties to perform those functions without considering whether they should go out to tender or test their contractual terms against the market.

There are contracts which are signed well after the commencement of the relationship without any clear indication as to the basis on which the law sanctions the related-party dealings.

We have seen contracts that contain generic carve-outs with little detail regarding the proposed related-party dealings and remuneration. In many cases, the disclosure about related-party dealings and remuneration is made well after the contract comes into existence.

It is still possible that these related-party dealings can rely on the second implied exception to the conflicts rules. However, it requires a particular finding on the facts and, accordingly, is less certain in its application.

contributions

Contributions to the *Financial Services Newsletter* are welcome.

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Copy should preferably be presented as an email with an electronic copy of the submission attached.

What does this mean for the institutions?

Citigroup is not a complete answer for wealth management, as those businesses either cannot, or have not, contracted out of the conflicts rules. Related-party dealings within these businesses are only permitted if you can rely on one of the exceptions to the conflicts rules. If you get it wrong, the institution is exposed to reputation damage, statutory penalties and may be liable to account for the profits.

There is still a chance for a happy ending to this conflicts journey. However, it requires the institutions to test and strengthen the basis on which their wealth management businesses come within the exceptions to the conflicts rules.

One noticeable absence from the current landscape is ASIC. It hasn't made any comment on conflicts for some months now. However, it won't be long before it re-engages with industry on its favourite topic. In the meantime, the wealth management industry has an opportunity to make sure its house is in order. ●

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Recent developments in breach reporting

On 4 October 2007, the Australian Securities and Investments Commission (ASIC) and the Australian Prudential Regulation Authority (APRA) issued a discussion paper on a proposed online breach reporting system for dual-regulated institutions. Interested parties are invited to make submissions by 31 October 2007.

These proposals follow in the wake of the recent passage in Parliament of the Financial Sector Legislation Amendment (Simplifying Regulation and Review) Bill 2007. The new regime will apply a common platform to APRA-regulated entities, such that those entities will need to report significant breaches to APRA of not only provisions of a relevant piece of legislation, but also a prudential standard, a prescribed statutory direction, or a condition of an entity's licence or authority.

The regime, to become effective on 1 January 2008, proceeds on the basis of certain breaches being *immediately* reportable to APRA.

These are:

- breaches by a class of persons with auditing functions — where the person has reasonable grounds for believing that the company is insolvent (or there is a significant risk thereof) or an existing or proposed state of affairs may materially prejudice the interests of a class of depositors; or
- breaches where the breach relates to a general insurer or life insurer's financial obligations to policy holders or to the insurer's minimum capital requirements.

Other breaches of the legislation are subject to a materiality test — either the test of significance applicable to reportable breaches under s 912D of the *Corporations Act 2001* (Cth); or, in the case of insurers, additionally, a significance test where there is a matter which materially and adversely affects the insurer's financial position.

The time period for reporting significant breaches under both the ASIC and APRA regimes will be extended to 10 business days.

The legislation allows breaches reportable to ASIC and APRA by jointly regulated entities to be reported to APRA only, online. This online reporting will not apply to breaches referable to ASIC only. This initiative is voluntary. The reporting obligation to ASIC is also dispensed with where the Australian financial services licence holder is an APRA-regulated body and the auditor or actuary provides APRA with a written report on the breach.

The discussion paper extends these initiatives by:

- the proposed extension of the current ability of registrable superannuation entity licensees to report breaches to APRA online to allow authorised deposit-taking institutions and insurers to similarly report online; and
- the proposed ability of jointly regulated entities to report breaches to ASIC and APRA simultaneously online.

The discussion paper contains an attachment detailing procedures for the reporting process. There are six steps outlined in the attachment as follows.

1. An ABN is to be entered so that a tailored form can be created.
2. Identification details need to be entered to verify the origin of the form.
3. The form is then to be submitted to the nominated contact person within the regulated institution for verification and lodgement with APRA.
6. An email verifying the submission will be sent to the contact person and once approved by that person, the form will be considered lodged with APRA or ASIC.
5. A further email will be sent to the contact person acknowledging receipt and providing an APRA reference number.
6. Where the institution requests that ASIC be notified, APRA will send the relevant information to ASIC.

The online form procedures require HTML formatted emails. Additional material can be sent in single zip file. ●

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Corporations Amendment Regulations 2007 (No.12) — What's changed?

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Main points

- New authorised deposit-taking (ADI) franchise exemption from requirement to include details of an authorised representative's name and contact details in financial services guide (FSG).
- Specifies conduct that falls within FSG Public Forum exemption.
- Specifies the $15,000 threshold and method of calculation relevant to Record of Advice exemption.
- Specifies kinds of financial product that apply to the new provisions limiting liability for multi authorised representatives.
- Product disclosure statement (PDS) amendments in relation to PDS notification to the Australian Securities and Investments Commission (ASIC); replacement PDSs for stapled securities and definition of 'defective'.

The Government has now released *Corporations Amendment Regulations 2007 (No.12)* (Cth) (the new Regulations) as part of its financial services reform (FSR) simplification process. The new Regulations were registered on 28 September 2007. The following sets out the key changes.

Financial services guide changes

ADI franchise exemption from requirement to include details of an authorised representative's name and contact details in their financial services guide (FSG) commenced on 29 September 2007.

This change exempts a financial service provider from including details of their name and contact details in an FSG where:

- they are:
  - — a franchisee and a corporate authorised representative of an Australian financial services licence (AFSL) holder franchisor; or
  - — an employee of a franchisee of an AFSL holder franchisor; and
- the franchisor is an ADI regulated by the Australian Prudential Regulation Authority (APRA);
- the franchise agreement subjects the person to the franchisor's policies and requires compliance with the policies made to give effect to the franchisor's obligations under its AFSL; and
- the franchisor's FSG explains that the franchisor takes responsibility for the services provided by the person.

This regulation seeks to avoid the need to produce individualised FSGs identifying the name and contact details of individual franchisees that are corporate authorised representatives, or individual employees of franchisees of ADIs only.

It is not clear why only franchisees of ADIs obtained this relief, as it would have equally benefited other franchisor licensees.

FSG Public Forum exemption

This is applicable on a day to be fixed by Proclamation, but no later than six months from 28 June 2007.

Section 941C of the *Corporations Act 2001* (Cth) provides that a providing entity does not have to give a retail client an FSG if they provide general advice to the public, or a section of the public in a manner prescribed by regulation.

This regulation sets out the manner in which general advice must be given to the public in order for this FSG exemption to apply.

The circumstances are:

- providing general advice to the public, or a section of the public, at any event organised by or for financial services licensees to which retail clients are invited (giving a public lecture or seminar for retail clients, including employees of a workplace, is given as an example);
- a broadcast of general advice to the public, or a section of the public, that may be viewed or heard by any person (television or radio broadcasts is given as an example); and
- distributing or displaying promotional material that both provides general advice to the public, or a section of the public, and is available in a place that is accessible to the public (distributing promotional material contained in newspapers and magazines is given as an example).

Record of advice changes

This is not applicable to general or life insurance and derivatives; or to superannuation and retirement savings account (RSA) products the client doesn't hold an interest in. Commenced on 29 September 2007.

Personal advice triggers the requirement to provide a statement of advice (SoA) subject to various exemptions. The *Corporations Legislation Amendment (Simpler Regulatory System) Act 2007* (Cth) (SRS Act) introduced a threshold into the SoA requirements, so that a full SoA will only be required if the advice given is in relation to an investment amount that is above a certain monetary threshold (small investment advice).

The threshold and the method of calculation for various product types have

been set at $15,000 by new reg 7.7.9A.

The adviser is instead permitted to provide a record of advice (RoA) to the client and must keep the RoA.

If the personal advice does not include a recommendation to purchase or sell a financial product, and no remuneration is received by the adviser, the RoA must set out:

- the advice given to the client by the providing entity;
- brief particulars of the recommendations made and the basis on which the recommendations are made; and
- the information that, if an SoA were to be given, is required in the statement by ss 947B(2)(d) and (e) or ss 947C(2)(e) and (f) of the *Corporations Act* (that is, the required remuneration and interests information).

In all other cases the RoA must include:

- brief particulars of the recommendations made to the client, and the basis on which the recommendations are made;
- brief particulars of the information required by subss 947D(2) and (3) of the *Corporations Act* if the advice recommends replacement of one financial product with another (that is, disclosure of applicable charges, pecuniary interests and significant costs); and
- the information required by ss 947B(2)(d) and (e) or ss 947C(2)(e) and (f) as if an SoA were given to the client (i.e. the required remuneration and interests information.

The RoA is required to be given to the client when or as soon as practicable after the advice is provided, and in any event before the providing entity provides the client with any further financial service that arises out of, or is connected with, that advice.

If the RoA is not provided at the time the advice is provided, the client needs to be given at the time a statement containing:

- the information required by ss 947B(2)(d) and (e) or ss 947C(2)(e) and (f); and
- the information required by s 947D (if applicable) relating to additional information when the advice recommends the replacement of one product with another.

> Personal advice triggers the requirement to provide a statement of advice subject to various exemptions. ... a full SoA will only be required if the advice given is in relation to an investment amount that is above a certain monetary threshold (small investment advice).

Where a client expressly requests a further financial service to be provided immediately, or by a specified time, and the further financial service is related to the investment advice given to the client, and it is not reasonably practicable to give an RoA to the client before the further service is provided, then the RoA must be given:

- within five days after providing the further advice or as soon as practicable; or
- if the further service is the provision of a financial product and s 1019B (cooling off period) applies to the acquisition, before the start of the cooling off period or sooner if practicable.

Liability for authorised representatives

Commences on a day to be fixed by Proclamation but no later than 6 months from 28 June 2007

The SRS Act made changes to the joint and several liability of financial services licensees for the conduct of their authorised representatives in relation to different kinds or sub-classes of financial product. This regulation specifies the kinds of financial product those new provisions apply to:

- motor vehicle insurance;
- home building insurance;
- home contents insurance;
- sickness and accident insurance;
- consumer credit insurance; and
- travel insurance.

These changes and the SRS Act changes do not appear to have covered all relevant gaps, but it is an improvement.

It has not been expressed to apply to personal and domestic insurance in reg 7.1.17.

PDS changes

Notification to ASIC of PDSs

Commences 1 July 2008.

In the SRS Act, the requirement to notify ASIC of statements (PDSs or supplementary PDSs) that did not need to be lodged with ASIC was amended to require notification from 1 July 2008 when any 'change is made to fees and charges set out in this Statement'. This was too broad and it has been amended by a new regulation to read when a change is made to the fees and costs template required by the enhanced fee disclosures contained in the PDS, rather than simply the fees and charges set out in the PDS.

The enhanced fee disclosures refer to the requirements for the disclosure of fees and charges in PDSs for superannuation and managed investment products. The Fees and Costs template is a standardised fee template that simplifies the disclosure of fees and costs and allows for more effective comparison across products. The template is set out in items 201

and 202 of Sch 10 to the *Corporations Regulations 2001* (Cth).

Replacement PDSs for stapled securities

Commences 29 September 2007.

The SRS Act allows the use of a replacement PDS to correct errors and omissions in a PDS for listed stapled securities. The new Regulations clarify that a licensee must include its licence number whenever it identifies itself in a replacement PDS.

Definition of 'defective' relevant to PDSs

Commences 29 September 2007.

A new Regulation clarifies that the definition of 'defective' in s 1022A applies to replacement PDSs, and makes a change providing that non-compliance with s 1013A (which provides that the PDS must be prepared by the issuer) results in the PDS being defective. Otherwise the definition of defective was unchanged. ●

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Do you need PI Cover?

John Bassilios and **Harry New** HALL AND WILCOX

New compensation requirements were introduced by Reg 7.6.02AAA of the *Corporations Regulations 2001* (Cth) (the Regulation) on 28 June 2007. These requirements apply to Australian financial services licence (AFSL) holders that provide financial services to retail clients.

The new obligations under the Regulation will commence on 1 January 2008 for new licensees (that is, those persons granted a licence from 1 January 2008), and 1 July 2008 for existing licensees.

The Regulation provides that the primary method of compliance with the obligation is for licensees to obtain professional indemnity insurance, and that the level of cover should be 'adequate'. However, some licensees may rely on alternative arrangements or guarantees from a related company who is regulated by the Australian Prudential Regulation Authority (APRA).

The Regulation provides that the following matters must be taken into account when determining whether professional indemnity insurance is adequate:

- the licensee's membership of a dispute resolution scheme taking into account the maximum liability that realistically has the potential to arise in connection with:
  - — any particular claim against the licensee;
  - — all claims in respect of which the licensee could be found to have liability; and
- relevant considerations in relation to the financial services business carried on by the licensee, including the:
  - — volume of business;
  - — number and kind of clients;
  - — kind or kinds of business; and
  - — number of representatives of the licensee.

However, general insurance companies, life insurance companies and authorised deposit-taking institutions regulated by APRA are exempt from the compensation requirements. Licensees who are related to exempt APRA-regulated entities are also exempt where they have a guarantee in place from the APRA-regulated entity that has been approved by the Australian Securities and Investments Commission (ASIC).

The Regulation also provides that security bonds previously lodged with ASIC may be discharged or returned by ASIC where:

(1) the licensee certifies, in the form approved by ASIC, that it holds professional indemnity insurance, or has an alternative compensation arrangement in place that:
  (a) provides compensation protection for clients of the licensee that is adequate to cover claims to which the security bond could apply; or
  (b) together with other financial resources available to it, provides compensation protection for clients of the licensee that is adequate to cover claims to which the security bond could apply;

(2) the licensee is a general insurance company, life insurance company or authorised deposit taking institution regulated by APRA; or

(3) the licensee certifies, in the form approved by ASIC, that it holds a guarantee given by a company or institution mentioned in paragraph (2) that, together with other financial resources available to it, provides compensation protection for clients of the licensee that is adequate to cover claims to which the security bond could apply.

On 23 July ASIC released a consultation paper on its proposals for administering the Regulation. In general, ASIC has proposed the following.

(1) A licensee's professional indemnity (PI) insurance policy should have a per claim limit at least as high as the maximum monetary limit that applies to their external dispute resolution scheme (EDR) scheme(s).

(2) For insurance brokers, the policy should maintain the *aggregate* amount of cover which would have been required under the superseded *Insurance (Agents and Brokers) Act 1984* (Cth).

(3) For other licensees:
  (a) the appropriate measure of a licensee's size is the total gross revenue derived from the licensee's dealings with retail clients; and
  (b) the minimum *aggregate* cover should be assessed on a sliding scale as follows:

— for licensees whose actual or expected revenue from retail services is up to $1 million – minimum $2 million cover;

— for licensees with revenue greater than $1 million – minimum cover should be two times actual or expected revenue from retail services (up to a capped minimum of $20 million cover).

(4) The policy objective and the legislation require the following as key features of an adequate PI insurance policy:

(a) the policy must cover loss or damage suffered by retail clients because of breaches of obligations under Ch 7 of the *Corporations Act 2001* (Cth);

(b) the policy must cover breaches by both the licensee and its representatives;

(c) the policy must be available to cover compensation awards made by the EDR to which the licensee belongs; and

(d) as far as possible, the policy must continue to provide cover for a period of time after the licensee ceases business (for example, run-off cover).

ASIC has commissioned research which indicates that current polices in respect of PI insurance products would not be adequate for ASIC's purposes, in general, because of certain exclusions, such as fraud, representatives acting outside the scope of their authority of and products not being on an 'approved product list'. In these circumstances ASIC has proposed that any shortfall be made up by a licensee using its own financial resources. ASIC has proposed a procedure which will help licensees assess whether or not they have adequate financial resources to meet such claims. It is envisaged that this requirement will need to be addressed in Regulatory Guide 166.

ASIC will accept applications for alternative arrangements to be assessed on a case-by-case basis. However, alternative arrangements will not be approved unless they provide no less protection than adequate PI cover.

The consultation paper sought feedback on:

- ASIC's proposed policy on what is adequate professional indemnity insurance cover;
- some challenges to the regime and some practical options responding to these challenges;
- ASIC's proposed guidance on how licensees should approach the new requirements; and
- ASIC's policy for approving alternative arrangements to professional indemnity insurance.

Comments on the proposals closed on 14 September 2007. ●

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FSR Industry FORUM

Ensure your compliance program is workable

Peter Cashel PARAGEM PARTNERS PTY LTD

This article is designed as a refresher, and may prompt a review of the compliance program within your business.

In the context of financial services businesses, compliance operates at two levels:

- first, compliance with the regulatory requirements that are imposed on both a licensee and the industry as a whole; and
- second, compliance with internal systems of control that are imposed by the licensee to achieve compliance with the regulatory requirements.

Section 912A of the *Corporations Act 2001* (Cth) requires that financial services licensees comply with particular obligations that are designed to underpin the primary requirement of operating fairly, honestly and efficiently. It is up to the licensee to have in place reasonable procedures to ensure compliance with s 912A.

There is a fundamental principle of compliance with the financial services reform (FSR) requirements: *you must comply* — there are no half measures. Non-compliance is a breach, and the *Corporations Act* is unambiguous regarding the penalties that can be imposed for non-compliance.

Reviewing the business activities and the corresponding FSR requirements is essential. ASIC Regulatory Guides 104 and 105 are required reading for all Responsible Managers, directors and compliance staff. Each licensee should identify those areas of its business that are likely to cause non-compliance, and will therefore require a higher level of supervision and monitoring, through to areas that may be regarded as lower risk and, although they require monitoring, that monitoring may not be on a continuous basis.

Identifying risk

So what is low risk? One example relates to the primary requirement of the financial requirements imposed on a licensee — the requirement to be cash positive at all times. To ensure that a licensee is literally cash positive at all times may suggest that the cash flow projection is reviewed every day. But if a licensee has completed a three-month projection with accuracy, the risk of non-compliance will be low and there is no need for a daily cash flow review. However, I would expect that a licensee would need to develop a list of indicators or triggers that would signal a review of the financial resources was required, for example, the receipt of an invoice in excess of a particular dollar amount.

As a starting point in identifying risk, ask yourself the following question: 'Can any part of the way we operate jeopardise our clients' position?' Then measure the inhouse procedures against the legislative requirements. Risks to clients need to be identified and properly addressed by the compliance program.

Providing inappropriate advice will jeopardise a client's position and is high risk to the licensee, therefore there must be procedures in place to ensure that only appropriate advice is provided. This will include, but is not limited to, ensuring that representatives:

- have received training in respect of strategies and products;
- are competent in record keeping;
- know how to conduct research and keep working papers;
- are aware of what documentation is required; and
- that they can write a clear, concise and effective statement of advice (SoA).

If you do have an issue that ends up in court, not only the law will be taken into consideration but, in some instances, broader industry practices.

Once the licensee is satisfied its representatives have met these standards, it must do what is probably the most important thing, but is often regarded as the least important — and that is to check if the representatives are actually doing what they are supposed to be doing.

The goal is to be able to operate a business that can be successfully integrated with the regulatory requirements and operate within a culture of compliance. For some, this is not as easy as it sounds. So many licensees have the attitude of 'I run my business the way I want to, I'm not doing anything wrong, my clients love me'. The trouble is, there are trustworthy and lovable advisers who have been banned or are in jail.

I would like a dollar for every time a licensee or adviser has said 'I've had no complaints from clients, therefore I must be doing everything right'. The number of complaints received (or not received) is but one indicator of the effectiveness of a compliance regime, but it does not mean that the business is compliant. In some instances clients don't complain, they just change advisers or they do not realise that the position they are in is cause for complaint.

Some may say that compliance is costly, time consuming and doesn't add value to the business. If it is costly, time consuming and not adding value, your compliance regime may be inefficient. On the other hand, a good compliance program will enhance quality, reputation and profitability.

Risk management and compliance program

ASIC requires that every licensee has in place a documented risk management and compliance program and that the program is followed. Every licensee is required to consider its particular business operation and licencse authorisations, and to:

- identify the risks that the licensee faces;
- design and implement controls to protect the licensee from those risks; and
- monitor the effectiveness of those controls

Both risk management and compliance programs must be based on the respective Australian Standards (AS/NZS 4360:2004 Risk Management and (AS3806-2006: Compliance Programs. It is expected that licensees will use the standards in planning and implementing their programs.

Document your program

A compliance program must be documented. This can be one document or a series of documents, be it a compliance manual or various policies. Documenting the program and having it signed off by management may seem burdensome, but a document is the only way to give the program credibility and gives staff the ability to refer to the requirements as needed.

Monitor your program

Monitoring the program to ensure its relevance is essential and should take place at least annually. However, there are other occasions, such as changes to the Act, ASIC policy or the business operated by the licensee, that should prompt the licensee to review the procedures and the program to ensure any new requirements will be complied with. When changes do occur without notice, the compliance officer should immediately review the program and recommend changes and ensure that representatives are aware of the new requirements. Without appropriate monitoring, the program may become useless.

Where a breach of the same obligation occurs time and again, there is something wrong. The compliance procedures will require review to determine why the breach occurs, and the procedure changed to prevent reoccurrence of the breach.

Ensure your program is effective

If the policies and procedures of a program don't fit the particular business, the program is ineffective. There have been a number of cases where licensees have attempted to rely on a compliance program, only to be criticised for its ineffectiveness and inappropriateness. A licensee with two or three employee advisers in the same office will have quite different procedures in place to ensure compliance from a licensee with a national network of Authorised Representatives.

The licensee presumes that the policies and procedures must be right because a lawyer or consultant has written them— and they are in that they repeat the requirements of the *Corporations Act,* but what is missing at times are the procedures the particular licensee has in place to ensure it complies with the *Corporations Act*. It would have been cheaper to by a copy of the Act, or cheaper still to find it on the internet.

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When we conduct a licensee review we test the procedures written in the licensees, policies or compliance manual that are designed to ensure compliance. A simple example is this:if it states in the manual that only particular advisers can provide advice on margin lending I ask, 'who are those advisers?' and the compliance officer usually gives us a list of names. When I ask, 'How do you ensure that these advisers are the only advisers that provide advice on margin lending?' I usually get a response like, 'Well, it says in the manual that only these advisers can and every adviser has read the manual'. My reply is, 'Prove to me that every adviser has read the manual and then prove to me that only the approved advisers provide advice on margin loans.' This conversation can go on for an hour.

Reasonable procedure

So what's a reasonable procedure, because that is all that is required by the *Corporations Act* to ensure compliance with this internal requirement? It's pretty simple, give each representative written authorisation as to what products, including margin lending, they can and cannot advise on and deal in.

A reasonable way to ensure that a representative has read the compliance manual is for each representative to acknowledge in writing that they have read and understood the contents of the manual. You may wish to go further and have the representatives answer a few written questions about the manual's contents to ensure they understand its requirements.

I recently reviewed a licensee that has around 65 Authorised Representatives nationally. I was presented with a supervision and monitoring policy, written by a law firm, that was about 100 pages long and very nicely bound. I was surprised to find that it actually contained what I thought were procedures designed to ensure that representatives complied with the Act and the internal requirements.

However, like some that are produced, by page 30 I started to question what it was all about, and if any of the procedures were being carried out. I actually felt concern for the compliance manager. In respect of one requirement this person had to write seven different compliance reports a month about the same thing to different people, apart from the other procedural requirements. After testing the requirements as stated in the manual there was no evidence that a number of other procedures, including ensuring representatives were compliant, were being followed. The procedures in the policy looked impressive, but it was unworkable.

It was my view that the compliance procedures, even though tailored for this licensee, were disjointed and contained too many unnecessary and impractical requirements. Because they could never be complied with effectively, they were not carried out, and the policy sat gathering dust. However, the compliance officer, although not following the procedures in the policy, did instigate a compliance program and was aware of what was going on, and did try to create a compliant culture with the available resources.

The compliance officer and the board of that licensee have now developed a reasonable, manageable and relevant compliance program and the compliance officer sleeps at night.

Of the reviews we have conducted, probably 80 per cent of licensees did not comply fully with the requirements of ASIC Regulatory Guide (RG) 166. My suggestion to every licensee is to ensure that the Responsible Manager and the licensees accounting staff read RG166 and follow the requirements, in particular the cash projection.

Who is going to ensure the business is compliant?

RG104 and RG105 address the issue of separating compliance from other business functions. Depending on the nature, scale and complexity of a licensee's business, it may be appropriate for a licensee to have a separate compliance function.

While not all licensees will require a full-time compliance officer, those that carry out the function, be it the Responsible Manager or a senior manager, must understand what the role requires.

What duty, objective and responsibility does a compliance officer fulfill?

The compliance officer has a duty to the licensee to work with management and staff to identify and manage regulatory risk.

The overriding objective of a compliance officer is to ensure that a licensee has internal control systems that are reasonable, and to adequately measure and manage the risks that it faces.

The general responsibility of the compliance officer is to provide a compliance service that effectively assists business units to comply with relevant laws and regulations and internal procedures.

Representatives are also responsible for compliance. It is they who must be compliant in performing their relevant duties.

The person responsible for compliance should be unfettered in carrying out the duties and there should be no conflicts of interest. They should have access to relevant records, both in respect of the licensee and any representatives, be adequately resourced and report directly to the board. There should be no interference from sales or line managers.

It should be recognized that compliance and risk management are two components of one overall process. They are not distinct, even though adaptations need to be made to some normal risk management methods because of compliance requirements.

Difference between risk management and compliance

In formulating a compliance program for a financial services business, the difference between risk management and compliance should be understood and a risk assessment of the business undertaken. In conducting that assessment, a licensee should consider the following.

In compliance, a licensee must seek to eliminate the risk — in most risk management programs you reduce or control the risk to the extent that is acceptable.

The need to eliminate risk means that you cannot decide to retain part of the risk.

In financial services you cannot transfer the risk by outsourcing compliance — it always remains the licensee's risk and duty to comply.

A licensee cannot 'accept' the risk of non-compliance — that is, do nothing and run with the risk.

A licensee cannot elect to take steps to eliminate a legal risk on the grounds that is rated a low risk or unlikely to occur.

A compliance policy must state that the law will be observed at all times, whereas risk management policies will state that risks are to be controlled to the extent acceptable to the business.

The risk to a licensee of advisers not conducting research or providing a financial services guide (FSG) or a SoA when required, for example, is a risk that cannot be tolerated. Procedures must be in place to ensure research is conducted and an FSG and SoA are given to clients.

On the other hand, the risk of a business being burgled cannot be eliminated, but it can be controlled by having doors that lock and documents in locked cabinets. The processes in place to prevent a burglary have been assessed and deemed appropriate and the risk of burglary has been reduced to an acceptable level by the business.

In conclusion, effective compliance requires consistent effort, detailed procedures and methods, together with leadership dedicated to promoting the required corporate culture. ●

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This article is a modified version of a paper delivered by Peter to the AFA National Conference on 16 October 2007, entitled 'Taking the compliance risk out of your business'.

FSN NEWS

Commonwealth Legislation

Corporations (Fees) Amendment Regulations 2007 (No 1) (SLI326 of 2007)

These Regulations amend the *Corporations (Fees) Regulations 2001* to clarify that the lodgment of a replacement product disclosure statement (PDS) with the Australian Securities and Investments Commission (ASIC) does not attract a fee. The Regulations also clarify that the lodgement of a notice in relation to a PDS or Supplementary PDS does not attract a fee if a change is made only to the fees and changes in the statement, or if the financial product to which the statement relates is no longer recommended or offered to new clients in a recommendation, issue or sale situation. The amendment Regulations were made on 26 September 2007 and registered on the FRLI on 28 September 2007 (FRLI No F2007L03805). Regulations 1–3 and Sch 1 commenced on 29 September 2007 and Sch 2 commences on 1 July 2008.

Corporations Amendment Regulations 2007 (No 12) (SLI 324 of 2007)

These Regulations amend the *Corporations Regulations 2001* to support the provisions in the *Corporations Legislation Amendment (Simpler Regulatory System) Act 2007*. The amendment Regulations were made on 26 September 2007 and registered on the FRLI 4 on 28 September 2007 (FRLI No F2007L03804). Regulations 1–3 and Sch 1 commenced on 29 September 2007; Sch 2 commences on the commencement of Sch 1 Pt 3 items 218–219 of the *Corporations Legislation Amendment (Simpler Regulatory System) Act 2007;* and Sch 3 commences on 1 July 2008.

For details of these regulations, see the article by Mark Radford, 'Corporations Amendment Regulations 2007 (No. 12) — what's changed' on p 62.

Australian Securities and Investments Commission Amendment Regulations 2007 (No 3) (SLI 322 of 2007)

These Regulations amend the *Australian Securities and Investments Commission Regulations 2001* to allow ASIC to disclose particular information to the Institute of Chartered Accountants in Australia, CPA Australia and the National Institute of Accountants for the purpose of s 127(4)(d) of the *Australian Securities and Investment Commission Act 2001*. The amendment regulations were made on 26 September 2007 and registered on the FRLI on 28 September 2007 (FRLI No F2007L03845). The regulations commence on the commencement of Sch 1 items 1–48 of the Corporations Amendment (Insolvency) Act 2007, that is, 31 December 2007.

Financial Sector Legislation Amendment (Simplifying Regulation and Review) Act 2007 (No 154 of 2007)

This Act amends the financial sector regulation law to:

- implement recommendations of the Taskforce on Reducing Regulation Burdens on Business to streamline and simplify prudential regulation;
- provide more equitable financial assistance to superannuation funds who have suffered loss as a result of fraud or theft;
- abolish the special protection account;
- consolidate and rationalise prudential reporting requirements in the superannuation industry;
- close a regulatory gap for reporting contraventions of the market conduct and disclosure provisions in the *Corporations Act*; and
- make technical amendments consequential on the enactment of the *Legislative Instruments Act 2003*.

The Act received Royal Assent on 24 September 2007. Sections 1–3, Sch 1 Pt 1, Sch 1 Pt 5 and Schs 2–4 commenced on 24 September 2007; Sch 1 Pt 2 commences on 1 January 2008; Sch 1 Pt 3 commences on the day after the end of the period of 12 months beginning on the day on which the Act received Royal Assent, that is, 24 September 2008; and Sch 1 Pt 4 commences on 1 July 2011.

Financial Sector Legislation Amendment (Discretionary Mutual Funds and Direct Offshore Foreign Insurers) Act 2007 (No 149 of 2007)

Introduced with the Corporations (National Guarantee Fund Levies) Amendment Bill 2007, this Act amends the *Corporations Act, Financial Sector (Collection of Data) Act 2001* and *Insurance Act 1973* to prudentially regulate direct offshore foreign insurers and collect information on discretionary mutual funds (which will not be prudentially regulated); and makes an amendment consequential on the *Corporations (National Guarantee Fund Levies) Amendment Act 2007*.

The Act received Royal Assent on 24 September 2007. Sections 1-3 and Sch 1 commenced on 24 September 2007; Sch 2 commences on 1 July 2008; and Sch 3 commences on the 28th day after the day on which the Act received Royal Assent, that is, 22 October 2007.

Corporations Amendment Regulations 2007 (No 10) (SLI 259 of 2007)

These Regulations amend the *Corporations Regulations 2001* to specify that:

- if a general insurer, in providing a PDS in relation to a general insurance product, needs to comply with the dollar disclosure requirements, and this dollar amount can only be determined after the responsible person assesses the risk of the insured or after the insured has nominated desired levels of insurance cover, they can comply by a number of alternative prescribed methods:
- a transitional period for complying with these dollar disclosure requirements is provided from the day after the Regulations are registered, until 30 June 2008;
- under certain circumstances, the provision of financial product advice by an actuary is added to the list of

exemptions from the requirement to hold an Australian financial services licence (AFSL); and

- certain circumstances, incorporation by reference is permitted for two types of documents, the statement of advice (SOA) and the PDS.

The amendment Regulations were made on 22 August 2007, registered on the FRLI on 24 August 2007 (F2007L02637) and commenced on 25 August 2007.

Corporations Amendment Regulations 2007 (No 8) (SLI 199 of 2007)

These regulations make amendments to the *Corporations Regulations 2001* related to amendments made to the *Corporations Act* by the *Corporations (NZ Closer Economic Relations) and Other Legislation Amendment Act 2007*. Section 601CDA of the *Corporations Act*, recently introduced by the *Corporations (NZ Closer Economic Relations) and Other Legislation Amendment Act 2007*, exempts companies, incorporated in a country that is prescribed in the *Corporations Regulations 2001*, from the requirement to lodge information or a copy of a document with ASIC that is already lodged with an authority of the prescribed foreign country whose functions include functions equivalent to any of those of ASIC. The amendment regulations amend the *Corporations Regulations 2001* to list New Zealand as a prescribed country.

The amendment Regulations were registered on the FRLI on 29 June 2007 (F2007L01898). The Regulations commenced on the commencement of Sch 2 to the Corporations (NZ Closer Economic Relations) and Other Legislation Amendment Act 2007 which commenced on 1 September 2007.

Corporations Amendment Regulations 2007 (No 7) (SLI 198 of 2007)

These Regulations make amendments to the *Corporations Regulations 2001* related to amendments made to the *Corporations Act* by the *Corporations Legislation Amendment (Simpler Regulatory System) Act 2007*. For example, the Regulations make amendments to prescribe an amount of $5000 for the purposes of s 213(1) (as recently amended by the *Corporations Legislation Amendment (Simpler Regulatory System) Act 2007*).

The amendment Regulations were registered on the FRLI on 29 June 2007 (F2007L01899). Regulations 1 to 3 and Sch 1 commenced on 1 July 2007; reg 4 and Sch 2 commenced on the commencement of the *Corporations Legislation Amendment (Simpler Regulatory System) Act 2007*. ●

ASIC

Report on relief applications

On 6 September 2007, ASIC released a report outlining its recent decisions on applications for relief from the corporate finance, financial services and managed investment provisions of the *Corporations Act*, between 1 January and 31 May 2007.

Report 97 'Overview of decisions on relief applications (January to May 2007') (REP 97) provides an overview of situations where ASIC has exercised, or refused to exercise, its exemption and modification powers, from the financial reporting, managed investment, takeovers, fundraising and financial services provisions of the *Corporations Act*. The report also highlights instances where ASIC decided to adopt a no-action position regarding specified non-compliance with the provisions and features an appendix detailing the relief instruments it executed. A copy of REP 97 can be downloaded from the ASIC website at <www.asic.gov.au>. ●

Source: ASIC IR 07-41 6.9.2007.

APRA

Discussion paper on discretionary mutual funds

On 25 September 2007, the Australian Prudential Regulation Authority (APRA) released a discussion paper on proposals for the collection of data from discretionary mutual funds (DMFs). A DMF may be a trust, mutual, company limited by guarantee or other structure. Because of their discretionary nature, DMFs are not insurance companies and therefore are not required to be authorised by APRA. The government's announcement on 3 May 2007 'Enhancing the Integrity of Insurance in Australia' foreshadowed that DMFs would not be subject to prudential regulation but that they would be required to provide data to APRA under the *Financial Sector (Collection of Data) Act 2001*. APRA's discussion paper includes draft forms and instructions. It sets out proposed data collection arrangements and invites submissions on these as well as the forms and instructions. APRA considers the proposed level of reporting will provide the data necessary to assist the government to assess the need to prudentially regulate DMFs.

Submissions on the discussion paper and reporting requirements close on 2 November 2007. The discussion paper, forms and instructions are available from the APRA website at: <www.apra.gov.au>.

Source: APRA MR No 07.47 25.9.2007.

Online breach reporting

APRA has released a new version of the online form for lodging a breach notification under s 29JA of the *Superannuation Industry (Supervision) Act 1993* (SIS Act). Under s 29JA of the SIS Act an RSE licensee is required to give APRA a notice setting out particulars of a breach of any condition imposed on its license under ss 29E and 29EA of the SIS Act. All breaches, regardless of materiality, must be reported to APRA. A breach must be notified within 14 days after the corporate trustee or a member of the group of individual trustees becomes aware a breach has occurred. Failure to notify APRA of a breach of an RSE licence condition is a strict liability offence and a penalty of 50 units ($5500 for an individual and $27,500 for a body corporate) may apply. The online form is accessible from the APRA website at: <www.apra.gov.au>. ●

AUSTRAC

Guidance note on risk management and AML/CTF programs

The Australian Transaction Reports and Analysis Centre (AUSTRAC) has released a *Guidance Note on Risk Management and AML/CTF Programs*.

The purpose of the guidance note is to:
provide general information about risk management frameworks and relevant legislative requirements under the *Anti-Money Laundering and Counter-Terrorism Financing Act 2006* (AML/CTF Act) Act and *Anti-Money Laundering/Counter-Terrorism Financing Rules* (AML/CTF Rules) relating to AML/CTF programs; and
assist reporting entities in implementing an AML/CTF program appropriate to their business having regard to the business size, nature and complexity.

A copy of the guidance note is available at: <www.austrac.gov.au>.

Guidance note on civil penalty orders

AUSTRAC has released a *Guidance Note on Application of the Policy (Civil Penalty Orders) Principles 2006*. The purpose of the guidance note is to provide information to reporting entities about the AUSTRAC CEO's approach to the Policy Principles, including what constitutes reasonable steps. The effect of s 3(1) of the Policy Principles is that the AUSTRAC CEO may apply for a civil penalty order under s 176 of the AML/CTF Act in respect of a reporting entity for a contravention of a provision that is enforceable by the imposition of a civil penalty. This may be done if the AUSTRAC CEO is satisfied that the reporting entity has failed to take reasonable steps to comply with the provision during the specified 15 month period.

A copy of the guidance note is available at <www.austrac.gov.au>.

Release of draft Rules

On 24 August 2007 AUSTRAC released draft Rules on threshold transaction reports and a revised draft on ongoing customer due diligence. Under the AML/CTF Act all reporting entities will be required to report certain threshold transaction details and carry out ongoing customer due diligence from 12 December 2008.

The draft AML/CTF Rules set out the proposed reportable details for threshold transactions to AUSTRAC as well as requirements for ongoing customer due diligence. Comment on the draft rules closed on 14 September 2007.

A copy of the draft rules is available at <www.austrac.gov.au>. ●

IFSA

Streamlining Breach Reporting discussion paper

The Investment and Financial Services Association (IFSA) has welcomed the release of the discussion paper, *Streamlining Breach Reporting*, by APRA and ASIC. IFSA will consult with members and prepare a submission, prior to the closing date of 31 October 2007.

IFSA Deputy CEO John O'Shaughnessy said that the proposal to allow a single online report to both institutions, as part of the government response to the report of the Rethinking Regulation Taskforce, will streamline the breach reporting process in many cases and remove duplication where a report must be submitted to both regulators.

Source: MR 4 October 2007.

For further details, see the article by Michael Vrisakis, 'Recent developments in breach reporting' on p 61.

Supporting super decisions requires industry-wide effort

IFSA and Investment Trends have published their report, *Super Decisions: Communicating with Customers and Effective Disclosure*. It follows qualitative and quantitative research of people who have made a superannuation decision in the previous year or two, and provides insights as to how customers make their decisions and the importance of disclosure documents.

Richard Gilbert, CEO of IFSA, noted that viewing the superannuation decision-making process from the customer's perspective has provided a clear picture of where the industry needs to lift its game, also noting, 'The high levels of satisfaction and comfort recorded in our research show that many companies are supporting the decision-making process well, however we can't ignore the fact that customers are still calling for shorter documents that are presented well and written in plain English. Regardless of the size and complexity of the information, customers are making an effort to read the documents.

'Through this research, we know that the workplace and the employer's choice of default fund are crucial to decision-making behaviour — particularly for those under the age of 45 years. We know that that information on performance, risk, investment options and fees is most important to people — all areas where we're told the documents can be improved.'

The report contains six recommendations that will require industry-wide effort to better support superannuation decisions.

1. Continue to support the Financial Literacy Foundation's focus on workplace financial education programs through the development of initiatives for the industry's own employees and tools to help other workplaces.
2. Further research, testing PDS composition, categorisation and presentation of information
3. Further research, testing ways to improve customer understanding of key investment concepts.
4. Greater use of online superannuation account checking and increasing the frequency and timeliness of super statements i.e. emailing statements.
5. Development of descriptors that can be applied consistently in conjunction with the names of documents to improve understanding about what each of the documents is and what they are designed to do.
6. Continue to promote best practice through the development of industry standards and use of the IFSA logo.

The Report is available from: <www.ifsa.com.au>. ●

Source: MR 20 September 2007.

Inaugural meeting of FICA Board with ASIC and APRA executive

On 31 July 2007, the Board of the Finance Industry Council of Australia (FICA), together with Abacus, Australian Mutuals and the Association of Superannuation Funds of Australia (ASFA), met with the ASIC Commissioners and APRA members to discuss significant regulatory and industry issues facing the financial services industry. The meeting focused on issues that are relevant to the responsibilities of the two agencies. It was also provided with an update of the work of the Joint APRA/ASIC Working Group that is

evaluating how any overlaps, inconsistencies or duplication in the activities of the two agencies might be reduced.

The meeting was a response to the Government's encouragement of ASIC and APRA to explore with industry representatives possible mechanisms to provide industry with the opportunity to raise issues about how regulatory coordination operates in practice. *Rethinking Regulation: Report of the Taskforce on Reducing Regulatory Burdens on Business* (January 2006) had also made recommendations about improving industry consultation. FICA consists of the Australian Bankers' Association, Australian Finance Conference, Australian Financial Markets Association, Financial Planning Association, Insurance Council of Australia and IFSA. ●

Source: MR 9 August 2007.

CPA Australia

Concerns about disclosure requirements for unlisted, unrated debentures

CPA Australia has provided a submission to the Australian Securities and Investment Commission (ASIC) raising concerns about its proposals to improve disclosure requirements for unlisted, unrated debentures.

While welcoming ASIC's proposals in principle, CPA Australia warns against relying primarily on disclosure improvements to achieve the desired outcome of retail investors understanding the inherent risks of investing in unlisted, unrated debentures.

ASIC's consultation paper identifies a range of significant potential risks of these types of investments and proposes that issuers of unlisted, unrated debentures be required to disclose eight relevant benchmarks for these on an 'if not, why not' basis.

According to CPA Australia's financial planning policy adviser Kath Bowler, benchmarks are not always a reliable indicator of value and require expert knowledge to interpret.

Ms Bowler said 'Although unlisted, unrated debentures are high-risk and often complex investments, many retail investors are attracted to them because they may appear on the surface to resemble term deposits, And it is unrealistic to expect individual investors to understand benchmark figures, or even read them. Indeed, in the absence of expert professional advice, providing benchmarks may inadvertently add to the impression of a safe and comfortable investment option when recent experience has certainly demonstrated otherwise.'

CPA Australia emphasises that improving disclosure is only one element of assisting retail investors make better investment decisions. While retail investors must take responsibility for their investment decisions and ensure that they seek further information or professional financial advice where appropriate, ASIC, professional financial planners and credit ratings agencies also all have a role to play. ●

Source: CPA Australia, 4 October 2007. To view CPA Australia's submissions on this and other topics, visit <*www.cpaaustralia.com.au/links?14131_24418*>.

Standards Australia

Two new employment screening handbooks

Standards Australia has published the *Employment Screening Handbook*; and the *Reference Checking in the Financial Services Industry Handbook* which was developed in close collaboration with the Australian Securities and Investments Commission (ASIC).

Supporting the Australian Standard for Employment Screening (AS 4811-2006), the only Standard of its type in the world, the handbooks have been produced to assist employers reduce the risk of potential security breaches and ensure the identity, credentials and integrity of staff and contractors.

The *Employment Screening Handbook* provides a framework to build an employment screening process that could be just as effectively used in a multi-nation corporation or a start up small business. It is designed to reduce the risk of individuals using fraudulent and deceptive means to gain employment, advance through the ranks or gain other benefits they may not be entitled to or qualified for.

It examines in detail all aspects of building an effective employment screening regime including:

- developing an employment risk analysis;
- the employment screening process;
- communicating with staff; and
- the types of people employed to do the screening

The *Reference Checking in the Financial Services Industry Handbook* has been developed by the Australian Securities and Investments Commission (ASIC) in partnership with Standards Australia to provide a reference-checking framework for the financial services industry to minimise the movement of dishonest, incompetent or unethical employees or representatives within the industry.

It provides clear guidelines to help employers use a reasonable and objective process to gather relevant, factual and balanced information for reference checks.

Together, the two handbooks provide the best possible guidance to help employers reduce the risk of security breaches and ensure the identity, credentials and integrity of staff and contractors. ●

Source: 11 October 2007, <*www.standards.org.au*>.

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