FLYING SOLO

A POST-FOFA GUIDE TO OBTAINING AN AFSL

With the new regulatory regime bedded down and certainty returning to the market, some advisers are again embracing dreams of self-licensing

Aleks Vickovich and Rachael Micallef report

Since the time then-financial services minister Chris Bowen announced the Future of Financial Advice (FOFA) reforms, some commentators have heralded the beginning of the end for self-licensed financial advisers.

The additional regulatory requirements would have practice principals buried deep in red tape and make the dream of licence ownership a relic of a bygone financial services era, the story went.

Undoubtedly, the period of FOFA consultation and implementation has been a period of consolidation by the larger players, with stories of longstanding advice firms joining AMP or bank-aligned financial services licensees emerging almost by the day.

This influx of new advisers into the warm embrace of the institutional dealer groups has arguably been hastened by the collapse of mid-tier, non-aligned licensees such as AAA Financial Intelligence and Australian Financial Services (AFS) Group and troubles faced by groups such as WealthSure – events that have seen many former authorised representatives taking refuge in insto financial planning channels, either by choice or by convenience.

And yet, while the market movement is undeniable, predictions of Doomsday for boutique financial planners have been grossly exaggerated. By way of example, Paul Tynan of Connect Financial Services Brokers, a consultant specialising in mergers and acquisitions in the financial planning market, says the mass exodus of firms predicted has not come to pass and that there are in fact "more buyers than sellers" in the market.

Indeed, not only have the existing boutiques not headed for the exit, but there are signs of a growing interest in obtaining an Australian Financial Services Licence (AFSL).

"We are definitely seeing an increase," says Alex Euvrard, business manager of consultancy My Dealer Services, referring to interest in AFSL applications. "The reasons for it really do differ between practice to practice and adviser to adviser, but some of the main reasons we are seeing is the dissatisfaction with current dealer groups, the restrictions placed on the freedom of advice and the direction of advisers by their current licensees".

It is with these rumblings of dissatisfaction in mind that *ifa* has prepared a post-FOFA guide to obtaining an AFSL, laying out the process step-by-step and asking some hard questions about what your licensee is offering and whether FOFA has really changed anything at all.

FOFA fears

Many commentators feel that underlying the trend towards institutional licensing has been one of the most pervasive of human emotions – fear. "The consolidation we've seen is a result of people being scared," says Kate Humphries, general manager of Netwealth-affiliated consultancy Pathway Licensee Services.

"They didn't understand the new requirements and whether they were going to be able to continue running licences," she adds.

Mr Euvrard agrees that FOFA – or at least uncertainty about the finer details in the reform package – has been impacting demand for AFSLs. "I think a lot of people stuck with their current licensee to see what the implications were of the new FOFA regime," he says.

Therefore, from a theoretical perspective, FOFA has been a roadblock for those advisers thinking of flying solo – something the recruitment officers of the larger dealer groups have been keen to exploit.

Chief among the FOFA uncertainties is the issue of grandfathering and whether grandfathered revenue will stay with an adviser who moves to new licensing arrangements. Ms Humphries points out that this is indeed "an issue generally", but says that at the same time, it is something that affects everyone in the market.

Beyond this provision of the legislation which requires further guidance, overwhelmingly the experts canvassed in compiling this guide believe FOFA has in no way made self-licensing more difficult.

In fact, financial services compliance lawyer Sophie Gerber of Sophie Grace says that, if anything, the opposite is true: "[FOFA's ban on product commissions] was designed to lead people towards getting their own licence and I'm very glad people are bouncing back," she says.

First steps

While FOFA may not present any real roadblocks, and may be theoretically supportive of self-licensed advice, there are still a number of important considerations you should look at closely when deciding whether or not to get your own AFSL.

1. DO YOU KNOW WHAT YOU'RE GETTING INTO?

Before putting pen to paper on an application, Mr Euvrard says knowing what you're in for is critical. "You should never be in a position where something was not known up front or surprises you later down the track," he says. "The first thing I say to anybody is make sure you know absolutely everything about the process [and also] what comes after you are given an AFSL – and that includes both costs and regulatory impositions."

Chris Mee, special counsel at Thomsons Lawyers, agrees that being on top of regulatory change – particularly in the current climate – is non-negotiable for a licensee. "If compliance isn't your thing then you probably have to consider whether or not it's really appropriate for you to get your own licence," he says.

For Ms Humphries, self-licensing requires not just staying on top of regulatory and market changes, but adopting a more managerial outlook.

"[Advisers] need to realise that they will have significant additional responsibilities: they will have a role as director, a managerial role, and this is a different hat from giving advice," she says. "They should always focus on the client and the advice given to that client, but realise there is a significant time commitment over and above the advice part of the business."

In other words, beyond the world of financial services and the intricacies of its licensing and regulatory system, at its core, obtaining your own AFSL is about running your own business – meaning the buck will stop with you.

This new managerial hat will almost certainly demand more of your time, so before making the call, practice principals need to be ready to part with their traditional modus operandi.

Dover Financial Advisers founder Terry McMaster received his own AFSL eight years ago and says it can run the risk of being a distraction. "Now we're an AFSL and we're in the business of being an AFSL, but if you're looking at a financial planner or an accountant who is really in the business of being a financial planner or accountant, they're being distracted from their main game," Mr McMaster says.

"It's not just the person's salary that is being expanded in the experience, it is actually the

Coalface *case study*

ifa spoke to one financial adviser who is in the process of getting his own AFSL. He shares the pros and cons of the experience:

WHERE ARE YOU IN THE PROCESS?
What I'm going to look at first is just to get a full understanding of the best interests duty under FOFA – there are a lot of things up in the air at the moment. So there are a couple of things that I want to fully understand first and then I'll go through with the application.

WHY ARE YOU LOOKING TO GET YOUR OWN AFSL?
Conflict of interest is the first and foremost thing – I want to be completely independent. Also, I didn't want to be forced into paying unnecessary PI insurance premiums due to past claims histories [associated with] other authorised reps that were under those dealer groups.

WHAT BENEFITS DO YOU SEE SO FAR?
The two mains things are... full retention and control of revenue, and you can outsource specific areas of your business to dedicated service professionals such as legal and compliance.

WHAT CHALLENGES HAVE YOU COME ACROSS?
Believe it or not, the biggest challenge at this point is probably the PI insurance – it's the cost. In terms of competence or getting through the process, if you partner with the right service provider, that wouldn't be a problem because they do it day in and day out... they know what to look for and what your weaknesses are straight away.

opportunity cost that that person otherwise would have been doing."

2. DO YOU NEED HELP?

Not surprisingly, all of the third-party consultants and advisers to AFSL applicants that *ifa* spoke to believe an application will be significantly enhanced by enlisting some help.

"I think it is absolutely necessary that for the first 12 months of licensing a new licensee partners with a service or compliance support service company and, if anything, all they do is hold their hand and guide them through the first year's licensing," says Mr Euvrard.

Ms Humphries adds that the process is just "much simpler" if you contract an expert who understands "exactly what the regulator requires in terms of documentation and the principles sitting behind the questions". However, she adds that the Australian Securities and Investments Commission (ASIC) portal is "relatively user-friendly" and there are also application kits available. Ms Gerber agrees that you can take a more collaborative approach, "having a go" at applying yourself and then seeking help if and when you require it.

Theo Afkoudias of The Financial Writing Company says outsourcing help in applying for an AFSL should be considered less a cost and more an investment. "Typically, running an AFSL is not one's core so there is great value for money [in seeking] help from outsourced service providers," Mr Afkoudias said.

There is evidently no shortage of expert consultants who can assist with this process. While going it alone may be more in line with the independent spirit of self-licensed advice, prospective licensees should be aware of the help that's on offer.

Value proposition

It is often said that good advisers are those who are very aware of their value proposition and can articulate it effectively to clients.

The same logic can be applied to AFSL applications. Once you have decided to take on the process of self-licensing you need to decide on what kind of AFSL you require, meaning you need to re-assess exactly what you intend to offer the market.

According to a Thomsons Lawyers report, *Applying for an AFS licence*, "not all AFSLs are the same" and the type of licence needed depends on several factors that you will need to consider.

1. WHO IS APPLYING?

First, you need to determine who is applying for the AFS licence: whether it is you as an individual, a partnership, a company, the trustee of a trust or 'other' entity. This is an important aspect even before the application stage as you may need to apply for an ABN or an ACN before starting the process.

A trustee cannot be the holder of an AFSL so you need to apply in your own name rather than in the name of the trust.

2. WHAT SERVICES WILL YOU PROVIDE?

The type of licence required boils down to the type of services that you are looking to provide. These all need to be outlined and approved by ASIC for you to work under your AFSL. The authorisations you choose during your application also impact the products you can give advice on, your obligations to ASIC and whether you have use of particular "restricted" terms such as "insurance broker".

Your choices will, in addition, impact the questions asked during the remainder of the application.

"There are many different kinds of licences providing a diverse range of financial services," ASIC outlines in AFSL guidance RG104.21.

"We do not take a 'one-size-fits-all' approach to regulation. Rather, we acknowledge that what you need to do to comply with your obligations will vary according to the 'nature, scale and complexity' of your business."

Thomsons Lawyers' Mr Mee says that ensuring you are applying for all the products and services you wish to provide is critical for the rest of the application.

"If you're a financial planner you're normally giving advice and you're dealing in a financial product by arranging for people who buy products and there will be different classes of assets," Mr Mee says.

"You need to work out what sort of authorisations you need because that will dictate what experience you also need to prove that you can operate a business that has those authorisations".

ASIC recommends breaking down the type of financial services you wish to provide and then identifying the types of products that these financial services may cover.

However, the regulator makes note that an applicant shouldn't apply for unnecessary products or services "just in case you might want them in the future" and stresses the importance of only listing those that align to your business.

3. WHO ARE YOUR 'RESPONSIBLE MANAGERS'?

The Thomsons guide explains that "the success of any AFS licence application is largely dependent upon the skills and experience of the [people you nominate as 'reasonable managers'".

"A 'responsible manager' is a person who is directly responsible for significant day-to-day decisions about the ongoing provision of your financial services," it continues.

All responsible managers are required to meet one of five minimum education standards which differ depending on whether the manager holds an industry standard qualification, diploma, degree or has miscellaneous experience. However, the experience guidelines for responsible managers generally must meet "3 years relevant experience over the past 5 years" or "5 years relevant experience over the past 8 years".

"Here, 90 per cent-plus of enquires fall short of what I would consider adequate experience," Mr Afkoudias says.

"We're looking for strong experience in a compliant Australian financial environment and, to this end, we work backwards from three years as a responsible manager for another licence. For example, the further the potential applicant digresses from this level of experience, the less likely they are to be successful."

In addition, your responsible managers need to have combined knowledge and skills that cover all of your financial services and products in order for you to be compliant. This also means they need to have direct responsibility for significant day-to -day decisions.

"So if you, for example, didn't have experience in giving advice on shares it would be difficult for you to show – to prove to ASIC – that you have experience in providing advice on that particular product, so that's important," Mr Mee says. "Every AFSL is different, obviously, and you choose which authorisation you think you require in order to operate your business."

Applying yourself

1. WRITING TIPS

ASIC's form FS01 for AFSL application can be submitted online and Mr Euvrard said the process for its completion can effectively be broken down into two processes.

"It's a) about putting forward the business or licensee entity in a way to show ASIC that it can hold and maintain a licence going forward and has all the right policies and procedures in place," Mr Euvrard said.

"Then b) it is making sure that the resources and in particular the human resources within the business are of a standard to hold and maintain an AFSL going forward, and in particular being able to meet responsible manager obligations."

Writing AFSL applications is the speciality of the Financial Writing Company and Mr Afkoudias said he has three expert tips for advisers wishing to undertake the process.

"The word 'balance' comes to mind," Mr Afkoudias says. "The main thing to remember is that the entire application is considered in balance and that every section is considered as important as the other.

"At a high level, the entire application requires prudent thought and the needs to reflect a business model that is: a) Well thought out and supported by appropriate systems and processes; b) supported by adequate resources; and c) run by highly experienced credible management.

"Any gaps or shortcomings in any of these areas will reduce likelihood of success. In terms of style, be factual, brief and transparent," he adds.

2. FINDING FORM

Specifically, the form requires you to provide your details, business details, information on the types of financial services and products you want to provide and how you meet your obligations in regards to responsible managers, systems and processes.

This also includes a business description which needs to go into some detail about types of clients, expected income and growth and service delivery models.

"The next step is to gather together all the proof that you need to put together on each .... responsible manager," Mr Mee says.

"A couple of business references, a police check and of course experience qualifications as well, so there is a little bit of time in getting those materials together."

This includes a table of competence for all of the nominated responsible managers.

ASIC also requires various financial statements which depend on the type of financial services to be provided.

Ms Gerber said financials can be a considerable cost for anyone wishing to be an AFSL holder as holders are required to have at least 20 per cent of their next three months' cash flow.

In addition, if you're providing services to retail clients you need to provide arrangements for internal and external dispute resolution, compensation and insurance, which usually involves Financial Ombudsman Service (FOS) membership.

Ms Gerber said FOS can be a challenge in itself for advisers and the initial membership fee can cost around $600-$700.

"That's your membership fee and then you've got an annual subscription," Ms Gerber says. "They'll ask you [for] your funds under management (FUM) or your funds under advice (FUA) and the number of clients and they calculate a fee based on that, so it does fluctuate."

ASIC will need to receive an emailed copy of your application form, a statement of personal information and your core proofs within 20 days of your submitting your online application.

3. UP FOR REVIEW

Once the application has been lodged ASIC will allocate it for review and is likely to request additional "proofs" regarding compliance.

"You have to give them statements about how you're going to manage conflicts of interest, how you're going to manage risk, show them what your IT resources are and how you'll deal with things like disaster recovery, how you'll handle clients' money... how you'll train your responsible managers," Mr Mee says.

If ASIC requests further information at this stage then it needs to be provided within 10 business days. Thomsons' guide recommends that you prepare these documents while waiting for your application to be reviewed or even prior to lodgement so they are ready to go with minimal fuss.

Ms Gerber says that if ASIC has any problems with the application up to this point the regulator generally provides feedback before rejecting it outright.

"Generally they'll call us if there is going to be an issue and they'll say, 'look, there is going to be an issue, it's probably not going to work' and you have the option to withdraw it [or] amend it and resubmit," Ms Gerber said.

"Generally, it comes down to the responsible manager ... and at that point the licensee will have to find someone else."

If the application is successful, ASIC will then issue you a letter of offer which, for applicants looking to provide retail services, is conditional upon obtaining professional indemnity (PI) insurance.

The trade-off

While market conditions may be improving slightly in favour of boutique advisers, and the process through which a licence can be obtained is relatively simple, the decision to self-licence should not be taken lightly. The institutional dealer groups have been highly successful in perpetuating the view that they can offer greater security and a plethora of services from compliance to research assistance, allowing advisers to focus on their core client-facing role.

Overwhelmingly, these are the reasons given by advisers seeking refuge under institutional umbrellas. For example, one former authorised representative of collapsed dealer group AAA Financial Intelligence told ifa that despite their long-held views on the benefits of independent advice, they have ultimately opted for a bank-aligned licence since the risk of non-compliance made the prospect of joining another non-aligned AFSL "just not worth it".

Similarly, speaking at a recent industry event, CBA general manager of advice Marianne Perkovic said firms that have recently joined CBA-aligned licensees say that "having their own licence was too cumbersome", while others have said it is just too expensive.

All of these are valid concerns and the sorts

AFSL *checklist*

AFSL

PRE-PROCESS

- ✓ Know the ins and outs of the process
- ✓ Do your research and factor in cost
- ✓ Speak with a lawyer or consultant
- ✓ Apply for an ABN or ACN

THE APPLICATION

- ✓ Decide which products and services to offer
- ✓ Choose your responsible managers
- ✓ Ensure you meet the "three out of five" or "five out of eight" years' relevant experience
- ✓ Clarify any threshold issues such as organisation competency
- ✓ Prepare documentation, including application FS01, supporting proofs and underlying procedures
- ✓ Organise financials documents – which includes having 20 per cent of the next three months' cash flow
- ✓ Lodge membership with an external dispute resolution scheme such as FOS
- ✓ Organise PI insurance
- ✓ Submit application, ensuring core proofs are submitted within 20 days of the online application
- ✓ Liaise with ASIC to provide additional documentation where necessary

POST-PROCESS

- ✓ Maintain compliance, including regulatory knowledge and licensee obligations
- ✓ Ensure legal documentation, including FDS, is compliant
- ✓ Ensure you keep up to date with your regulatory knowledge

of issue that should be weighed up when making the all-important licensing decision. However, when you draw up a basic cost-benefit analysis, flying solo may not be all that daunting an alternative.

1. THE HIP POCKET

Cost is one of the most ambiguous topics in financial services licensing. A perfunctory surf of a few institutional licensee websites will lead you to some weasel-word descriptions of benefits and services but very little transparency around dealership fees.

While noting the difficulty of gaining an accurate picture of dealership costs, Ms Humphries says that "as a sweeping generalisation, the cost of self-licensing is probably somewhere between $20,000 and $30,000" while "anecdotal evidence suggests dealer fees can be anywhere between $15,000 and $80,000".

If this anecdotal evidence is accurate, it would suggest the basic costs of self-licensing are less, but that there are some discount AFSLs on offer.

Mr Euvrard agrees that for many advisers the costs of self-licensing may be equal to or lesser than dealership fees – depending on the case. "People wouldn't be making five enquiries a week [about obtaining an AFSL] if it was a lot more expensive," he says.

However, Ms Humphries also points out that a prospective licensee needs to factor in the non-negotiable continuing costs, including "software, ongoing education and the governance of the licence" – not to mention any consultants' fees to be added on.

Adam McGuren, national manager of BT Financial Group's Licensee Select business, a Westpac-aligned consultancy, says that if you are to "look at headline numbers, being self-licensed is generally cheaper than being institutionally licensed" but that this does not take into account the time costs of running a business and the costs of FOFA implementation.

Within that discussion of the costs associated with licensing, one of the most controversial moot points is PI insurance.

Ms Gerber and Ms Humphries agree that the most commonly heard hesitations about self-licensing concern PI.

The two consultants place the basic premium costs of PI for a self-licensed adviser as between $10,000 and $20,000, while some dealer groups maintain they only charge around $3,000 for insurance. However, Ms Gerber says comparing licensee PI costs with self-licensed

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premiums is misleading since often dealer groups will "subsidise the cost and get money out of you in other ways".

Undoubtedly, the scale and power enjoyed by institutional dealers allows them to negotiate a cheaper PI premium for their representatives, which prospective AFSL holders should keep in mind. But as Kate Humphries points out, other players can also negotiate with PI insurers, such as industry associations.

2. SO LONELY

For any small business owner, cost-effectiveness will be a significant issue. But Ms Humphries says it should not dominate the decision-making process for licensing. "You really need to think about more than money," she says. "The conversation needs to be about control of destiny, the service offered to clients and the implications for approved product lists."

A thirst for independence – and the costs associated with that increased control of destiny – should therefore be the driving force behind any decision to self-license.

At the same time, it is the security of having someone help ensure you are on the right track that a self-licensed adviser may be giving up. "A lot of dealer groups out there do provide very good resources to their advisers and to their authorised representatives and by taking the route of getting your own AFSL you do give up a lot of those extra resources available to you," Mr Euvrard says.

At the same time, there is a perception that with the right systems and partnerships in place, "you can get just as much exposure to those resources", he adds.

For Ms Humphries, the idea of being a self-licensed 'one-man band' is increasingly unviable. She recommends that self-licensed advisers ensure they have a "network" of some sort, a forum for sharing ideas and getting feedback, whether it be a competent support staff, industry association or whether a licensee moves quickly to establish their own dealer group.

What is abundantly clear is that for independently-minded advisers, chasing the dream of having their own licence will almost certainly involve some cost and sacrifice. But evidently, there is no shortage of experts and consultants available to help make that dream a reality. «