



A Practical Guide to Financial Services Regulation

A courtesy guide prepared by Swaab Attorneys

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Overview of Financial Services Regulation in Australia

What initial issues do you need to consider?

What is involved in the licence application process?

What are your obligations after a licence is granted?

Additional issues to consider when setting up an investment fund

Overview

The *Financial Services Reform Act 2001* was introduced to ensure that a wide range of financial products are regulated by a single framework. These products include securities, managed investments, derivatives, superannuation and retirement savings accounts, deposit accounts, means of payment services such as smart cards and e-cash, general and life insurance, and foreign exchange. This legislation is now incorporated in the *Corporations Act 2001*.

The financial services regulations (*FSR*) originating from the *Financial Services Reform Act* established a new licensing scheme, impose disclosure requirements for financial services and set out conduct requirements for participants in the financial services sector.

The *FSR* provides for three types of licence:

- Ø a financial markets licence (for example, granted to the Australian Stock Exchange)
- Ø a clearing and settlement facilities licence (for example, granted to CHESS¹)
- Ø an Australian financial services licence (*AFSL*) (for example granted to financial planners, insurance brokers, superannuation trustees, custodians, stockbrokers and investment fund managers).

The most relevant licence for the purposes of this publication is an *AFSL*. *AFSLs* are issued by the Australian Securities and Investments Commission (*ASIC*) on satisfaction of the relevant licensing application criteria. Licence applications can require quite extensive documents in support.

The *Corporations Act 2001* provides that all persons who carry on a financial services business in Australia are required to have an *AFSL* or have the benefit of an exemption. The definition of a financial services business and the ambit of the legislation are very wide.

An *AFSL* holder has extensive obligations in relation to operating a financial services business, providing financial services and recommending financial products. Whilst these obligations apply to both retail² and wholesale³ clients, there are greater disclosure obligations in relation to retail clients.

The carrying on of a financial services business without an *AFSL* or in breach of the obligations is a criminal offence and may allow counterparties to terminate transactions.

Under the relevant Australian legislation:

- § a financial service provider may be deemed to carry on a financial services business in Australia even though it has no physical presence in Australia, and
- § there is no general licensing exemption based merely on the fact that a financial service provider only deals with institutional Australian counterparties (such as Australian banks, financial services licence holders, insurers and fund managers).

If you are planning to set up a new business in the financial services sector or to create new investment products, you will need to give serious thought to the effect the *FSR* will have on your business.

¹ CHESS is an electronic share trading system

² Retail clients means clients who are not wholesale clients

³ Wholesale clients means sophisticated, professional and high net worth clients

What initial issues do you need to consider?

What is my business and what authorisations do I need to apply for?

You will need to ensure that your AFSL authorises you to provide the full range of services and products you intend your business to deliver. You will need to think through each type of business activity you will engage in, the types of products that they will relate to and what kind of client they will apply to.

The following questions will be relevant to your application and we would use this information in assisting you to prepare the application documents.

Advice

- § What type of information will clients be given by you?
- § How will that information be delivered to your clients and by whom?
- § How will you maintain contact clients or potential clients?
- § Will you be recommending or providing opinions in relation to financial products?
- § Will you be providing opinions in relation to financial products?
- § How will your client make decisions about your product and services?
- § What type of information will you ask your clients or prospective clients to provide to you and will this include the clients personal circumstances?
- § Will there be a third party between you and the client?

Dealing

- § Will you be developing, issuing or manufacturing a financial product?
- § Will you be arranging for clients to invest in or purchase your product?
- § Will you be buying or selling financial products on behalf of clients?
- § Will you be arranging for someone else to buy or sell products for your clients?
- § Will you be arranging for another party to issue or manufacture a product?

Products

- § What type of products will you provide opinions on (either positive or negative)?
- § What are the elements of the products or facility that you will be dealing or advising in?

Pooling

- § Will you be pooling any of your clients' money?
- § Will you be providing your clients with benefits by acting on behalf of more than one client at once?
- § Will you be providing administration and reporting services to your clients?
- § Will you be controlling or investing your clients' money in one or more trusts?
- § Will you be managing your clients' money in separate accounts but pooling other investment or administration services?

Your clients

- § Will your clients be able to contribute a minimum of \$500,000?
- § Will your clients be institutions?
- § Will you be associated with superannuation products?
- § Where will your clients be located?

Disclosure documents

- § What are the different types of disclosure documents that may apply to your products and services?

Representatives

- § What external parties will be representing you in delivering your services or product?
- § Are these parties associated?
- § Do they represent any other providers?
- § What type of control do you want to have over these parties?
- § How will you be remunerating these parties?

Distribution

- § How will your products be distributed and how will you pay for that distribution?
- § Will you only deliver via the web?
- § Will you use other AFSL holders?

Capital

- § What financial resources will you need to obtain an AFSL?
- § What capital requirements will you have to meet?

Experience and Qualifications

- § What skills, experience and qualifications will we need to show to obtain and keep our licence?
- § What proofs will we need to provide in relation to good fame and character?
- § What credit and police checks, referees and personal statements need to be completed?
- § Will you need to complete any training before applying for the AFSL?

Other resources

- § What resources, processes and systems will need to be in place before an AFSL can be applied for?
- § Do you need a compliance committee or independent board members?
- § Do you need membership of an external dispute resolution scheme?
- § Do you need professional indemnity insurance?
- § Who will be your auditors for your AFSL and if applicable, registered schemes?
- § What functions if any are being outsourced?

What is involved in the licence application process?

AFSL

- § Preparing the draft application form
- § Preparing all supporting documentation and business proofs (including detailed description of business, responsible officer declarations, proof of education and experience, and financial information and cash flows)
- § Lodging electronic licence application form
- § Lodging supporting proofs with fee within 20 days of the electronic licence application
- § Answering requests for further information from ASIC. ASIC generally operate on a two to three month turn-around time for processing applications
- § Draft licence issued by ASIC
- § Lodging scheme registration documents (for registrable managed investment schemes) within 4 months of draft licence (if applicable)
- § Final licence issued by ASIC
- § Scheme registered (if applicable)

Scheme registration (retail)

- Responsible Entity to be authorised
- Compliance plan to be put in place
- Constitution to be adopted
- Independent board or compliance committee to be formed

What are your continuing compliance obligations after a licence is granted?

- § Disclosure to ASIC of material changes to shareholding and key persons
- § Annual financial reporting and audit certificates to ASIC
- § Notification to ASIC of significant breaches of licence obligations and financial services laws
- § Notification to ASIC of any change to statutory information (including directors details and addresses)
- § Holding of application money in trust account
- § Confirmation of transactions to clients
- § Ensuring compliance of advertising material, web site, client reporting, research reports and disclosure documents
- § Training of employees, directors, responsible officers and representatives
- § Monitoring and supervision of all representatives
- § Maintaining effective and efficient compliance measures (including incident recording, management and rectification)
- § Maintaining risk management systems and policy
- § Maintaining and applying conflicts policy, procedures and management
- § Implementing a code of conduct, fraud policy, training policy, human resources policies (including responsible officer policy and procedures), investment policy and procedures, due diligence procedures and complaints policy and procedures
- § Producing updates of Product Disclosure Statements, Financial Services Guides and Statements of Advice
- § Monitoring of financial requirements including net tangible assets and cash flows
- § Producing board and / or compliance committee reports
- § Providing the financial services, efficiently honestly and fairly, including having adequate resources and competent management and staff
- § Complying with the compliance plan and constitution
- § Certain additional obligations as a Responsible Entity under the *Corporations Act 2001* including acting in the best interest of members

Additional issues to consider when setting up an investment fund to hold and invest client money

- § **Offering document for the fund** – consider the positioning relative to other offerings in the market and clarify the proposed investment focus, fund size, proposed terms and other characteristics of the fund.
- § **Credentials** for investment management team and board of directors.
- § **Track record** – this will include building underlying cashflows and return on investment figures from projects undertaken to date.
- § **Investment process documents** illustrating methodology for investing in, and divesting of investments, from the initial stage of assessing an investment opportunity, including the various decision making points, and decision makers.
- § **Information on sources of deal flow** – prospective investors will want to ensure you have a sustainable pipeline of investment opportunities.
- § **Risk management plan** - defines the investment parameters of the fund, including number and size of transactions, investment characteristics, specific sectors, and investment limitations.
- § **Investor due diligence questionnaire** – this document will provide prospective investors with a summary of the due diligence information which they will require to evaluate the investment opportunity.
- § **Legal, tax and compliance documentation** – among the documents you will need to present to prospective investors, and which determine the way in which the fund will operate, are the partnership agreement or trust deed (depending on the structure of the fund), the subscription agreement, a chart illustrating the structure, tax advice, AFSL, and the policies and procedures manual.
- § **Identifying target investors for the fund** – once the positioning of the fund has been agreed on, the prospective investors, and the preferred method for distribution, can be targeted.
- § **Fundraising process** – putting into effect the process of raising capital from investors.
- § **Marketing and investor relations plan** - to ensure the fundraising process is managed systematically, and to maintain ongoing investor relations following the closing of the fund.
- § **Setting up operating and monitoring systems** – this will involve building a database that will track investment opportunities and portfolio companies, and data concerning investors for ongoing communication and capital calls (drawdowns).
- § **Ongoing investor relations** - information must be provided to investors, and annual investor meetings should be held.

The corporate team at Swaab Attorneys is committed to working with companies to help them meet their ambitions. **Pauline Vamos** (former Head of Compliance at ASIC) acts as a consultant to the firm on financial services matters.

If we can help you with any of the issues raised in this Guide, please contact either Fred Swaab or Alistair Jaque. We would be very pleased to discuss any issues with you.

Contact Us

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This Guide is intended to give an overview of the issues involved in financial services regulation in Australia. It is not intended to be fully comprehensive or to be a substitute for legal advice.