Morgans Financial Limited ('Morgans') – Executive Summary

1.1 Purpose

The purpose of this document is to:

a) establish key background and antecedents;
b) summarise compliance analysis and findings;
c) identify concerns; and
d) outline recommendations.

1.2 Background & Antecedents

a) Market Participant (ASX only), with ~ 550 representatives and ~ 60 offices across Australia. Approximately five of these offices are owned offices and the remainder 'Managed Offices';
b) traditional stockbroking model with strong financial planning/wealth management activities;
c) has 'strategic alliance' with CIMB (Malaysian banking group) which involves co-branding, shared research coverage and corporate finance arrangements – there is no indication that CIMB intends shareholding/ownership at present;
d) over recent years Morgans has had a significant regulatory footprint, due mainly to retail client complaints concerning representative conduct re; advice and options, resulting in:
   i. a number of representatives being considered or put forward for banning actions (e.g. Wilkins, Peters), along with significant clusters of retail client exposures (e.g. Springwood, Burleigh Heads);
   ii. 35+ PI insurance notifications since 2011 involving mainly advice and options (with individual claims routinely in the hundreds of thousands of dollars);
   iii. ASIC oversight of Burleigh Heads retail clients remediation (re; s 22 [redacted]
   iv. s 22 [redacted]
   v. s 22 [redacted]

1.3 Analysis & Findings

a) current surveillance was established to assess the adequacy of representative supervision and monitoring, in particular supervision of the managed office network;
b) analysis involved reviews of high level risk management and compliance practices comprising: breaches and complaints registers, Board Reports indicating reviews of representatives and branch/managed offices, compliance plans demonstrating key arrangements and the 'management agreement' between head office and managed offices;
c) surveillance to this point has identified significant compliance issues and deficiencies comprising;
   i. numerous significant open complaints emanating from the Springwood office s 22 [redacted];
   ii. negligible effective compliance response to incidents, breaches and complaints involving representative conduct, which by any reasonable compliance standard were actionable/reportable (predominantly around

personal advice, tax schemes and options). Furthermore poor formatting of breach register and dismissive tone in assessing breaches;

iii. Quarterly Reports used to evidence day to day compliance are not systematically reviewed by compliance and not scaled for managed offices of different sizes. s 22 [redacted] and in some instances managed offices may not have the relevant expertise to supervise their representatives.

iv. Annual compliance visits by head office to managed offices is not always carried out and may not be sufficient to supervise the managed office network.

v. conflicted managed office compliance functions (vis remuneration and PI insurance excess cost sharing thresholds with Morgans); and

d) a key feature of the management agreement is the PI insurance responsibility/cost break-up, vis Morgans paying insurance premiums only versus managed offices paying any settlement, excess and associated claims costs – while this may be seen to place a greater compliance onus on the managed offices, in effect it is a significant disincentive to actually deal with incidents, breaches and complaints appropriately (from our first-hand review this sentiment appears consistently).

e) Poor controls regarding confidential information handling and staff trading as expressed by MET. Compliance isnot informed of capital raising activity by corporate and Morgans recently advised that no restricted trading lists are maintained. Staff trading isapparently only reviewed to ensure no adverse impact upon market conditions for that day.

1.4 Concerns

a) although the quantum of breaches and complaints might be considered 'usual' for this size of business, the issues of inappropriate advice and options trading are consistent features of our experience with Morgans;

b) Morgans, by placing the bulk of compliance responsibility on branch managers, are attempting to minimise their own responsibilities under 912A;

c) Morgans' current supervisory framework (where conflicted branch managers are responsible for day to day compliance, submit Quarterly Reports and head office conducts annual visits etc.) is not an adequate arrangement to ensure compliance; and

d) save for an extensive overhaul of Morgans' compliance model, and implicitly its business model with the 'managed offices', Morgans poses an ongoing regulatory threat/burden.

1.5 Recommendations

a) considering the significant ongoing regulatory experience and antecedents, along with the serious deficiencies identified from this latest work-stream, we have sufficient relevant grounds to table concerns with Morgans;

b) meet with Morgans before any further surveillance activity to express ASIC's lack of confidence in their compliance model;

c) place upon Morgans the expectation that they respond with an action plan to address the concerns and that any such plan should include a request to apply varied licence conditions involving ASIC oversight (implicitly via a 3rd party); and

d) in the absence of any reasonable plan express the intention of proceeding with the surveillance, with the expected outcome of a referral to a delegate for licensing action.

e) the recommendation to obtain licence conditions (voluntarily or otherwise) is one of a number of possible formal outcomes expected and should be considered in this context.

NB: Morgans have agreed to attend a meeting in Sydney on 17 June to discuss the concerns, which have been prefaced in discussions. The meeting will involve:

- Brian Sheahan - Managing Director
- Jennet Butler - Director, Legal & Compliance
- Hamish Dee - Director, Market Operations