ASIC
Australian Securities & Investments Commission

Senate inquiry into the performance of the Australian Securities and Investments Commission

Supplementary submission by ASIC on Commonwealth Financial Planning Limited

December 2013

Contents

A Purpose and scope

1 The Senate Economics References Committee Inquiry into the performance of the Australian Securities and Investments Commission (ASIC) has terms of reference that cover a wide range of ASIC's functions, powers, activities and resources.

2 ASIC has already provided three submissions to the Senate Economics References Committee:

(a) We provided an initial submission on 2 August 2013, which provided an overview of our actions in relation to Commonwealth Financial Planning Limited (CFPL), as well as some context about our work in the financial advice sector (*Initial submission by ASIC on Commonwealth Financial Planning Limited and related matters*).

(b) We provided a submission on 24 October 2013, which discussed the regulation of the Australian credit industry, the reforms that have taken place over time, and their impact, and, more specifically, the regulation of 'low doc' loans (*Submission by ASIC on reforms to the credit industry and 'low doc' loans*).

(c) We provided a main submission on 31 October 2013, which addressed all the inquiry's terms of reference (*Main submission by ASIC*).

3 ASIC's main submission foreshadowed that we would make a further submission to the Senate Economics References Committee regarding the wholesale change in the manner and culture in which financial advice is now provided by CFPL. Accordingly, the primary purpose of this submission is to highlight key aspects of CFPL's transformation as a result of entering into an enforceable undertaking with ASIC.

4 This submission also provides:

(a) further information on the methodology used by CFPL to compensate those clients who received inappropriate advice and suffered financial loss; and

(b) an update on CFPL's compensation scheme.

B ASIC's enforceable undertaking with CFPL

Key points

In making the decision to accept an enforceable undertaking from CFPL, ASIC considered that it would provide:

- the most effective outcome for clients of CFPL who received inappropriate financial advice and suffered financial loss (affected clients); and
- the most effective way to address the systemic problems within CFPL.

As a consequence of CFPL entering into an enforceable undertaking with ASIC, CFPL has fundamentally reshaped the risk management framework of its business. Key changes include:

- redesigning its key performance indicators (KPIs) and remuneration framework to drive appropriate behaviours among advisers;
- selecting a senior management team that has, according to PricewaterhouseCoopers (PwC), 'significant leadership experience' and demonstrates 'strong ethical values in relation to the business';
- implementing a program of culture change to bring about the desired culture of 'quality advice' and 'making money safely';
- launching 'Connect'—CFPL's new technology-based risk management system, which has resulted in a significant increase in transparency of adviser monitoring;
- increasing the number of financial planning managers within the business by 25, meaning that one manager is now responsible for 12 to 15 advisers rather than 25, as was previously the case; and
- delivering a minimum of 80 hours of training to each adviser, with a focus on the requirements of their role, particularly as it relates to risk management, supervision and monitoring.

The terms of the enforceable undertaking

5 ASIC's investigations and surveillance of CFPL[1] established that there were significant problems within the CFPL business. ASIC was concerned about issues including:

(a) the adequacy of CFPL's processes and controls to deal with ongoing risks of non-compliance;

(b) CFPL's ability to deal with misconduct by its representatives in a consistent manner; and

[1] For further detail, see *Initial submission by ASIC on Commonwealth Financial Planning Limited and related matters*.

(c) CFPL's capacity for early identification of irregularities in its advice process.

6 ASIC sought to deal with these issues on a systemic basis; accordingly, on 25 October 2011, ASIC entered into an enforceable undertaking with CFPL. The terms of the enforceable undertaking required CFPL to, among other things:

(a) assess the adequacy of its risk management framework against generally accepted risk management standards; and

(b) develop an implementation plan to address deficiencies in its risk management framework as well as ASIC's concerns.

Purpose of an enforceable undertaking

ASIC may accept an enforceable undertaking given by a person or entity on a matter over which ASIC has a function or power under s93AA of the *Australian Securities and Investments Commission Act 2001* (ASIC Act).[2]

An enforceable undertaking is a written undertaking given to ASIC that an entity or person will operate in a certain way. ASIC may apply to the court for appropriate orders if the undertaking is not complied with.

We will not consider an enforceable undertaking unless we have reason to believe there has been a contravention of relevant legislation and have commenced an investigation into the conduct we believe gives rise to the suspected breach.

We will only accept an enforceable undertaking if we consider it provides a more effective and appropriate regulatory outcome (given the significance of the issues to the market and the community, the nature and seriousness of the alleged breach, and the compliance history of the party) than non-negotiated, administrative or civil sanctions.

In appropriate cases, such as CFPL, an enforceable undertaking provides ASIC with a greater capacity to achieve a comprehensive response to systemic conduct than court action. That comprehensive response may include (as in CFPL) timely and effective compensation arrangements.

Compared to court action, an enforceable undertaking provides ASIC with much greater scope to influence and manage future conduct and, through the requirements for ongoing reporting and supervision by ASIC, to drive changes to systems and culture, and to monitor and judge the effectiveness of those changes. That was ASIC's aim in the CFPL matter.

[2] ASIC may also enter into an enforceable undertaking given by a responsible entity of a registered scheme on a matter involving the registered scheme, and over which ASIC has a function or power under the related legislation: s93A of the ASIC Act. ASIC may also accept an enforceable undertaking under s322 of the *National Consumer Credit Protection Act 2009* (National Credit Act).

The role of PricewaterhouseCoopers

7 PwC was engaged by CFPL as an independent expert under the terms of the enforceable undertaking. PwC's role was to:

(a) validate CFPL's assessment of its risk management framework (see paragraph 6(a));

(b) assess whether the implementation plan developed by CFPL (see paragraph 6(b)) addressed ASIC's concerns and the deficiencies in CFPL's risk management framework;

(c) comment on the design and implementation of systems, policies, procedures and controls, as required under the implementation plan; and

(d) test and report on the effectiveness of the changes to the systems, policies, procedures and controls throughout the reporting period 31 March 2013 to 30 September 2013.

8 The terms of the enforceable undertaking also required PwC to produce five reports, as follows:

(a) an initial report, addressing the matters referred to in paragraphs 7(a) and 7(b);

(b) three interim reports, addressing the matters referred to in paragraph 7(c); and

(c) a final report, addressing the matters referred to in paragraph 7(d).

9 PwC's final report was submitted to ASIC on 25 October 2013. ASIC accepted the final report on 26 November 2013, which formally brought the enforceable undertaking between ASIC and CFPL to a close.

10 At ASIC's request, CFPL will:

(a) conduct further independent testing on a range of matters relevant to the ongoing effectiveness of the enforceable undertaking in CFPL's business, including:

(i) testing of controls and operating effectiveness for changes made to KPIs and remuneration structures that were introduced in August 2013; and

(ii) testing of the operating effectiveness of CFPL's revised procedures and processes for notifying ASIC of significant breaches, as required under the *Corporations Act 2001* (Corporations Act); and

(b) provide the results of that independent testing to ASIC for review.

PwC's final report on the effectiveness of CFPL's actions

11 The remainder of this section of the submission highlights a selection of the key changes reported by PwC, including:

(a) major changes to CFPL's management team;

(b) the launch of 'Connect'—CFPL's new technology-based risk management system, which has resulted in a significant increase in transparency of adviser monitoring;

(c) the redesign of CFPL's KPIs and remuneration framework to drive appropriate behaviours among advisers;

(d) the implementation of a program of culture change to bring about the desired culture of 'quality advice' and 'making money safely'; and

(e) the introduction of a range of qualitative and quantitative indicators to enable a risk-based approach to the supervision and monitoring of advisers.

CFPL governance, funding and resources

PwC noted that:

> The robust governance, significant funding and number and quality of resources that were dedicated to the Program reflected the significant commitment made [by CFPL] to addressing ASIC's concerns and the overall requirements of the enforceable undertaking.

PwC reported that the funding and resource investment made by CFPL helped to ensure that the milestones under the enforceable undertaking were delivered on time.

Up to 90 staff worked on the design and delivery of milestones under the enforceable undertaking. Further external specialists were engaged to assist with the design of specific milestones and in the delivery of training.

Management restructure

12 CFPL's management team has undergone profound change in recent years. The senior management team previously directly responsible for CFPL is no longer with the business. In its place is a core management team comprising:

(a) an Executive General Manager CBA Wealth Management Advice (EGM CBA WM Advice);

(b) a General Manager CFPL (GM CFPL); and

(c) a General Manager Advice Licensee Services (GM ALS).

PwC observed that 'each of these people have demonstrated to us significant leadership experience and strong ethical values in relation to the business'.

13 Further, CFPL reports that none of the staff involved in the 2008–09 Continuous Improvement Compliance Program (CICP)[3] remain at CFPL. The CICP failed to satisfy ASIC's concerns arising from ASIC's 2007 surveillance of CFPL.[4] That failure led to ASIC putting the matter on a more formal investigative path and entering into an enforceable undertaking with CFPL.

14 In May 2012, CBA separated its advice business from its product manufacturing business. This allowed the head of the advice business (EGM CBA WM Advice) to report directly to the CBA Group Executive Wealth Management, thus elevating the advice business's position within CBA.

Launch of a tailored risk management system ('Connect')

15 On 1 May 2013, CFPL launched the new 'Connect' system. CFPL reports that Connect was the result of a $25 million investment by CFPL in technology to deliver a tailored risk management system. CFPL management and staff, when interviewed by PwC, reported that Connect was 'a significant improvement for the management and monitoring of advice activity'.

16 Connect delivers a consolidated view of information on all employed advisers ('single view of adviser'). This single view includes data on each adviser's qualifications, professional development, potential conflicts of interest and support needs, among other things. The Connect system also supports compliance with CFPL's procedures because it controls workflow and ensures that processes are completed in the correct sequence with appropriate approvals.

Redesign of KPIs and remuneration framework

17 CFPL redesigned its KPIs and remuneration framework to drive appropriate behaviours among advisers. Two different models have been introduced for different categories of employees/representatives:

(a) *Salaried advisers*: To receive a short-term incentive (bonus), salaried advisers must meet revenue and behaviour criteria (the 'gate openers'). The bonus amount is then determined by a combination of revenue mix, with a deferred payment based on customer satisfaction, behaviours and quality of advice measures. Salaried advisers who exhibit poor behaviours or are the subject of 'consequence management' are ineligible for bonuses for a period of time.

[3] For further detail, see paragraphs 16–19 of *Initial submission by ASIC on Commonwealth Financial Planning Limited and related matters.*
[4] For example, see paragraph 5 of this submission.

(b) *Management and staff*: A portion of the incentive scorecard is determined by the KPIs for supervision and monitoring. 'Gate openers' are linked to risk management and culture.

Culture changes

18 CFPL developed a roadmap to achieving its desired culture of providing 'quality advice' and 'making money safely'. CFPL's commitment to this cultural shift has been supported by developments over the past two years, including:

(a) restructuring the business in May 2012 to separate the advice business from the product manufacturing business (as discussed in paragraph 14);

(b) changes to the assessment criteria for remunerating staff—that is, changes to KPIs and the remuneration framework (as discussed in paragraph 17); and

(c) a significant increase in transparency of adviser monitoring with the introduction of Connect (as discussed in paragraphs 15–16).

19 As part of its culture change program, CFPL conducts six-monthly cultural assessments. The most recent assessment found that:

(a) client feedback is very positive—the average score from clients who did not proceed following the initial interview was 18/20, and the average score was even higher from:

(i) clients *after* receiving a Statement of Advice; and

(ii) ongoing clients; and

(b) there is a strong positive response from employees to questions regarding understanding of risk management expectations and demonstrations of quality and improvement as priorities.[5]

20 PwC interviewed a number of advisers and financial planning managers from CFPL. A common theme among these individuals was how, over the past two years, there has been a significant cultural shift in the business from a product sales focus to advice quality, with many interviewees commenting that 'revenue league tables are never discussed anymore'.

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[5] The employee component of the culture assessments performed in March 2012 and October 2012 showed a significant positive trend in results, followed by a slight decline in the March 2013 results. PwC notes that the results of the March 2013 survey were inconsistent with the findings of its interviews with staff, which were conducted in August and September 2013. PwC also notes that the slight decline in survey results is consistent with its experience in considering employee survey results, which often show a significant upswing at the start of a change program followed by a slight decline as changes are embedded and move towards a more 'business as usual' state.

PwC's observations on CFPL culture change

PwC observed that as a consequence of the actions taken under the enforceable undertaking, CFPL had undergone 'a significant cultural shift … to a more balanced focus on advice quality'.

PwC also commented on the example set by CFPL's senior management team:

> Tone at the top is important. Through observations and interviews with staff we note that the CFPL leaders (specifically the EGM CBA WM Advice, GM CFPL and GM ALS) have led and continue to lead the culture change by example. Through meetings and interviews with each of these individuals, we have observed they believe in the importance of quality advice and making money safely, and frequently reinforce these messages (in their communications and interactions with staff). Further, examples of their integrity, honesty and customer service were cited by many CFPL staff members during our interviews.

Improved supervision and monitoring framework

21 CFPL now uses a range of qualitative and quantitative indicators to enable a risk-based approach to supervising and monitoring advisers. Quantitative indicators include asset class bias, switching activity, risk profile discrepancies and adviser commission volumes. Qualitative indicators include results of previous customer file reviews, customer meeting observations, mystery shopping and customer feedback surveys.

22 CFPL combines qualitative and quantitative indicators to produce an overall adviser support profile (high, medium or low need). The adviser support profile determines the level of supervision and monitoring activities to be undertaken in respect of an adviser: see Table 1.

Table 1: CPFL's adviser support profiles

Category	Description
High need	Higher frequency of supervision and monitoring activities required, with a minimum of six activities performed over an adviser per quarter.
Medium need	Mid-range frequency of supervision and monitoring activities required, with a minimum of four activities performed over an adviser per quarter.
Low need	Lower frequency of supervision and monitoring activities required, with a minimum of two activities performed over an adviser per quarter.

23 Support activities include adviser observations (i.e. customer interview observations), file reviews (i.e. file audits, pre-vetting of advice) and customer experience (i.e. mystery shopping and customer surveys).

24 To bolster the supervision and monitoring framework, CFPL reports that it has also:

(a) increased the number of financial planning managers within the business by 25, meaning that one manager is now responsible for 12 to 15 advisers rather than 25, as was previously the case; and

(b) delivered a minimum of 80 hours of training to each adviser, with a focus on the requirements of their role, particularly as it relates to risk management, supervision and monitoring.

C The CFPL compensation scheme

Key points

ASIC negotiated a comprehensive compensation scheme with CFPL, which has, to date, resulted in:

- CFPL paying out approximately $51 million in compensation to affected clients; and
- more than 1,100 clients accepting a compensation payment from CFPL.

Overview of the compensation scheme

25 CFPL implemented its compensation scheme in two phases:

(a) The first phase was referred to as ‘Project Hartnett’, which remediated clients of Don Nguyen and, later, Anthony Awkar.

(b) The second wider phase, developed under the enforceable undertaking, was known as the ‘Past Business Review’. This phase remediated clients of advisers who were the subject of a breach report[6] (by CFPL to ASIC) or about whom CFPL had received a complaint or who were otherwise a concern to CFPL.

26 ASIC negotiated with CFPL to ensure that:

(a) settlements entered into before the commencement of Project Hartnett (March 2010) were reviewed and assessed using the Project Hartnett methodology;

(b) clients claiming hardship were dealt with first, with fast tracking of compensation in appropriate cases;

(c) an independent expert was appointed to review the adequacy and appropriateness of the compensation process;

(d) clients were informed of dispute resolution options, notably the Financial Ombudsman Service (FOS); and

(e) clients were able to obtain independent advice (from an accountant, lawyer or licensed financial adviser) up to the value of $5,000 and paid for by CFPL, to assess the compensation offer.

[6] Under the *Corporations Act 2001* (Corporations Act), a holder of an Australian financial services (AFS) licence must report material breaches of financial services laws to ASIC.

Compensation scheme methodology

27 The overarching aim of the CFPL compensation scheme was to restore clients to the financial position they would have been in had the inappropriate elements of the advice not occurred and they had been provided with appropriate advice.

28 This was done by assessing the advice strategy and comparing the client's actual portfolio financial position against a reference portfolio, based on their assessed risk profile. The difference was paid as compensation to the client. CFPL also repaid any fees that did not reflect value for the service provided. The compensation amount also considered the time value of money and taxation impacts as appropriate.

29 Under Project Hartnett, the process of determining whether compensation was payable to a client and, if so, how much, occurred in three phases:

(a) In phase one, a letter was sent to clients, who had not already engaged with CFPL, informing them that CFPL had concerns with the advice provided by their adviser and would be seeking to review the advice each client had received.

(b) In phase two, CFPL assessed the client's circumstances and, in appropriate cases, telephoned the client to verify whether CFPL held accurate records relating to the client's needs, objectives and circumstances, and the advice that was provided to the client. These conversations allowed CFPL to test the reliability of the information CFPL had on its file, make an assessment as to whether inappropriate advice had been given to the client and, further, whether compensation could be paid promptly to the client.

If the client's situation varied from CFPL records or other special circumstances existed (e.g. the client had submitted a formal complaint about the adviser; the client had been affected by multiple complex issues that would require more investigation; the client raised new issues regarding the advice they were given which CFPL was not aware of; the client had suffered from a particular hardship or special disadvantage), phase three occurred.

(c) In phase three, CFPL employees, as required, met with clients to obtain detailed information regarding their personal financial circumstances, needs and objectives, and the advice provided by their advisers.

30 In addition to these steps, a large amount of analytical work was completed on each client file. CFPL considered a number of questions, including:

(a) Did the adviser conduct a comprehensive investigation into the client's circumstances?

(b) Was the client's risk profile clearly established?

(c) Did the advice address the client's needs and objectives?

(d) Was the advice delivered in a manner that complied with legislative and other requirements?

31 If CFPL determined that compensation was payable, a letter was sent to the client which, among other things:

(a) made an offer of compensation;

(b) explained how the compensation offer had been calculated; and

(c) advised that CFPL would pay the reasonable costs (up to $5,000) of an accountant, lawyer and/or independent licensed financial adviser to assess the compensation offer.

32 A professional services firm was appointed as the independent expert under Project Hartnett.[7] The independent expert's role was to review the adequacy and appropriateness of the compensation process and specifically included tasks such as:

(a) assessing the compensation methodology to validate its design and accuracy;

(b) reviewing a number of files from beginning to end;

(c) testing a sample of cases to ensure that the compensation scheme methodology was operating as intended;

(d) reviewing a sample of cases where there was a dispute with the client about the amount of compensation; and

(e) testing a sample of cases to assess the accuracy of the compensation calculations. The independent expert re-performed the calculations of the client's actual and reference portfolios using business analytics software and CFPL raw data files, transaction histories, and the business rules from the compensation scheme methodology.

Current status of compensation payments and claims

33 More than 7,000 customer reviews were performed and, to date, more than 1,100 clients have been paid a total of approximately $51 million.

34 ASIC understands that seven former clients of Mr Nguyen have remaining issues against CFPL. One client is currently pursuing their claim through FOS. Of the remaining clients, ASIC understands that:

(a) In September 2013, one client had an amount of $164,171 (representing CFPL's latest settlement offer) credited to their account by CFPL.

[7] PwC's role as independent expert under the enforceable undertaking included assessing whether the Past Business Review compensation process complied with CFPL's remediation policy.

(b) In September 2013, one client had an amount of $112,590 (representing CFPL’s latest settlement offer) credited to their account by CFPL.

(c) One client (a company), who was assessed during Project Hartnett as not requiring compensation because a gain was made, is alleging that it is owed compensation.

(d) Two clients who previously signed settlement deeds with CFPL in 2010 are seeking to reopen settlement negotiations. CFPL recently advised these clients that it will not object to FOS determining the issue of compensation afresh.

(e) One client who previously signed a settlement deed with CFPL in 2012 now disagrees with CFPL about a matter which, according to the client, was not considered in the original settlement.

35 ASIC also understands that there are 30 former clients of Mr Awkar and other advisers the subject of the Past Business Review where CFPL has been unable to complete its remediation process. Four clients are currently pursuing their claim through FOS. Of the remaining clients:

(a) Three clients (who have not entered into a settlement deed with CFPL) are dissatisfied with the offer made or compensation received by CFPL.

(b) CFPL has been unable to contact and finalise compensation in respect of 19 clients.

(c) CFPL is considering the compensation due to four clients.

36 ASIC’s view is that where claims cannot be resolved by agreement, the best course for claimants—consistent with the design of the compensation arrangements—is for the claimants to take their matter to FOS for independent determination. ASIC is regularly seeking updates regarding the outstanding claimants.

Key terms

Term	Meaning in this document
affected clients	Clients of CFPL who received inappropriate financial advice and suffered financial loss
AFS licensee	An Australian financial services licence under s913B of the Corporations Act that authorises a person who carries on a financial services business to provide financial services Note: This is a definition contained in s761A of the Corporations Act.
ASIC	Australian Securities and Investments Commission
ASIC Act	*Australian Securities and Investments Commission Act 2001*
CBA	Commonwealth Bank of Australia
CICP	Continuous Improvement Compliance Program
CFPL	Commonwealth Financial Planning Limited
Corporations Act	*Corporations Act 2001*, including regulations made for the purposes of that Act
EGM CBA WM Advice	Executive General Manager CBA Wealth Management Advice
FOS	Financial Ombudsman Service
GM ALS	General Manager Advice Licensee Services
GM CFPL	General Manager CFPL
KPI	Key performance indicator
National Credit Act	*National Consumer Credit Protection Act 2009*
PwC	PricewaterhouseCoopers