FINANCIAL SERVICES COUNCIL

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Financial Services Unit
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The Treasury
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By email (Word and PDF formats)

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Dear Colleagues

Design and Distribution Obligations and Product Intervention Power (DDO and PIP respectively):
Proposals Paper (Paper): December 2016

The Financial Services Council (**FSC**) has over 100 members representing Australia's retail and wholesale funds management businesses, superannuation funds, life insurers, financial advisory networks and licensed trustee companies. The industry is responsible for investing more than $2.7 trillion on behalf of 13 million Australians. The pool of funds under management is larger than Australia's GDP and the capitalisation of the Australian Securities Exchange and is the fourth largest pool of managed funds in the world. The FSC promotes best practice for the financial services industry by setting mandatory Standards for its members and providing Guidance Notes to assist in operational efficiency.

Thank you for the opportunity to provide a submission on the Paper.
Our submission follows.

We have set out a summary of our views in Part 1, followed by more detailed analysis of the DDO and PIPs proposals in Parts 2 and 3 respectively.

Design and Distribution Obligations and Product Intervention Power (DDO and PIP respectively):
Proposals Paper (Paper): December 2016: FSC Submission: 15 March, 2017

PART 1: BACKGROUND: FINANCIAL SYSTEM INQUIRY (FSI) RECOMMENDATIONS

1. As you know, the genesis of the proposals is the FSI recommendations, 21 and 22. The Executive Summary of the Paper notes:

As part of the Government's response to the Financial System Inquiry (FSI), Improving Australia's Financial System 2015, the Government accepted the FSI's recommendations to create new accountability obligations for entities that issue or distribute financial products (recommendation 21) and to strengthen consumer protection by introducing financial product intervention powers (recommendation 22).

2. The FSC, on 31 March 2015, provided a submission on the final FSI recommendations, including recommendations 21 and 22. We have **attached** an extract from our submission relevant to these two recommendations. In summary, the FSC views then were as follows-

Recommendation 21 (DDO)

The FSC recommends that the Government not introduce a new and unnecessary product design and distribution obligation given: existing multi-layered obligations on financial services providers; implementation risks associated with the proposed obligation; the significant compliance burden it would impose; and the negative impact such an obligation would have on consumer autonomy and choice.

Recommendation 22 (PIP)

The FSC recommends that the Government not provide ASIC with a product intervention power given ASIC already has wide-ranging powers which allow it to act where there have been breaches of the law or license conditions. The introduction of a new discretionary power would see ASIC stray into the field of mandating permissible products, a role which is properly the responsibility of the legislature. If introduced, the FSC recommends that the power only be exercised as a last resort, be constrained through robust accountability and oversight mechanisms, and that clear guidance be provided regarding the circumstances in which ASIC might exercise the discretion.

3. We confirm our previous submissions for the purposes of the Paper. In particular, our concerns are that the introduction of a DDO is a new obligation which has the following potential implications-

(a) the stifling of innovation;

(b) prohibiting the distribution of certain classes of products to retail consumers as this removes choice across a range of products for consumers who may understand the *risk* involved; and

(c) the imposition of a significant compliance burden for industry where existing obligations on licensees already afford protection against the mis-selling of products.

In relation to the PIP, our view remains that ASIC has sufficiently wide and far-reaching powers and an additional discretionary overlay of power is not required.

4. We appreciate however, that our views on the proposals set out in the Paper are being sought and accordingly, we make the following observations by way of summary of our position:

(a) if the Government were to introduce a DDO, then sensible and practical parameters should be placed around that obligation. These parameters:

(i) should recognise existing regulatory and general law obligations of issuers and distributors, and on that basis exclude certain low risk and well-regulated products such as basic banking deposit products from the regime, or at a minimum provide that they are deemed appropriate for all target markets ;
(ii) should factor in start-up and on-going compliance costs for distributors and issuers;
(iii) should preserve to the extent practicable, existing customer autonomy and choice;
(iv) should not be overly prescriptive and be principles-based which necessarily would be capable of being adapted to each issuer's and distributor's circumstances, including the reality of the commercial relationship which generally exists between distributors and issuers, which is generally weighted in favour of distributors (see Question 6);
(v) ought to exist within a framework where obligations are *scaleable* having regard to the nature and type of product, and should not apply to MySuper or ERF products or to quoted securities (see Question 1) and, consistent with this approach, basic deposit products and other "mass-customised" products, excluded by Regulation;
(vi) ought to include reasonable and appropriate "safe harbours" for issuers and distributors, for example deeming issuers to have complied with their obligations where the distributor is licensed to provide personal

advice with respect of the relevant financial product and distribution is limited to a personal advice channel; and
(vii) ought to allow for product issuers and distributors to devise a compliance framework that is proportionate to the risks faced by retail clients, and appropriate for the type and number of retail clients that the product will be made available to and the level and type of marketing activity proposed, so as to not stifle innovation or impose inefficiency; and
(viii) ought to avoid the duplication of work between issuers and distributors (which would be wasteful and inefficient and would unnecessarily result in increased costs, which will ultimately be passed on to the retail clients) by a coordinated industry-wide matrix of product types and suitable targets which is published for most commonly distributed products.

Importantly, consumer remedies for breach of the DDO should not amount to a de facto capital guarantee of the product or a performance guarantee.

(b) if the Government were to introduce a PIP, then the PIP also should be subject to parameters given the nature of the PIP. These parameters would include the following:

(i) the PIP should be exercised only in connection with an actual or suspected breach of law, based on the expanded base of law created by the DDO;
(ii) the PIP should be a "power of last resort";
(iii) the PIP should not be exercised until such time as all appropriate confidential consultation with the provider (in the case of individual interventions) or industry consultation (in the case of market wide interventions) has occurred;
(iv) the exercise of the PIP should be subject to appropriate administrative and judicial review (including via a commercial panel);
(v) the final outcomes of the exercise of a PIP by ASIC should be clear and transparent.

5. Also in relation to the proposed intervention power, we reiterate some key points from our 2015 submission:

- an intervention power should not be exercised purely because a product is new or innovative, as this would be contrary to the Government's objective of encouraging innovation; and
- the introduction of a new discretionary power could see ASIC stray into the field of mandating permissible

products, a role which is properly the responsibility of the legislature.

6. We continue to query whether the PIP is needed and whether ASIC's existing powers would be sufficient, for example if stop order powers could also be extended beyond defective PDS disclosure to breach of DDO obligations (including in relation to unlicensed issuers), and whether enhancements to ASIC's existing powers would be a simpler and quicker solution to advance the policy drivers of the PIP, rather than imposing an extensive new PIP regime.

7. Having made these general observations, we now will address the specific issues raised in the Paper. For convenience, we will adopt the headings and numbering in the Paper and a summary of the proposal, taken from the Executive Summary, followed by the relevant Questions (taken from the body of the Paper).

PART 2: DESIGN AND DISTRIBUTION OBLIGATIONS

Issue 1: What products will attract the design and distribution obligations?

Summary of proposal: The obligations will apply to financial products made available to retail clients except ordinary shares. This would include insurance products, investment products, margin loans and derivatives. The obligations would not apply to credit products (other than margin loans).

QUESTION

1. Do you agree with all financial products except for ordinary shares being subject to both the design and distribution obligations and the product intervention power? Are there any financial products where the existing level of consumer protections means they should be excluded from the measures (for example, default (MySuper) or mass-customised (comprehensive income products for retirement) superannuation products)?

8. If DDO and PIP are implemented, we support the proposal that they are limited in scope to products issued to retail clients. We propose that they should take the form of a graduated approach, that is, a scalable obligation based on the complexity of the product. It would follow that the more complex the product, the greater the content of the DDO applicable to the product. Necessarily, and consistent with the recommendations of the FSI, the drafting of the DDO framed in legislation should be principles-based rather than prescriptive. The principles should be enshrined in legislation at a fairly high level, for example in the case of product issuers going no further than requiring them to:

   (a) put in place arrangements to identify appropriate target for their products (with the exception of certain "simple" products which should be specifically exempted from the regime);

   (b) select distribution channels and marketing approaches for their products that are appropriate for the identified target market; and

   (c) periodically review their "on sale" products to ensure that the identified target market and distribution channel(s) continue to be appropriate. We note that the DDO proposal does not suggest that (and we consider it important to confirm, to avoid any misunderstanding) that an issuer is required to provide any personal financial product advice itself to an applicant at the time of issue or under the periodic review and that the periodic review does not require the issuer to assess if the product continues to be suitable for a particular

investor (which would be the role of a personal advice provider) but is limited to reviewing whether the initially identified target market continues to be a suitable target market and whether the initially identified distribution channel continues to be suitable.

9. In addition, certain products should be expressly excluded, including ordinary shares, as proposed by Treasury. However, we do appreciate that there are policy grounds and reasonable arguments for consideration to be given to the exclusion of certain other products from the proposals. These potentially include the following classes of products:

   i. Basic banking deposit products;
   ii. ***All*** investments that are listed or quoted on a *prescribed financial market* for the purposes of the *Corporations Act* (**Act**) and *Corporations Regulations*;
   iii. MySuper products;
   iv. Eligible Rollover Funds;
   v. Non-MySuper "choice" superannuation products;
   vi. Certain Life Insurance products (Friendly Societies) and;
   vii. Ordinary units in a business trust;

10. In this regard, we note that some products currently and in the future will be "mass-customised" and have product features which are highly-regulated and prescribed and have terms which largely will be standardised across the industry. A current example is MySuper. A future example may well be a comprehensive income product for retirement (**CIPR**). At the least, we suggest that there be a specific regulation-making power in any final legislation to address issues of this kind going-forward.

11. We also note that for the reasons we outline below, there are strong policy reasons why publicly-traded products should be excluded from the proposals.

12. In any event, it seems to us that all "included products" should be subject to obligations which are **scaleable** having regard to the complexity of the relevant product. Such a graduated, principles-based approach should operate in conjunction with a "safe harbour" for issuers and distributors. The "safe harbour" would deem issuers and distributors who had taken steps which were reasonable and appropriate in the circumstances to have satisfied their duties with respect to the principles-based DDO. For example, where the issuer has arranged with distributors who are licensed to provide personal advice for a product to only be sold through a personal advice channel, or with distributors (eg platform providers) who only make product available to

customers advised by a financial adviser operating under a personal advice model.

13. There are precedents for a "safe harbour" where legislation is principles based.

   (a) For example, S961B(1) of the Act states that a provider must act in the best interests of the client in relation to the advice. A "safe harbour" with respect to this obligation is provided in S961B(2), such that the provider will be taken to have satisfied the duty… if the provider proves that the provider has done each of certain specified matters. This concept is further explained by the remaining subsections of S961B and Ss961C-961F. Just as advice is capable of being *scaleable* and dependent upon the specific circumstances, we submit that a DDO similarly is capable of being scaleable, dependent upon the particular circumstances.

   (b) Section 912A(1)(aa) of the Act provides that an AFS licensee must have adequate arrangements for the management of conflicts of interest that may arise wholly, or partially, in relation to the provision of financial services by the licensee or a representative of the licensee, as part of the financial services business of the licensee or the representative. This obligation is evidently expressed at a fairly high level in the Act and there is no further detail in the legislation itself as to what this obligation entails. Instead, the detail and guidance is provided by ASIC, which has published ASIC *Regulatory Guide 181: Licensing: Managing conflicts of interest* (**RG 181**).RG 181 sets out:

   (i) ASIC's general approach to guidance with the statutory obligation;
   (ii) guidance for AFS licensees generally on controlling and avoiding conflicts of interest;
   (iii) guidance for AFS licensees generally on disclosing conflicts of interest; and
   (iv) issues for AFS licensees to consider in complying with their obligations.
   As with other ASIC Regulatory Guidance, ASIC takes the guidance and expectations articulated in RG 181 into account in administering the law and is of the view that those AFS licensees who do not operate consistently with RG 181 are less likely to be meeting their conflicts management obligations.

We submit that an equivalent approach should be taken to the DDO, whereby the legislation should enshrine the primary

obligation, expressed at a high level which is then supplemented by regulatory guidance provided by ASIC for issuers and distributors in which ASIC outlines its expectations as to what steps issuers and distributors should be taking to comply with their DDO. Clearly, significant industry input would be required to frame this guidance and we would be happy to provide assistance and comments at an appropriate time prior to finalisation of any such guidance.

14. We submit that the effect and implementation of a DDO should be proportionate to the risks faced by retail clients and so should not stifle innovation or growth or impose unnecessary inefficiencies on issuers and distributors. For example, the stepped approach should recognise that the suitability steps that are appropriate for a relatively complicated product actively marketed to large number of retail would be scaled back significantly in the case of a simpler product or one not actively marketed or available to only a small number of retail clients. For an issuer to implement comprehensive compliance measures for a very small number of unadvised clients would seem inefficient and disproportionate.

15. As for what would be reasonable for an issuer or distributor to do to comply with their DDO obligations, this should vary depending on the type of products involved, we suggest that guidance as to the steps an issuer or distributor should take to comply with its statutory obligations should be set out in ASIC guidance.

16. While the DDO will not apply to closed products which are no longer open or able to be issued, which we support as an important principle underlying the proposed DDO, we suggest that the DDO should have regard to FSI Recommendation 43 in relation to the rationalisation of "legacy products"[1]. Our position has been, and remains, that we support the introduction of mechanisms to allow for rationalisation of legacy products, particularly in the life insurance and managed investment sphere, where that it is streamlined and cost effective and favourable to consumers. We hope that the DDO would not block or limit the product rationalisation reforms and that the Government would move forward on legacy product rationalisation on a "whole of legislation" basis including taxation, the Act and product specific legislation such as SIS and the *Life Insurance Act 1995* (Cth).

[1] The Final FSI Report at page 274 defines these as *...products that are closed to new investors and have become uneconomic or rendered out of date by changes to market structure, Government policy or legislation.*

17. In the following paragraphs in response to this question we have outlined some of the policy reasons which could be advanced to exclude certain classes of product from the DDO. However, we appreciate that this is an area where views may reasonably differ. Thus, if Government were minded to include all products, apart from say quoted and basic banking deposit products, our position remains that as outlined above, that is, obligations are scaleable having regard to the complexity of the relevant product, with an appropriate safe harbour provided ..

18. ***Possible Exclusions –Superannuation Products: MySuper***

(a) The existing level of consumer protections currently in place for default and mass customised superannuation products are appropriate (**MySuper**). Superannuation products are governed by well-established general law rules which govern trustee and fiduciary obligations together with detailed regulatory and prudential requirements. This is likely to be the case in the future for CIPR products, as we have noted above.

Under the *Superannuation Industry (Supervision) Act 1993* (Cth) (**SIS**), MySuper Product and Eligible Rollover Fund (**ERF**) Authorisations can only be issued to registrable superannuation entity (**RSE**) Licensee holders, in respect of a registered Australian Prudential Regulation Authority (**APRA**) RSE.

(b) MySuper RSE Licensees must undertake a detailed application process before they are able to offer MySuper products. These products are subject to detailed rules under Part 2C of SIS. These include specific and enhanced obligations on a trustee offering a MySuper product and directors of such a corporate trustee to, amongst other things: *"promote the financial interests of the beneficiaries of the fund who hold the MySuper product, in particular returns to those beneficiaries (after the deduction of fees, costs and taxes."* SIS S29VN (a).

(c) Additional enhanced trustee obligations relating to MySuper are found in S29VN (b)-(d). These obligations are additional to general law trustee obligations and duties and the statutory covenants such as the 'best interests' duty, applying under S52 SIS.

(d) There are also specific obligations with respect to insurance provided in superannuation, requiring trustees to: formulate an insurance strategy for the benefit of beneficiaries, consider the cost to beneficiaries of insurance cover, only offer cover that does not

inappropriately erode retirement benefits, and do everything that is reasonable to pursue and insurance claim for a beneficiary if the claims has a reasonable prospect of success. (S 52 SIS).

Further, each director of a corporate trustee of a regulated superannuation fund that includes a MySuper product must exercise a reasonable degree of care and diligence for the purposes of ensuring that the corporate trustee carries out the obligations referred to in S 29VN (S 29VO(1)).

(e) We note that the FSI Recommendations for DDO were proposed because they would create positive obligations on the part of issuers and distributors to supplement the disclosure requirements. The obligations described above provide an effective framework, including a number of positive obligations, that require issuers/distributors to consider (and promote) the interests of consumers. The additional layer of obligations a DDO regime would impose appears to be unnecessary (putting to one side considerations of cost, complexity and potential confusion of regulatory ambit).

(f) A person who suffers loss or damage as a result of the conduct of another person that was engaged in contravention of these provisions may recover the amount of the loss or damage by action against that other person or against any person involved in the contravention. An action may be begun at any time within six years after the day on which the cause of action arose (see Ss 29VP and 29VO SIS).

(g) Employers may only make (effective) superannuation guarantee-type contributions to default superannuation funds or plans which are MySuper products. For these purposes, *default superannuation funds* are those funds to which employers make compulsory superannuation contributions for employees who do not choose a fund to receive those contributions. For these employees, a default fund is selected by their employer, or nominated through an industrial award or enterprise agreement. The target market is thus already identified by operation of legislation and its attributes are legislatively defined. RSE Licensees and directors already are subject to extensive general law and statutory obligations and duties and subject to prudential supervision by APRA.

Possible Exclusion – Superannuation Products: ERFs

19. In relation to ERFs, we note as follows-

(a) there are reasonable arguments that ERFs should be excluded from the DDO regime;

(b) an ERF provider is appointed by an RSE licensee when it determines that it is in members' best interests to offer an ERF for particular member scenarios (e.g. low balance);

(c) by way of general observation, a member joins an ERF in circumstances where the member is "lost" or has a low balance and accordingly, cannot be regarded as having being "mis-sold" a product;

(d) ERFs are unable to be sold or marketed direct to retail investors and unlike most other choice superannuation products do not contemplate receipt by the trustee of a member application form;

(e) by their nature, ERFs may only accept rollovers and not contributions;

(f) in order to comply with a DDO, an ERF issuer is likely to need to "look through" RSEs to RSE membership demographics, which may raise practicality, general law confidentiality and privacy issues;

(g) as with MySuper products, ERFs are subject to prudential supervision by APRA and from 1 July 2014 a fund only has been able to operate as an ERF with APRA authorisation. There are a range of extensive SIS obligations in relation to the conduct and operation of an ERF. DDO obligations would impose an overarching layer of complexity and governance with little or no end benefit to consumers.

Possible Exclusion – Superannuation Products: Choice Funds

20. Similar observations to those above in relation to MySuper and ERFs may also be made during the course of the consultation process in relation to non-MySuper ("choice") superannuation products. Given the extensive overlay of general law and SIS regulation, together with prudential supervision by APRA, we question whether an overarching DDO would achieve any higher consumer benefit than already exists for such choice products.

Possible Exclusion – Life insurance products in MySuper

21. Funds that have a MySuper licence are required to offer death and permanent disability cover on an opt-out basis and income protection cover on an opt-in basis. Minimum cover amounts are prescribed in legislation. As these products are mandated by the legislature, we submit that insurance that meets the requirements for MySuper should be exempt from DDO obligations or be deemed to have met the safe harbour requirements.

Possible Exclusion – Products complying with Life Insurance Code

22. Sections of the life insurance industry have already progressed in developing industry standards to self-impose DDO like obligations, to improve consumer protections. For example, the FSC Life Insurance Code of Practice includes the following requirements for compliance from 1 July 2017:

3.1 a) Define suitable customers for the product
b) Include benefits intended to cover genuine risks that generally affect the relevant customers
c) Incorporate plain language into our sales and policy information and consumer test the plain language into
d) Ensure that the policy information for policies sold directly to individuals is clear and informative for a consumer to reasonably assess the suitability of the policy for them
e) Regularly review our on-sale products to ensure they remain generally suitable for the relevant customers. We will re-design our on-sale products where necessary.

23. We submit that there should be an option for industry sectors, like the life insurance industry, to adopt a code of practice which sets out the steps that are appropriate for industry members to take to meet the DDO. Industries should be encouraged to develop and seek approval for codes that impose requirements on industry members which address the specific issues for that industry. Where this occurs, the approved code should be able to displace the statutory DDO regime. Alternatively, complying with an approved code should be the basis for a reasonable steps defence to the statutory DDO regime.

Possible Exclusion – Pensions and annuities that meet SIS definitions.

24. The *Superannuation Industry (Supervision) Regulations 1994* contain definitions of 'annuity' and 'pension' in Part 1A. These definitions are required to be met in order to qualify for

concessional tax treatment. As the definitions are very detailed, we submit that these products should be exempt from DDO obligations or be deemed to have met the safe harbour requirements.

25. As part of Treasury's proposed introduction of innovative income stream rules for retirement, new definitions are expected to be introduced into Part 1A of the SIS Regulations for "deferred pensions" and "deferred annuities". Consistent with the treatment for 'annuities' and 'pensions', we submit that "deferred pensions" and "deferred annuities" should also be exempt from the DDO obligations or be deemed to have met the safe harbour requirements.

Possible Exclusion – Certain Life Insurance Products (Friendly Societies)

26. Similar to MySuper and ERF obligations, life insurance products, that are investment bonds or benefit funds, are also governed by well-established general law rules and statutory covenants which govern life companies and friendly societies and prudential requirements. Investment bonds/benefit funds can only be issued by APRA registered friendly societies, which are governed under the *Life Insurance Act 1995* (Cth.) (the **Life Act**).

There is also a detailed application process that a friendly society must undertake before the friendly society is authorised by APRA to offer investment bonds/benefit funds to retail clients - Division 2 of the Life Act and APRA Prudential Standard LPS700.5, including "a report by the appointed actuary on the establishment of the benefit fund and the proposed benefit fund rules".

Each director of the friendly society of the investment bond/benefit fund must exercise a reasonable degree of care and diligence for the purposes of ensuring the friendly society carries out the obligations referred to in the Life Act as well as S912A of the Act, for Australian Financial Services Licensee obligations.

The additional layer of obligations a DDO regime would impose unnecessary costs, complexity and confusion of regulatory ambit.

Possible Exclusion – Basic banking deposit products

26. Basic banking deposit products should also be excluded from the DDO because:

(a) they are well understood and frequently used by customers. Customers are more likely to be engaged with their transactional accounts which they use on a daily basis. Treasury's position expressed in the paper is

that ordinary shares are excluded as they are well understood – we submit that basic banking products are more commonly used and better understood than ordinary shares;

(b) Basic banking deposit products are protected, in the event the Authorised Deposit-taking Institution (**ADI**) account issuer becomes insolvent, by the Financial Claims Scheme, up to a limit of $250,000 per customer, per ADI;

(c) ADIs which are subscribers to the Code of Banking Practice (or the Customer Owned Banking Code of Practice) provide additional protections to customers:

(i) 95% of the retail banking market is covered by the Code of Banking Practice (source: Australian Prudential Regulation Authority, June 2015);
(ii) whilst the Codes are voluntary, they provide customers with substantial protections and enforceable rights against subscribers (*Doggett v Commonwealth Bank of Australia [2015]* VSCA 351) – including in relation to suitability of accounts (clause 16 of the Code of Banking Practice); and
(iii) the Code of Banking Practice is likely to be substantially re-drafted in 2017 with additional protections provided to be provided to customers of subscribing ADIs.

Possible Exclusion – ordinary units in a business trust

27. In relation to ordinary shares made available to retail clients, we question whether the proposed exclusion of such products alone from a wider class of securities does create the potential for arbitrage and unfairness. In our view, any exception should also extend to ordinary units in trusts which carry on a business (other than an investment business). Otherwise a business which operates through a trust structure would be unfairly prejudiced.

Possible Exclusion – listed or quoted products

28. Also, we submit that the exception should extend to all investments that are listed or otherwise quoted on a *prescribed financial market* such as the market operated by the ASX Limited. One example here is that of units in listed trusts (particularly those which are part of stapled structures) which are indistinguishable from listed shares other than in their legal form should be excluded from the regime along with ordinary shares. Quoted investments afford a range of protections to

investors which we submit render the protections of DDO unnecessary. Quoted products are by definition liquid. They can be easily and quickly sold on market within two business days on a T+2 basis, which means that a retail client who considers that an investment that they have made is not (or is no longer) suitable for them, can quickly and simply exit that product. Additionally, continuous disclosure requirements applicable to listed and widely held entities require the prompt disclosure of materially price sensitive information to the market which allows investors and their advisers to make informed decisions about continuing or exiting an investment. Also, listed entities must go through their own suitability requirement in being assessed by ASX as "suitable for listing". Finally, once the product begins to be traded, holders of quoted products can quickly change, which makes it difficult or impossible for the issuer and distributor to practically confirm whether the acquirers of the product in the secondary market are inside or outside the 'target market'. It is therefore impractical and not desirable to require an ongoing review of the suitability of the target market following the listing of the entity (or quotation of the products). Also, the harm that would be caused to existing investors and confidence in the financial markets by withdrawing a product from the market if it is considered unsuitable, and denying investors the ability to sell on market, would outweigh any benefit of restricting future sales. For this reason, if a suitability requirement is to be imposed on any products that are listed or quoted for trading, the suitability process should be restricted to the period prior to quotation.

29. In our view then, there are sound policy reasons not to include quoted products within the DDO regime. In summary:-

(a) once issued and quoted the issuer and distributor have no control and little to no visibility over who purchases the investment product on market. Ownership can change daily and intra-daily. Monitoring and categorising on-market holders of quoted investment products is therefore futile;

(b) quoted investment products are already subject to numerous design and distribution constraints imposed by the listing rules and operating rules of the relevant market operator. For example, to be eligible for admission to the ASX a registered managed investment scheme must not allow for the redemption or buy-back of units on the instigation of the holder which effectively leads to units in a listed registered managed investment scheme to be similar in structure to ordinary shares;

(c) quoted and widely held investment products are subject to Corporations Act and listing rule imposed continuous and periodic disclosure obligations which provide a ready catalyst for the imposition of supervisory and intervention powers by the ASIC and the market operator. Imposing additional product intervention powers over quoted investment products is an unnecessary and unreasonable cost and regulatory burden on both the issuer and regulator;

(d) quoted investment products are already subject to supervisory and intervention powers under the terms of the relevant listing rules and operating rules. Imposing additional product intervention powers over quoted investment products is an unnecessary and unreasonable cost and regulatory burden on both the issuer and regulator;

(e) *Prescribed financial markets* are well known and the products quoted on them are the most well understood of all financial products by the investment community. Investors understand what they are buying when they buy a product on a prescribed financial market. In addition, these products are already subject to a high level of regulatory, market operator and press scrutiny. We submit that financial products quoted on a prescribed financial market are not the types of products intended to be caught by the proposed new regulatory framework.

Adjustment of Exclusions by Regulations?

30. Noting that one of the objectives of the FSI was not to limit or deter innovation, we suggest that the DDO framework should include a mechanism, for example by regulation, which allows for the creation of new exemptions as new types of financial product are developed. As we have said, CIPRs may well be an example of such a product in the future.

DDO followed by Exclusion by Regulations?

31. We have recommended a number of exemptions and we recognise that there may be concerns that in certain circumstances it may be appropriate to impose the DDO notwithstanding our submissions above. To address this concern, we recommend that there should also be an ability for regulations to adjust the exemptions after suitable consultation has occurred with the affected part of the industry.

QUESTIONS

2. Do you agree with the design and distribution obligations and the product intervention power only applying to products made available to retail clients? If not, please explain why with relevant examples.

32. Yes, we agree that the DDO and PIP should apply only to products made available to retail clients. The distinction in the Act between retail and wholesale clients is a long-standing one.

3. Do you agree that regulated credit products should be subject to the product intervention power but not the design and distribution obligations? If not, please explain why with relevant examples.

33. Yes, we agree that the PIP should apply to regulated credit products but not the DDO. We support the proposal and agree with the rationale set out in section 2.2 of the Paper.

4. Do you consider the product intervention power should be broader than regulated credit products? For example, 'credit facilities' covered by the unconscionable conduct provisions in the ASIC Act. If so, please explain why with relevant examples.

34. No response to question 4.

Issue 2: Who will be subject to the obligations?

Summary of proposal: 'Issuers' and 'distributors' of financial products must comply with the obligations. 'Issuers' are the entities responsible for the obligations under the product. Examples of issuers include insurance companies and fund managers.
'Distributors' are entities that either arrange for the issue of the product to a consumer or engage in conduct likely to influence a consumer to acquire a product for benefit from the issuer (for example, through advertising or making disclosure documents available). Distributors that provide personal advice will be excluded from the distributor obligations. Examples of a distributor include a credit provider that offers its customers consumer credit insurance or a fund manager that distributes its products using a general advice model.

QUESTION

5. Do you agree with defining issuers as the entity that is responsible for the obligations owed under the terms of the facility that is the product? If not, please explain why with relevant examples. Are there any entities that you consider should be excluded from the definition of issuer?

35. Yes, broadly we agree with the concept of the proposed definition. In some cases however, an issuer also may be a distributor and we suggest that the operation of the DDO in such circumstances is confirmed.

    (i) for example, a trustee (or for a registered managed investment scheme, a Responsible Entity (**RE**)) thus will be an issuer of product.
    (ii) However, as noted in the above example, if an issuer distributes its products under a general (or even a no) advice model, it may be also characterised as a distributor.
    (iii) There is also uncertainty in relation to the operation of the DDO where an issuer engages the services of distributors who provide personal advice, but the issuer itself only provides general advice, for example on its website.

    Presumably in both circumstances the DDO regime would operate in relation to imposing issuer DDO obligations only on the issuer.

36. In a practical sense and in a similar vein, it seems to us that specific consideration and regulatory guidance in relation to the stepped approach and what is reasonable and appropriate in the circumstances also will need to be given to the following situations-

    (a) advised clients (personal advice);

    (b) clients who receive general advice only;

    (c) orphaned clients (noting that ASIC's regulatory guidance in RG148 requires platform providers to have policies in place to deal with the situation where investors do not opt in to continuing to receive financial product advice and cease to have an adviser);

    (d) clients who receive no advice;

    (e) platform clients (retail clients who acquire a product through a platform, where the issuer of the product will be aware of the platform operator but will have no visibility on the underlying retail client or whether they are or are not within the target market. Is the issuer's target audience the platform operator rather than the underlying retail clients?);

    (f) no active distribution (where the issuer makes the product documentation available on request or on its website but does not engage a distributor and does not actively distribute the product); and

(g) group entities in a conglomerate where some entities may *issue* and others may *distribute* products.

37. Further, for the reasons given in our response to Question 2, where a life insurance policy is issued by a registered life insurer to the trustee of a superannuation fund as a wholesale client and on that basis, the trustee issues a superannuation interest to the member based on the terms of the life insurance policy, we would like it to be clear that the trustee is the only issuer.

QUESTION

6. Do you agree with defining distributors as entity that arranges for the issue of a product or that:
(i) advertise a product, publish a statement that is reasonable likely to induce people as retail clients to acquire the product or make available a product disclosure document for a product; and
(ii) receive a benefit from the issuer of the product for engaging in the conduct referred to in (i) or for the issue of the product arising from that conduct (if the entity is not the issuer).

38. One particular concern which has been expressed by our members is the potential breadth of this definition and any consequent liability for issuers. Practically, it is extremely difficult for issuers to monitor the actions of distributors, particularly distributors who are not required to be licensed under the AFSL regime. In this context we suggest that consideration be given to tempering the potential breadth of the definitions by making "safe harbour" and "due diligence" approaches available to entities.

39. Also, given the breadth of the definition it will be important to ensure that, in addition to media company exemption, other persons involved in the issue or acquisition of products who should not be subject to distributor duties are appropriately exempted, for example:

(a) trustees of superannuation funds in relation to the insurance cover provided to members of the fund – there are already significant obligations for such trustees under the Insurance Management Framework requirements;

(b) employers who have selected a default superannuation fund for their employees – employers and the Trustee of the superannuation fund already have significant obligations for MySuper default super arrangements selected by the employer; and

(c) registries;

(d) other "media" related entities and providers which, technically, are not "media companies" in the relevant sense, for example-

(i) websites such as search engines;
(ii) social media;
(iii) online blogs;
(iv) websites of government and other information providers-these commonly "host", for a fee, advertisements or teasers from a multitude of issuers, but do not conclude contracts and in a practical sense have no ability to monitor the sale or issue of products;

(e) execution only providers such as the ASX or Chi-X which provide a platform or secondary market for products to be traded; and

(f) licensed trustee companies and public trustees when acting under an enduring power of attorney, or under a financial management order of a court/tribunal in respect of an individual with impaired decision making capacity.

40. The Paper appears to assume that issuers select and appoint distributors and that issuers are in a commercial position to be able to monitor and report on the distribution activities of their distributors. In fact, most issuers are selected by the distributors (in that the demand for a product originates with the distributor and the distributor's clients). In a post-FoFA environment significant constraints are imposed on the ability of an issuer to provide inducements to distributors in relation to the distribution of an issuer's product. The commercial reality is that there is little ability for the issuer to influence and control the activities of distributors or to monitor and review the activities of a distributor. Accordingly, we raise whether this aspect as it is articulated in the Paper, should be reconsidered.

41. Many issuers, who are not members of a conglomerate group, rely on third party distributors. Distribution itself of a financial product by a third party should not be characterised as an outsourcing activity under an outsourcing agreement; which would generally confer rights of control to the outsourcing party (the issuer) and access to data held by the distributor. If the DDO is introduced, issuers would be required to seek and negotiate for amendments to their distribution agreements to facilitate the DDO (including data reporting) and as a practical matter they may not have the bargaining power to achieve what they would like.

42. We submit that it will be important to clarify and limit the obligations of issuers and the obligations of distributors, to avoid duplication of work and promote an efficient financial services industry. Where both the issuer and the distributor duplicate work eg in reviewing retail client information and identifying target markets, the process is inefficient and wasteful and adds to the cost of doing business, which will ultimately be passed on to the retail client.

43. We also request that consideration be given to limiting the benefit referred to in paragraph (ii) to a monetary benefit.

44. It would be useful for Treasury to consider its approach towards the relationship between managed funds and platform (superannuation and investment) providers and whether a platform provider is considered a distributor for a managed funds issuer. A platform provider will be an investor in the fund manager's managed fund in order to make such fund available on platform through which retail investors may then, indirectly, access exposure to the managed fund. Platforms will be charged a wholesale rate management fee on their investment, but in some circumstances may not (particularly post FoFA) receive a benefit to place a managed fund on platform. In such circumstances, would a platform provider be considered a distributor? We also discuss the issue in paragraph 53 below.

45. Where a life insurance policy is issued by a registered life insurer to the trustee of a superannuation fund as a wholesale client and, on that basis, the trustee issues a superannuation interest to the member based on the terms of the life insurance policy, we would like it to be clear that, on the basis that the trustee is the issuer in that scenario (see our responses to Questions 2 and 5), the trustee is therefore not the distributor.

QUESTION

7. Are there any situations where an entity (other than the issuer) should be included in the definition of distributor if it engages in the conduct in limb (i) but does not receive a benefit from the issuer?

46. No. An entity should only be included in the distributor definition where it receives a benefit from the issuer.

QUESTION

8. Do you agree with excluding personal financial product advisers from the obligations placed on distributors? If not, please explain why with relevant

examples. Are there any other entities that you consider should be excluded from the definition of distributor?

47. Yes, licensed advisers or advisers otherwise authorised to provide personal product advice (such as an employee of a licensed entity) who provide personal financial product advice should also be excluded from the definition of distributor. The reason for this is that such persons (or the licensed "principal") are already subject to a raft of de facto distribution obligations under the Act, such as the "best interests" obligation. These advisers should also be excluded when providing scoped/scaled advice or general advice.

48. We also suggest that where the issuer and distributor entities are o part of a corporate group, the distribution entity should also be excluded from the definition of distributor as the issuer and distributor will have the same parent entity and there should only be one instance of the obligations being imposed.

49. We suggest that such a carve-out or limit would need to be reflected in the issuer obligations as well. How will an issuer be able to comply with their obligations to conduct ongoing reviews of target markets for products and their distribution arrangements where a personal advice providing distributor is carved out of the obligation to comply with reasonable requests for information from the issuer related to the issuer's product review? Therefore if a personal advice carve-out is provided for distributors, a corresponding carve-out or limit needs to be applied to a product issuer's product review obligations as they apply to review of distribution arrangements where distribution occurs under a personal advice model. This is consistent with the scaled approach suggested above and recognises the limits on what the issuer can reasonably be expected to do in the circumstances.

50. Issuers will generally enter into distribution arrangements with an advice licensee entity (not with individual financial advisers). An advice licensee may be involved in the provision of both general and personal financial advice, however the issuer will have no line of sight as to which form of advice is provided to the retail client who ultimately invests (often indirectly via a platform) in the issuer's financial product.

51. Building on the theme noted above, from an issuer's perspective a better approach would be that where issuers enter into distribution arrangements with a distribution entity (such as an advice licensee entity) that has a personal financial advice authorisation, the issuer should be carved out from obligations, or have modified obligations, that reflect the personal advice carve-out for distributors. For example where an issuer has a

distribution arrangement/agreement with a distributor that has a personal advice authorisation under its AFSL:

- the issuer is deemed to have met its obligations to select a distributor that is likely to result in products being marketed to the identified target market; and
- the issuer is not obliged to undertake review of its distribution arrangements with such a distributor.

52. Issuers will also often enter into distribution arrangements/agreements with platform operators. Financial advisers then utilise these platforms to access the issuer's financial products for their clients which may be on the basis of personal advice provided by the adviser. So the ultimate retail client has had the benefit of personal financial advice, but that personal advice has not been provided by the platform operator with whom the issuer has the contractual distribution arrangement (and therefore again the issuer has no knowledge of the provision of personal advice or not).

53. We propose that where a client accessing a financial product via a platform has been the recipient of advice from a financial adviser (eg reference to an adviser is included on an application form), to the extent a platform is deemed to be a distributor, it should be able to obtain the benefit of the personal advice carve-outs, and as above:

- the issuer is deemed to have met its obligations to select a distributor that is likely to result in products being marketed to the identified target market; and
- the issuer is not obliged to undertake review of its distribution arrangements with such a distributor

54. In any event, care should be taken in the drafting to ensure that there is no increase in the onus on the issuer as a result.

QUESTION

9. Do you agree with the obligations applying to both licensed and unlicensed product issuers and distributors? If they do apply to unlicensed issuers and distributors, are there any unlicensed entities that should be excluded from the obligations (for example, entities covered by the regulatory sandbox exemption)? Who should be empowered to grant exemptions and in what circumstances?

55. Our view is that unlicensed issuers (including those distributing to retail investors without a licence under the Asia Region Funds Passport, when implemented) and distributors should be captured by the DDO requirements and that where a distributor

is not subject to the obligations and compliance checks and balances applicable to AFSL holders consumer outcomes would be improved if the DDO applied to impose a minimum level of protection for consumers. Also it is inequitable to subject licenced issuers and distributors to a further layer of regulation where they are already subject to compliance requirements and not impose the same obligations on unlicensed issuers and distributors. If the DDO obligations are principles based and scaleable then the steps that it would be reasonable to expect an unlicensed distributor to take in meeting its DDO obligations would be different to those that it would be reasonable to expect a licensed distributor to take.

Issue 3: What will be expected of issuers?

***Summary of proposal**: Issuers must: (i) identify appropriate target and non-target markets for their products; (ii) select distribution channels that are likely to result in products being marketed to the identified target market; and (iii) review arrangements with reasonable frequency to ensure arrangements continue to be appropriate.*

QUESTIONS

10. Do you agree with the proposal that issuers should identify appropriate target and non-target markets for their products? What factors should issuers have regard to when determining target markets?

11. For insurance products, do you agree the factors requiring consumers in the target market to benefit from the significant features of the product? What do you think are significant features for different product types (for example, general insurance versus life insurance)?

56. We note that issuers generally consider a target market when creating a financial product. Regardless of this target market it should remain the consumer's choice as to whether or not they invest in the financial product. If issuers are to define their target market, it would be reasonable to assume that the level of detail and specifics of the target market would depend on the complexity of the product.

57. The obligation for determining target markets should be general and not extend past the point of identifying the general characteristics of investors or product features relevant to suitability. Issuers cannot and should not be required to collect or verify personal information (eg investment or risk management needs and financial literacy or ability to understand key features of the product) from potential investors

or applicants in order to determine whether they meet their defined target market. We would ask that Treasury recognises that many issuers do not have personal advice AFSL authorisations, and do not have infrastructure, processes and procedures associated with the provision of personal advice. Therefore they are cognisant of not seeking information from potential customers such as would be deemed to be the provision of personal financial advice in breach of their AFSL. Given the breadth of the definition of personal financial advice (ie the consideration of one or more of a person's objectives, financial situation and needs), any reform would need to be careful not to require issuers to obtain information in relation to a persons' objectives, financial situation and needs such that would push general advice (or no advice) issuers into the realm of providing personal advice. At the very least, activities required to be undertaken for the purposes of these obligations should be excluded from the definition of the provision of personal advice for Act purposes.

58. Accordingly and consistent with the approach we have outlined previously, our view is that these concepts should be expressed as high-level principles rather than by prescriptive rules. Our view is that these principles should be expressed at a fairly high level and that issuers should take reasonable steps depending on the circumstances. This is the approach which generally occurs as a matter of current commercial practice. As mentioned in the Paper, an example may be found in the AFMA *Product Approval Principles* of March 2016-

http://www.afma.com.au/afmawr/_assets/main/LIB90032/Product%20Approval%20Guidelines%20V%201.2%20March%202016.pdf

59. Our view is that in relation to these concepts, generally we feel that a graduated or stepped approach is preferable in these kinds of matters, with the overarching principle being one of what is reasonable for an issuer to undertake in the particular circumstances such as the nature of the risk faced by the investor, the nature of the relevant relationships and whether there is one or more AFS holder in the process and the number of retail clients involved.

60. Treasury moots that issuers should provide guidance on the maximum allocation to a "high risk" product in a balanced portfolio. Noting our point above about issuers not having personal advice authorisations, it is a matter for a consumer (possibly together with their adviser) in the context of their own personal objectives and circumstances (including risk appetite, investment timeframe and other investments in their portfolio) to determine an appropriate allocation to any investment

product. Issuers will not have sufficient line of sight of this information to be able to properly advise investors in this way.

61. The following suggestions mooted by Treasury in relation to the identification of target market should not be applied for the following reasons:

- The ability of consumers in the target market to understand key product features, and the risk tolerance of consumers in the target market – in a general or no advice model, an issuer (or distributor) is not in any position to know this information.
- The likely performance of the product – it is not appropriate or realistic for issuers to predict the future performance of their investment products. Given ASIC's robust guidance around the use of prospective financial information and hypothetical or non-actual performance, we find it surprising to that issuers be expected to consider likely future performance in the identification of target markets.

62. Consistent with the graduated or stepped approach we have proposed, we would like to work with ASIC to formulate some guidance and industry standards as to how to possible standard categorisations or descriptions of the target market (and the key features of the product and key characteristics of retail clients that would be used to identify and describe the target market). We envisage that there would be a range of categories which, if standardised, may be easier for retail clients to understand when they read the target market description in the PDS and want to test if they are within that target market or not. A simple and standardised approach should promote understanding, efficiency and access to the right types of products.

63. It should be made clear that there is no obligation on issuers or distributors to take any action to consider or analyse whether existing investors in products (ie invested prior to implementation of any legislative change) are within or continue to be within the target market.

64. For insurance products, we do feel it is reasonable (and indeed generally consistent with current commercial practice) to expect an issuer to identify and collate a list of significant product features and identify appropriate target markets. However, in this context it would be useful if ASIC were to provide guidance on the make-up of that list of significant product features. This would assist retail investors to make comparisons between such products.

For completeness we do note that some specific issues may well arise in relation to platform products, as noted above. These will require further consideration and review.

65. We believe it is sufficient for an issuer to identify a target market and do not believe it is necessary to identify non-target markets.

QUESTION

12. Do you agree with the proposal that issuers should select distribution channels and marketing approaches for the product that are appropriate for the identified target market? If not, please explain why with relevant examples.

66. Our view is that that any obligations here should be expressed subject to the caveat that an issuer need take only reasonable steps having regard to the circumstances and in particular, the class of product. Generally, we emphasise the nature of the reasonable controls a distributor is obliged to undertake, necessarily will depend on the nature of the product. Again, the controls should be proportionate and reasonable depending on the nature of the product and a graduated or stepped approach would apply. So, by way of example, the content of the controls and precise obligations will differ depending on the product- the content and level of the obligation for MySuper or CIPR/MyRetirement (assuming they are included would be markedly different and "lesser than" those applying to products such, say, CFDs and margin FX.

67. We would request that in drafting obligations, Treasury recognises that certain types of distributors may not have the ability to differentiate or target their distribution. Whilst advice licensees that employ a face to face advice model may be able to control which of their clients are provided "access" to certain products, other distributors may not eg:

(i) no advice or general advice distributors whose distribution is purely digital/online and accessible by any consumer; and
(ii) advertising in magazines/certain types of media either digitally or hard copy cannot differentiate based on target market as anyone is able to access/subscribe to it.

68. A ramification of this requirement may be that issuers only appoint distributors that operate a personal advice model. If this is the case, it removes access to products for all non-advised customers. Surely this cannot be Treasury's intent.

69. It is important for certain product types that certain distribution channels are able to be accessed, for example ETFs (including active ETFs) require brokers to be involved in their distribution.

QUESTIONS

13. Do you agree that issuers must have regard to the customers a distribution channel will reach, the risks associated with a distribution channel, steps to mitigate those risks and the complexity of the product when determining an appropriate target market? Are there any other factors that issuers should have regard to when determining appropriate distribution channels and market approach?

70. Our view is that the identified factors in this question are likely to represent a reasonable approach, provided that it is acknowledged that what is seen as reasonable will depend upon the particular circumstances and that issuers can only have regard to the customers a distribution channel can reasonably be expected to reach. The circumstances will determine the steps to be taken in any particular case. We do note that generally, distribution channels are selected based on the target market. In addition, and particularly where the issuer and distributor are both AFSL holders, there are due diligence obligations, processes and agreements, including AML/CTF agreements in place between issuers and distribution channels to mitigate risks.

QUESTION

14. Do you agree with the proposal that issuers must periodically review their products to ensure the identified target market and distribution channel continues to be appropriate and advise ASIC if the review identifies that a distributor is selling the product outside of the intended target market?

71. Consistent with our previous comments, we believe that an obligation to undertake a periodic review should apply on a graduated or stepped a basis. A “safe harbour” approach should apply here also in that an issuer need take only reasonable steps having regard to the circumstances and in particular, the class of product.

In this context, we note that issuers should not be obliged to revisit or reinvent the past. The DDO should not be retrospective. We note and support the proposal that closed products are excluded from the issuer obligation for periodic reviews. We request that any future issues of legacy products to existing

product holders (for example, the purchase of further units) are also exempt from the DDO.

72. We support the proposal that the DDO obligations only apply to new issues of products and do not apply with respect to retail clients' products issued prior to the implementation of the DDO and that periodic reviews of products to ensure the target market and distribution channel remain appropriate should be for products on sale and for new customers only.

73. We do note however that this obligation effectively imposes what is a post-sale review of relevant products. Taken to its logical extreme, this could be expensive and onerous for issuers. Again, it seems to us that the obligation should be to take steps which are reasonable and proportionate in the circumstances. The review should be a "fit for purpose" review- and not a "best of breed" review. On this analysis, any review thus should be directed to identifying any systemic issues in relation to the product.

74. Large issuers may have scores or even in excess of a hundred products and depending on the final form of obligation, may require significant resourcing to conduct regular reviews. This may be at cost to the consumer.

75. We believe that distributors will need to implement material systems changes in order to be able to source data on distribution to target market, and correspondingly issuers may need to undertake material systems builds to feed into / receive data from distributor systems. Again this may require significant resourcing which may be at cost to the consumer.

76. We do not agree that the issuer should be required to advise ASIC if they identify that the distributor has sold outside the identified target market. Rather this should be a matter as between the issuer and distributor and dealt with under the terms of any distribution agreement between them. Further, any distributor will already be subject to its own breach notification obligations under s912D of the Act. As noted above, the current commercial reality, post FoFA, is that commonly, it is the distributor which has the ascendant position, rather than the issuer.

77. To the extent any obligation to report is retained , we note that any final legislation ought to include "whistle-blower" and other protections (eg, breach of employment contract, and duties of confidence) where persons feel it appropriate to report to ASIC breaches of the obligations.

QUESTION

15. In relation to all the proposed issuer obligations, what level of detail should be prescribed in legislation versus being specified in ASIC guidance?

78. It may well be too early in point of time to sensibly comment on this aspect at this stage. We do note however that one possible approach here may be for ASIC to issue guidance in a manner similar to APRA (as distinct from binding APRA Standards). Given that in a practical sense, often ASIC's Regulatory Guides are seen as an expression of how ASIC interprets the law and applies it (and in effect de facto law); it may be more appropriate for this guidance to be provided in another form.

Issue 4: What will be expected of distributors?

Summary of proposal: Distributors must: (i) put in place reasonable controls to ensure products are distributed in accordance with the issuer's expectations; and (ii) comply with reasonable requests for information from the issuer related to the product review.

QUESTION

16. Do you agree with the proposal that distributors must put in place reasonable controls to ensure that products are distributed in accordance with the issuer's expectations?

79. Consistently with our comments in relation to Issue 3 (expectations of issuers), if obligations are imposed on distributors, a flexible process and approach should be taken having regard to the particular circumstances. Thus, it follows that the nature of the reasonable controls a distributor is obliged to implement to ensure products are distributed in accordance with issuer expectations, will depend on the nature of the product and the distributor's distribution model. Similarly, it follows that any controls should be proportionate and reasonable depending on the nature of the product, with a graduated or stepped approach imposed. Accordingly, the controls will differ depending on the particular product- refer to our earlier comments in relation to MySuper products compared with say CFD and margin FX products.

80. We do note that a number of the distribution controls set out on page 24 of the Paper require testing, eg, disclosure, calculator and self-assessment tools, and product features. This does raise the very important issue as to the level of testing

required to satisfy the proposed requirements and its implications. For instance:

(a) if a distributor were to test for effective disclosure, how is effectiveness to be measured? Is this an optimal outcome? If so, is the optimal outcome to eliminate all risks of consumer detriment?

(b) if this is the case, how will this impact on business innovation?

(c) how does this interact with existing disclosure obligations?

Our concern here is that the threshold for satisfying distribution controls is unclear and ambiguous and perhaps in its current form is not capable of being satisfied. In our view, these kinds of issues in a practical sense will require further consideration and consultation. Parameters will need to be placed around tests of appropriateness and suitability. We note that this will be a matter for ASIC guidance in due course and we would be happy to be involved in the development of that guidance with Treasury and ASIC.

81. There are a number of complex issues which arise here which we believe require further detailed consideration and consultation. Examples include the following-

(a) the position of platform and badged products in the distributor obligation regime;

(b) as mentioned in the context of issuer obligations, the outcomes where the issuer is also the distributor or where the distributor and issuer are different entities but they constitute part of the same corporate group. This is particularly relevant where customer information may be held by part of the corporate group but is kept confidential or on a separate data system such that it cannot be accessed by other parts of the corporate group. In such circumstances, if another part of the group holds information which indicates that a customer is not a suitable applicant for a product, it would not be reasonable for the issuer or distributor to seek out and become aware of that information and to take it into account when determining whether to accept an application from the customer and it would be reasonable for the customer to be required to provide relevant information in their application form or to their adviser;

(c) where entities operate on a no-advice or general advice model, the extent to which the DDO obligations require

both distributors and issuers to appropriately "screen" customers entering via websites to an issuer/distributor page to test whether the customers are inside or outside the target market. This issue also is relevant to the timing and transition timetable;

(d) it is not clear how concepts such as goals-based advice might be impacted by the distributor and issuer obligations;

(e) in essence, distributors will need to ensure that an issuer's expectations concerning the target market are appropriately addressed (we note that this also is relevant to the formulation of issuers obligations).

QUESTION

17. To what extent should consumer be able to access a product outside of the identified target market?

82. Theoretically, with appropriate disclosure, this should be permissible. However, we do note that one of the outworkings of FSI, is said to be that disclosure alone in its present form "is not working". If this is correct, it must be asked, should a customer be permitted to acquire such a product only if they have received personal advice from a licensed adviser? If so, there are certain implications and downsides such as:

(a) cost to the consumer;

(b) anecdotally, consumers inherently being reluctant in any event to expend money on advice; and

(c) implications for advisers in giving this kind of personal advice.

There are situations where an investor should reasonably be able to access a product outside of the identified target market; for example, a conservative investor may have a large portfolio with term-deposits and other cash products, however would like to invest 5-10% in a more 'riskier' product. While the defined target market may not meet this conservative investor's risk profile, looking at the investor's overall portfolio, this could be appropriate. In this scenario, the investor should be able to apply for the product and gain access to the investment to achieve their financial goals. Therefore, we submit that as a minimum there should be 'an exception to the rule' available to consumers if the consumer receives personal advice in relation to the acquisition of the product.

83. Alternatively, our preferred approach is that customers should be able to "self-assess" whether a product is suitable for them, using the target market information provided by the issuer and the distributor, including in a Product Disclosures Statement for the product and any appropriate methodology of self-assessment deemed acceptable by an issuer or distributor to enable this to occur. Again, we feel that a principles-level approach is appropriate and that if an issuer and distributor take reasonable steps and provide a reasonable framework to assist a customer to determine if they are inside or outside the target market and whether, if they are outside the target market, the customer determines that the product is nonetheless suitable for them and that they wish to acquire it, that is proportionate and appropriate. We note that this suggested type of graduated or stepped approach is consistent with the approach we have suggested in relation to product review.

84. Additionally, if a consumer has been advised by a financial adviser we see no reason for an issuer not to accept such an investment.

QUESTION

18. What protections should there be for consumers who are aware they are outside the target market but choose to access a product regardless?

85. As indicated above, our preferred approach here is for consumer self-assessment. Thus, if this approach is adopted, the response is that no further protections should be available in these cases.

QUESTION

19. Do you agree with the proposal that distributors must comply with reasonable requests from the issuer related to the product review and put in place procedures to monitor the performance of products to support the review? Should an equivalent obligation also be imposed on advised distributors?

86. Yes, we agree that this is sensible and reasonable if there are protections from any breach of privacy or confidentiality

obligations. However, it important to avoid situations where there are competing reviews and outcomes between an issuer and a distributor. Thus we see merit in recognition that an issuer's obligation may be delegated to a distributor; with appropriate "safe harbours" of the type we have discussed previously.

87. It should be recognised that there are limited unprompted touchpoints between distributors and consumers in a non-advised/general advice context. In this context the distributor will generally only touch the client upon entry into the product. Thereafter (other than in relation to a complaint) there is little opportunity for a no/general advice distributor to collect data from clients. Such a distributor will be unaware of changes in the circumstances of a client that could take the client out of the "target market". Further, we believe it is inappropriate for clients to be contacted by a non/general advice distributor in relation to personal information such as information about their circumstances/income.

88. Therefore, Treasury should make it clear that it is reasonable for an issuer to only request (and a distributor to only provide) target market information as it applied as at the time that the consumer made the initial investment into the product, and that there is no obligation for a no/general advice provider to obtain or provide information as to whether a client continues to fit within target market, unless the client has proactively advised the distributor that its circumstances have changed so as to fall outside of the target market.

89. It is important however that the legislation should **not** include an obligation to monitor the performance of a product as suggested in the Paper. We do not see this as an appropriate allocation of responsibility to a distributor. A distributor by definition should distribute and comply with any arrangements entered into with the issuer and meet the expectations of the issuer in regards to distribution. The role should not include a monitoring function for product performance. If anything, that concept should fall within the domain of the issuer, if it forms part of the review focus at all. We suggest that the ongoing review should be directed to confirming the target market and to assessing whether the distribution channels have been appropriate having regard to those classifications and to identifying any systemic risks arising, including as a result of reviewing customer complaint information. It is not helpful for customers or for issuers if short term performance is assessed as part of this ongoing review – if performance is to be assessed at all, it should be the long term performance of the product, taking into account ideally 5 years of performance.

90. We note with some concern the Example of Issuer and Distributor Obligations on page 27 of the Paper which for Case Study 2 notes that an issuer should "undertake stress testing of the product to identify how it will perform in various market circumstances and include this information in the disclosure document". Given ASIC's robust guidance around the use of prospective financial information (per RG 170) and the potential liability for forward looking statements, we query whether issuers should be required to, and will be prepared to, provide such information in a PDS.

91. Again, in this context, there are a number of complex issues in this area, which require further consideration and we would suggest further consultation. These issues include the following-

    (a) how feeder funds are to be dealt with;

    (b) the impact of and implications for the Asia Region Funds Passport regime;

    (c) any intended extraterritorial effect of the DDO regimes.

92. We assume that the final legislation will contain a saving provision for "grandfathered" distribution arrangements under FOFA. It will be important to confirm that if an issuer and distributor make any amendments to their grandfathered agreements to address or comply with the DDO obligations, those amendments do not imperil that grandfathered status, otherwise issuers and distributors will be prejudiced unfairly as a result of complying with the new DDO obligations.

QUESTION

20. In relation to all the proposed distributor obligations, what level of detail should be prescribed in legislation versus being specified in ASIC guidance?

93. Refer to our comments above in response to Question 15.

QUESTION

21. Do you agree with the obligations applying 6 months after the reforms receive Royal Assent for products that have not previously been made available to consumers? If not, please explain why with relevant examples.

94. We do note that there are a range of practical issues involved in industry making the necessary process and systems changes to accommodate the DDO rules including (as noted above):

    (a) the development/enhancement of processes and systems and allocation of appropriate resourcing to facilitate;

    - identification of target markets;
    - conduct ongoing product reviews;
    - conduct analysis of data between distributors and issuers;

    (b) development/enhancement of distributor systems to restrict distribution to target market, and to report product review related data to issuers; and

    (c) reviewing, negotiating and updating distribution agreements.

    Our experience has been that a six-month transitional period even from the date of Royal Assent for substantive and significant legislation such as this is likely to provide too short a timeframe. When considering the time that has been needed to implement FOFA and A-MIT changes to systems and processes, a transition period of two years would be preferable. We suggest that a transitional period of twelve months would be the minimum period that is workable.

    We agree with the approach that the DDO should only apply to open products and not closed products and would like to clarify that in relation to the application of the DDO to new issues, the ongoing review applies in relation to investors in new products which are issued after the implementation of the DDO.

95. We expect there will be a significant overlap between the infrastructure which will need to be developed/implemented in order for issuers and distributors to comply with the obligations for new products and the infrastructure required to comply with the obligations for existing products, therefore any timeframe for implementation for "new" products should reflect that fact.

QUESTION

22. Do you agree with the obligations applying to existing products in the market 2 years after the reforms receive Royal Assent? If not, please explain why with relevant examples and indicate what you consider to be a more appropriate transition period.

96. There is an important issue here in respect of existing products, whether prior to the introduction of final legislation into the

Parliament or the date of Royal Assent. There is an argument that such products, which were not designed with the DDO obligations in mind, should be exempted as they were not created with the DDO and PIP in mind. These products now cannot be unmade. Our preferred approach is that any new issues and distributions of these products should be subject to a disclosure obligation relating to targeted investor type only and should not be subject to the DDO or PIPs.

97. In any event, we ask that consideration be given to a longer "settling-in" period to enable industry to work through systems and processes in respect of "new" products. This will enable that learning to be transposed to existing products.

98. Again, consideration needs to be given here to the potential impacts upon legacy and closed products. We suggest that these be excluded from the DDO as they are no longer "in the market" as such.

PART 3: PRODUCT INTERVENTION POWER

Issue 5: What products will attract the product intervention power?

Summary of proposal: The power would apply to all financial products made available to retail clients (securities, insurance products, investment products and margin loans) and credit products regulated by the National Consumer Credit Protection Act 2009 (the Credit Act) (credit cards, mortgages and personal loans).

99. Refer to our responses to Questions 1-4 above.

Issue 6: What types of interventions will the Australian Securities and Investment Commission (ASIC) be able to make using the power?

Summary of proposal: ASIC can make interventions in relation to the product (or product feature) or the types of consumers that can access the product or the circumstances in which consumers access it. Examples of possible interventions include imposing additional disclosure obligations, mandating warning statements, requiring amendments to advertising documents, restricting or banning the distribution of the product.

QUESTIONS

23. *Do you agree that ASIC should be able to make interventions in relation to the product (or product feature), the types of consumers that can access a product or the circumstances in which a consumer can access the product If not, please explain why with relevant examples.*

24. Are there any other types of interventions ASIC should be able to make (for example, remuneration)?

GENERAL FSC OBSERVATIONS ON Qs 23 and 24
Introduction to our comments

100. While the Government agreed in its October 2015 response to the FSI to provide ASIC with a financial product intervention power to enable it to modify, or if necessary, ban harmful financial products where there is a risk of significant consumer detriment, the Government's paper also noted that there would be:

> *…detailed consultation with stakeholders to ensure that the power strikes the right balance — providing ASIC with a tool to enable it to take action in exceptional instances, but without stifling industry innovation*.

101. The questions in the Paper presuppose a broad and discretionary intervention power which would not strike that "right balance" and would indeed create a high risk of stifling innovation because of the uncertainty that would be created by a discretion to ban or modify products "without a demonstrated or suspected or breach of the law[2]".

102. The FSC does not oppose increasing ASIC's powers to protect consumers. On the contrary, we consider that appropriate consumer protection supports the trust in, and growth of, the Australian investment industry and its reputation and ability to expand globally, including into Asian markets.

We also appreciate ASIC's concerns that recent studies in the field of behavioural economics show that more detailed information in product disclosure statements does not necessarily result in consumers making better choices, and that there are gaps in the scope and timing of ASIC's existing powers that might be filled to allow more prompt and effective action to abort mis-selling of financial products to vulnerable consumers. However, the current proposal for a broad discretionary intervention power, the limits of which will only be known in hindsight, is deeply flawed. The ability to exercise the power should have a more certain and predictable basis in law, for the reasons and to the extent set out below.

Why should the intervention power be more limited?

The rule of law

103. A key objection to the intervention power is that in its presently proposed form – based on an assessment by ASIC of "risk of significant consumer detriment" – it has no basis in breach or suspected breach of law and is therefore arbitrary, contravening the principle of rule of law, which is fundamental to the operation of business and society, and trust in government.

In a speech on 13 October 2015[3], ASIC Chairman Greg Medcraft referred to the three cornerstones of the free market-based financial system being investor responsibility, gatekeeper responsibility *and the rule of law*.

[2] Paper, page 33
[3] *Putting the customer first: Creating a win-win*, speech to the CFA Australia Investment conference

Also, a key principle stated in the introduction to the FSI interim report was that 'A number of pre-requisites underpin a well-functioning financial system, including a predictable rule of law ...'

104. The principle of rule of law was well defined by the eminent British jurist Tom Bingham[4] who observed that "The rule of law does not require that official or judicial decision-makers should be deprived of all discretion, but it does require that no discretion should be unconstrained so as to be potentially arbitrary."

We consider that a sole test of risk of consumer detriment, which is a potential outcome of actions by a financial services provider and not a test by which the actions themselves can be judged, is arbitrary and operates retrospectively to punish conduct that was lawful at the time it was carried out.

105. The intervention power should only be available where there is a breach or suspected breach of laws that exist at the time the conduct occurs. If laws are expanded to include product suitability requirements (as proposed), and potentially some additional requirements relating to disclosure of risk and/or target market for a product, ASIC could be given intervention powers where there is a breach or suspected breach of those laws, expanding its existing power to issue a stop order for a defective PDS or prospectus[5]. An intervention power based on breach of suitability requirements would enable ASIC to act promptly on mis-selling such as in the case of Storm Financial or Opes Prime.

Supporting innovation

106. The proposed intervention power is also inconsistent with a key objective of the FSI, namely to encourage innovation in the financial services industry.

Businesses need to know in advance of investing in a new venture whether it is lawful and therefore will be able to continue to operate and recoup the investment. For product issuers to be able to adapt in a competitive way in a fast-moving global environment, they need to know if the innovations they devise will be legally permitted.

If an issuer complies with disclosure and product suitability laws, it should not be subject to an arbitrary and unpredictable hindrance on the launch or continuation of a product. Such uncertainty in relation to the substantial investment often made

[4] Tom Bingham, *The Rule of Law,* 2011 Allen Lane. Thomas Henry Bingham, Baron Bingham of Cornhill, was an eminent British judge and jurist, serving as Master of the Rolls, Lord Chief Justice and a Senior Law Lord

[5] If suitability requirements apply to all product issuers including those which do not hold an Australian financial services licence, this would fill an existing gap in ASIC's regulatory toolkit.

in product development could be a fatal disincentive to such investment.

Consequences for ASIC and Government

107. Another potential difficulty with the intervention power is whether it is realistic to expect that ASIC will have the resources, expertise and foresight to continuously monitor all products in the market to check whether they are being mis-distributed, and make appropriate and well-timed decisions to require a product to be withdrawn from the market. If ASIC has a very broad power, there may be an expectation by the public that it should be used whenever a disaffected investor complains.

An academic commentator has pointed out[6] "the simple fact that even large, sophisticated institutional investors made a series of tremendously bad investments in the run-up to the 2008 financial crisis", and queried whether a government regulator would be any less fallible.

Professor Robert Baxt also summarised this concern well in an editorial piece[7]:

> *Whether ASIC (and APRA) should be given the very wide-ranging powers suggested by the Murray Report is a matter of grave concern in my view. This is despite the fact that we have a precedent which the Murray Report relies on (the United Kingdom financial regulator was vested with similar powers in 2012) …. Equipping ASIC with many of the powers suggested by the Murray Report poses the danger that a new power of quite untested proportions and range will be vested in a regulator which arguably does not have the experience to take on such a challenge. Vesting such responsibilities and powers in ASIC, will in effect turn it into a 'market player'…*

108. The statutory mandate of the UK Financial Conduct Authority, which currently has an intervention power which is reflected in this proposal, includes "securing the appropriate degree of protection for consumers". [8] By contrast, ASIC's statutory charter is to "promote the confident and informed participation of investors and consumers in the financial system"[9]. The different philosophy in corporate regulation in

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[6] Ronald J Colombo, *Merit Regulation via the Suitability Rules*, World Economic Review (Issue No 2, 2013, 7 February 2013) http://wer.worldeconomicsassociation.org/files/WEA-WER2-Colombo.pdf
[7] Robert Baxt, *Corporations & Securities Law Journal,* (2015), 33 C&SLJ 3
[8] *Financial Services and Markets Act* 2000 (UK).
[9] *ASIC Act 2001*, section 1(2)(b)

Australia, which has prevailed since 1989[10], means that our regulator's people and processes may not be adapted to taking an interventionist approach without significant new resources. If ASIC is granted a fully discretionary intervention power, and does not use it in time to prevent "significant consumer detriment", the public opprobrium and political fallout for Government could be substantial.

Intervention as a last resort

109. We prefer the approach suggested by the FSI that an intervention power should be used infrequently and as a method of last resort to regulate the offer of financial products. While the proposals in the Paper in relation to consultation and consideration of alternative powers are helpful, we would prefer that the PIP is regarded as a power of last resort, particularly in relation to market wide interventions, which have the potential to significantly impact on financial services businesses and on ongoing investment in, and the confidence and trust in, the financial services sector. Unless the circumstances in which the power can be used are properly circumscribed in law, the difficulties of uncertainty and the hazards noted above will burden and constrain the industry in years to come in this post-mining boom period when growth and innovation of service industries such as financial services are essential to Australia's economic prosperity. We suggest that the legislation identifies the steps that ASIC must take before exercising the product intervention power and that these steps include an objective assessment of the availability and appropriateness of other remedies and why ASIC considers that the use of the product intervention power is appropriate in that circumstance. We also suggest that ASIC provides a copy of that assessment to the persons that will be subject to the power during the consultation process.

What limitations do we propose?

110. We propose the following modifications to the intervention power so that it is based on law and not a theoretically unlimited discretion granted to ASIC:

(a) Banning of products and changes to features or terms and conditions should only be empowered where there has been a breach of law, which would include failure to comply with the new product suitability laws, disclosure laws (PDS and advertising), failure of a licensee to act honestly, efficiently and fairly and the prohibition on

[10] Until that time, the Australian Securities Commission Act 1989 section 3(2)(b) provided that the remit of the Federal regulator was to "maintain the confidence of investors … by ensuring adequate protection".

misleading or deceptive conduct. The ability to ban based on breaches of the suitability laws (which should be made more certain than proposed – see responses on that section of the Paper) should be adequate to intervene in cases of mis-selling such as Storm Financial and Opes Prime, a key objective of the proposed new laws.

(b) Interventions to require changes in product features or terms and conditions should only apply to newly issued products. For existing products, such changes may make a product unsuitable for consumers who have already made the choice to acquire it, or the issuer may be unable to make the required changes, for example, a product which has features which have been approved by APRA. It would be impractical to have two classes of product on issue – one, newly issued, which has modified features and terms and an older class which does not. Modifications to terms and features are particularly problematic for quoted securities which need to be fungible to remain quoted and capable of sale on market.

(c) Interventions to change product features or restrict distribution channels should engage a mechanism for issuers to terminate the product if it would be made uneconomic. Any constraints in the terms of the product or at law[11] that would prevent the product being terminated in a case where intervention makes it unviable should be able to be overridden.

111. Generally, we think that industry could live with interventions that require additional warnings or disclosure, or changes to advertising, so long as they have a basis in law. It may also be preferable to an untrammelled intervention power to introduce some minor changes to disclosure laws such as to require a standardised notation of risk level (by number or symbol) in all product materials.[12]

112. A final point is that unless a product or feature of a product was unique to a particular issuer, ASIC would need to consider whether intervention was appropriate on an industry-wide basis otherwise implementation may result in an uneven playing field across product issuers.

[11] Such as a constitution that does not provide for termination in those circumstances.

[12] In the parlance used by the behavioural economists which Treasury and ASIC have in part informed their thinking on this subject, such simple labelling could deliver a "nudge" to product manufacturers to design and target products appropriately, because for example a product labelled as extremely risky would have a narrower market.

SPECIFIC FSC OBSERVATIONS IN RELATION TO Qs 23 & 24

113. Our general observations on the scope and nature of the intervention power are set out in the introduction section above.

Specifically in response to question 23, we see the interventions listed in the table in the Paper as "covered" falling into two categories. The first three in the table, to require disclosure, warnings and changes in advertising, may be able to be implemented without significant constraint on innovation or other harm to industry, so long as there is a sufficient connection to existing laws and ASIC's approach is predictable and not arbitrary.

114. However, for the reasons set out in detail in the introduction above, banning, change of features or terms and conditions or distribution restrictions should only occur where there has been a breach or suspected breach of the law (including the new suitability requirements for design and distribution).

FSC members are concerned to ensure it is understood that the development of new financial products can require a substantial investment over six to twelve months, and for an apparently legally compliant product to then be banned, or changed so it is uneconomic, does not represent an appropriate balance of the interests of consumers and product issuers.

115. If an intervention power in the proposed form were introduced, we expect that FSC members would be seeking to ascertain through discussions with ASIC whether a new product would be allowed to be offered to the proposed target markets before launch. This could either place a strain on ASIC resources, or if ASIC was unwilling to consult (noting that the Paper proposes that pre-vetting will not be available), leave issuers in a position of high risk that would be likely to inhibit any innovation. While this could be in part addressed by release of ASIC policy, the very nature of innovation is that it produces products which have not been considered by regulators before and so would not be covered by policy. However, if the use of the intervention power were based on breach or suspected breach of existing laws, issuers would be able to determine for themselves whether the product idea could lawfully be pursued and marketed in the proposed way, and have sufficient certainty to invest in new ideas.

116. In relation to Question 24, ie, whether the "not covered" items in the table should be the subject of intervention, our response is "no". We accept and confirm the view of the Paper that training obligations, remuneration and complaints processes are generally adequately regulated by other laws.

Issue 7: When will ASIC be able to make an intervention?

Summary of proposal: *In order to use the power, ASIC must identify a risk of significant consumer detriment, undertake appropriate consultation and consider the use of alternative powers. ASIC must determine whether there is a significant consumer detriment by having regard to the potential scale of the detriment in the market, the potential impact on individual consumers and the class of consumers likely to be impacted.*

QUESTION

25. Do you agree that the extent of a consumer detriment being determined by reference to the scale of the detriment in the market, the potential scale of the detriment to individual consumers and the class of consumers impacted? Are there any other factors that should be taken into consideration?

117. On balance, our view here is the litmus test in this area should be the formation of a view on reasonable grounds that there is a reasonable likelihood of there being a significant financial detriment. The relevant risk level is one that should be considered in the aggregate in relation to the type or class of consumer.

118. Accordingly, for these purposes our view is that consumers should be considered on a group basis and the impact on that group being actual or potential significant financial detriment (with appropriate safeguards and modifiers around these formulations). Refer also to our response to Question 23.

QUESTION

26. Do you agree with ASIC being required to undertake consultation and consider the use of alternative powers before making an intervention? Are there any other steps that should be incorporated?

119. Consistently with our comments in relation to Questions 23-25, yes, we support as a pre-condition to the exercise of the power that there be prior consultation. Further, we suggest that

the power should be exercised on the basis that it is a last-resort power only and this necessarily means that ASIC would not be able to properly exercise the power if there were an equally efficacious power available to it to prevent the perceived harm.

120. There should be quite clear and well-defined procedural aspects as to the mechanics of the exercise of the power. For example, the consultation process and anything said in that process should be treated as privileged and confidential and not admissible in other matters.

121. We submit that it is essential that there should be appropriate consultation and notification before the PIP is exercised. In the ordinary course, ASIC should give affected industry participants adequate notice of any proposal to exercise the PIP and affected industry participants should be given the opportunity to object to the proposed exercise of the power. We recommend 60 days' notice should ordinarily be given to affected industry participants. They should receive a further 60 days' notice of any significant change to the proposed exercise of the power following consultation with a further opportunity to object to the revised proposal.

122. If, following consultation, ASIC decides to make the intervention order, the order should not ordinarily commence immediately. The order should specific a commencement date which should not be less than 30 days' after the order is made, giving affected industry participants the opportunity to appeal to the AAT for a review of ASIC's decision. If an appeal is lodged, the order should ordinarily not take effect until the appeal is finalised.

123. One further area that we think it would be appropriate to address, is that given the nature and impact of the exercise of the power, ASIC should be obliged to provide an ADJRA-style Statement of Reasons for its decision to exercise the power.

124. By way of general comment and observation, our view is that the appeal and review rights which currently apply in relation to ASIC stop orders could be a model for an exercise by ASIC of a PIP.

125. We do appreciate that there may be instances where ASIC does need to exercise a power on an urgent basis. In this instance we would suggest that this be viewed as similar to an application for an urgent injunction on an *ex parte* basis. Thus, drafting which accommodates application to the Court by the Commission itself would be preferable and desirable in ensuring that the rule of law is satisfied.

We also suggest that a PIP be capable of being exercised by the Commission itself and not a delegate for similar reasons.

QUESTION

27. Do you agree with ASIC being required to publish information on intervention, the consumer detriment and its consideration of alternative powers? Is there any other information that should be made available?

126. We refer to our response in relation to Question 26. However, for procedural fairness reasons if our proposal concerning a Statement of Reasons were accepted, that document itself should not be subject to public release until after the confidential consultation with the affected party has been completed.

Issue 8: What will be the duration and review arrangements for an ASIC intervention?

Summary of proposal: *An intervention by ASIC can last for up to 18 months. During this time, the Government will consider whether the intervention should be permanent. The intervention will lapse after 18 months (if the Government has not made it permanent). ASIC interventions cannot be extended beyond 18 months. ASIC market wide interventions are subject to Parliamentary disallowance. ASIC individual interventions are subject to administrative review.*

QUESTION

28. Do you agree with interventions applying for an initial duration of up to 18 months with no ability for extensions? Would a different time frame be more appropriate? Please explain why.

127. We agree with the time frame proposed without the ability for there to be an extension beyond 18 months. By that time, it ought to be clear to ASIC and Government as to the course to be followed to resolve the issue. However, a distinction does seem to be drawn here between individual and market-wide interventions. It is not entirely clear to us why this ought to be the case. Ideally both forms of intervention should be subject to Parliamentary scrutiny.

128. In any event, we would have thought that in the case of Parliamentary scrutiny, a normal consultation process would apply given the 15 day disallowance period for an Instrument-see paragraph 131 in relation to our response to question 30 below. It may be the case that rather than a legislative instrument, that an enactment of the Parliament itself should be considered as more appropriate in particular cases.

129. Commercially speaking, it is unlikely that an issuer or distributor would offer the product again to market after a lengthy ban.

QUESTION

29. What arrangements should apply if an ASIC intervention is subject to administrative or judicial appeal? Should an appeal extend the duration that the Government has to make an intervention permanent?

130. No. Given the nature of the power and the impact its exercise would have, an 18 month cut-off is appropriate-see our response to question 28.

QUESTION

30. What mechanism should the Government use to make interventions permanent and should the mechanism differ depending on whether it is an individual or market wide intervention? What (if any) appeal mechanisms should apply to a Government decision to make an intervention permanent?

131. In our view, if the intervention is market-wide, this ultimately should only be made permanent by the passage of an Act of Parliament. If the intervention is an individual-based intervention, then this should occur by way of an appropriate regulation. However, consultation with the affected parties should be mandated as a pre-condition as a mechanical matter of making the intervention permanent.

132. In our view, in this context, usual and common appeal rights should apply, ie administrative and judicial review. There also is merit in the concept of internal review being considered here. This area requires further explanation, consideration and consultation.

QUESTION

31. Are there any other mechanisms that could be implemented to provide certainty around the use of the product intervention power?

133. Yes. The intervention power should only be used to ban a product, change features or terms and conditions or restrict distribution in cases of actual or suspected breach of the law, including a failure to comply with the new suitability requirements:

- by the issuer in the case of ban or change of feature; and
- by the distributor in the case of distribution restrictions.

In any case, including if the intervention is to require any additional or corrected disclosure, consultation with the affected issuer or distributor prior to any proposed exercise of the power will be extremely important, although it is expected the consultation process would be brief in circumstances where an emergency use of the power is clearly required.

QUESTION

32. Do you agree with the powers applying from the date of Royal Assent? If not, please explain why with relevant examples.

134. If, as we submit is essential, certain intervention powers are enlivened by failure to comply with the new product suitability laws, industry will need time to implement process and system changes to comply with suitability requirements, so the proposed 2 year transition period (or any extension of that period) should apply to any intervention on that basis. In respect of intervention in relation to breaches of existing disclosure laws that could apply from Royal Assent, and to any new disclosure requirements from a reasonable period after introduction, such as 15 months, to cover PDS "roll" cycles.

Issue 9: What oversight will apply to ASIC's use of the power?

Summary of proposal: *Interventions made by ASIC in relation to an individual product or how a specific entity is distributing a product will be subject to administrative and judicial review.*

Market-wide interventions subject to Parliamentary oversight including a 15-day Parliamentary disallowance period.

135. One approach here may be for consideration to be given to the establishment of a commercial review panel, similar to the Takeovers Panel, to provide independent review of ASIC's

intervention decisions. The broader the discretionary intervention power given to ASIC, the more important it will be for there to be a high level of accountability for use of the power as proposed by Recommendation 22 of the Financial System Inquiry. A specialist panel comprised of independent industry professionals could be established to provide independent review the merits of intervention decisions on the application of any interested person, and have the power to vary them or set them aside.

ENFORCEMENT AND CONSUMER REDRESS

What regulatory tools should be used to address non-compliance

QUESTION

33. What enforcement arrangement should apply in relation to a breach of the design and distribution obligations or the requirements in an intervention?

136. The extensive list of existing regulatory tools discussed in the Paper seem appropriate in connection with the suitability regime, although the administrative action of cancellation of a licence should be applied sparingly, as it is at present, because of the seriousness of the effect on the licensee's business.

Consumer redress

QUESTION

34. What consumer rights and redress avenues should apply in relation to a breach of the design and distributions obligations or the requirements of an intervention?

137. The Paper, in relation to this topic, details broadly the steps and measures a consumer may take to obtain redress. Although these approaches may be appropriate in the case of a financial product such as an insurance contract (where cancellation and/or substitution by a new product for future cover is a sensible remedy in cases of mis-selling) this is not the case for all financial products. By contrast, it is of the utmost importance to ensure that in the case of investment or investment-linked products, rights available to consumers do

not amount to underwriting of the performance of a product, transferring the market risk to the issuer and making all products effectively capital guaranteed or performance guaranteed. As pointed out in the Law Reform Commission / CAMAC report No 65 Collective Investments – other people's money, (June 1993),

It is not practical or economically efficient for laws and regulations to try to protect individual investors from a fall in overall market values or a decline in value of a particular investment. The law governing collective investment schemes cannot – and should not – eliminate investment risk. The cost of doing so would be too great, and fund managers would be discouraged from devising innovating financial products.

138. The principle that the investor, and not the product provider, should bear market risk was reflected in the drafting of the laws concerning the cooling off rights for acquirers of financial products, in particular in section 1019B of the Act and Corporations Regulation 7.9.67 which provide that although a product may be returned, the amount of money given back is adjusted so that the investor bears the market risk in the period between acquisition and exercise of their cooling off right.

139. Indeed, it would not be exaggerating to suggest that allowing investors to cancel their investments and be compensated for the movement of financial markets since the time they made their investment, which could be many years prior, could represent a systemic risk to the Australian financial system if the aggregate amount of that risk fell on financial institutions who issued the investment products. The increasing prevalence of class actions heightens the scope for this risk to have a catastrophic effect on product issuers.

140. It is acknowledged that there is a remedy available to investors under section 601MB of the Act where a contract to acquire a managed investment scheme interest may be voidable if the issuer has not registered the scheme or given the investor a PDS, but these are fundamental and specifically defined obligations, very different from the rather vague concept of whether a product has been designed for and marketed to an appropriate target audience. The suitability rules should NOT be the basis for a remedy that allows an investor to cancel the contract. Rather, ordinary contractual damages of the amount of the loss – excluding market movements during the period of the investment – would be an appropriate remedy.

141. Further, allowing the consumer to cancel the contract in the case of an investment product where markets have fallen (seemingly the circumstance when the investor would elect to do so) punishes the issuer and not the distributor, even if the issuer was innocent in the transaction, having chosen appropriately the design of, and distribution channels for, the product.

142. Finally, in the case of illiquid managed investment schemes, allowing withdrawal by cancellation of the investment by investors who seek it as a remedy for alleged mis-selling will mean they are given their money back ahead of other investors, contrary to the principles of part 5C.6 of the Act.

Should you have any questions in relation to our comments, please contact us on 02-9299-3022.
We look forward to discussing this matter further in due course.

Yours Faithfully

Paul Callaghan
General Counsel

<u>CHAPTER 5: REGULATORY SETTINGS</u>

The Final Report made nine relevant recommendations in relation to the overall regulatory system. The FSC's response to each of those recommendations is set out below.

<u>FSI RECOMMENDATION 21:</u>

<u>Introduce a targeted and principles-based product design and distribution obligation.</u>

A proposed obligation would apply to both product manufacturers and distributors, and require compliance at various stages of the product life cycle, including after the point of sale.

The FSC has concerns that such an obligation will be uncertain in its application; impose a significant compliance burden; and unnecessarily limit consumer autonomy and choice. Accordingly, the FSC does not support the Government adopting FSI recommendation 21.

In addition to existing disclosure obligations (in particular, the requirement for information to be 'clear, concise and effective'), financial services licensees are already subject to an extensive range of obligations including section 912A of the *Corporations Act 2001* (Corporations Act) which requires licensees, amongst other things, to do all things necessary to ensure that the financial services they offer are provided 'efficiently, honestly and fairly', and that any conflicts of interest are adequately managed. These provisions exist to help ensure consumers are treated fairly and have adequate information to make informed financial decisions. Of course, no law can prevent unethical or fraudulent behaviour. Instead, a combination of adequate disclosure, improved financial literacy, compliance with the law, and regulator enforcement is critical to ensure positive consumer outcomes.

To create an additional product design and distribution obligation would be to impose a significant compliance burden on financial services providers (FSPs), as it is proposed that the product be assessed for suitability, by *both* the product manufacturer and distributor, during the product design phase, product distribution process, *and* after the sale of a product. A continual cycle of product review is impractical, costly and will stifle productivity and innovation.

For example, a situation could arise in a post sale review whereby a product issuer no longer considers the product to be 'suitable' for a class of consumer, whilst a distributor, takes the opposite view. Similarly, there may be circumstances where a consumer wishes to purchase a product or

service despite the provider and/or distributor not believing it is suitable for a consumer within that class – would the consumer be prevented from purchasing the product?

The person best placed to determine whether a product is suitable for a client is the consumer and/or their financial advisor. In the case of advisers, they are already required to act at all times in the 'best interests' of their clients (section 961B, Corporations Act), and provide 'appropriate advice' (section 961G, Corporations Act). The 'FOFA' reforms are already being implemented, and should not be supplanted by additional, potentially conflicting and unclear obligations.

Further, the introduction of a product design and distribution obligation is likely to engender uncertainty as to its application and may lead to litigation as to the obligation's exact parameters.

The FSC notes that the proposed obligation is intended to cover both complex *and* non-complex products. We believe that for non-complex products in particular, the introduction of such an obligation is not justified. Indeed ASIC's discussion of product suitability is limited to complex products in its Report 384 (Regulating Complex Products), released in January 2014, recognising that complex products, due to their nature, can be difficult for investors to understand, which can lead to them being mis-sold (see also ASIC Report 400: Responses to Feedback on Report 384). Such risks are significantly reduced where the product is non-complex, and therefore do not warrant additional government regulation.

Product suitability type obligations already exist in some areas, for example in credit (responsible lending rules) and superannuation (default/MySuper products). However these areas, which involve individuals consuming compulsory or otherwise essential products, can be contrasted to wealth management products, which fundamentally involve an investor assessing how they wish to utilise their disposable income. Additional regulatory intervention is not warranted where the transaction is fundamentally one of choice rather than need (credit) or compulsion (superannuation), and particularly given the obligations of AFSL holders under the Corporations Act. Where a product or service is considered 'too risky', it is open to the Parliament to legislate to prevent it being offered to consumers.

RECOMMENDATION:

The FSC recommends that the Government not introduce a new and unnecessary product design and distribution obligation given: existing multi-layered obligations on financial services providers; implementation risks associated with the proposed obligation; the significant compliance burden it would impose; and the negative impact such an obligation would have on consumer autonomy and choice.

FSI RECOMMENDATION 22:

Introduce a proactive product intervention power that would enhance the regulatory toolkit available where there is risk of significant consumer detriment.

This proposed product intervention power would allow: product banning; distribution restrictions; warnings/labelling; and amendments to marketing and disclosure materials.

The FSC has concerns regarding ASIC being given such a wide-ranging power, and does not support FSI recommendation 22. In our view, a strong enough case has not been made that ASIC is unable to carry out its mandate with the powers which it is already has. Currently, ASIC can intervene where license conditions/law has been breached. In particular, a stop order is an administrative mechanism that allows ASIC to prevent offers being made under a disclosure document where ASIC believes it contains: a misleading or deceptive statement; an omission of information required to be provided under the legislation, or a new circumstance has arisen since the disclosure document was lodged. Such stop orders have been utilised by ASIC, for example in the area of mortgage funds.

Further, we note that the proposed new discretionary power could be exercisable by ASIC even where there has *not* been a suspected breach of the law. In practice this means that a FSP could issue a product which complies with the law, but ASIC could nonetheless, exercise its intervention power. Such ASIC action could have a major market and reputational impact on the FSP.

We believe that the scope of permitted products or characteristics is not a matter which should be delegated beyond Government/Parliament – rather, to the extent it was considered necessary to proscribe a product or product characteristic, for certainty it should be set out in legislation or regulations, and not a matter for regulator discretion.

There is also a potential moral hazard, in that ASIC may feel obliged to exercise the power or risk consumers viewing a lack of ASIC action as an implied endorsement of a product's suitability for them.

Although we understand it is intended that such a significant power, if introduced, only be exercised as a 'last resort', it is important that it be constrained through appropriate accountability and oversight mechanisms, including judicial review. If such a power is introduced, in order to ensure procedural fairness, and prevent wasted resources, potentially affected FSPs must be afforded the opportunity to present their position prior to any ASIC decision to exercise the power.

It would also be appropriate to consult with APRA, where the affected entity is APRA-regulated. Further, in the interests of transparency, ASIC should be required to provide clear guidance to industry regarding the instances where ASIC may consider using such a power.

In relation to the launch of new product types, if ASIC is provided with a product intervention power, there should be an arrangement for a product issuer, *prior to issuing the product*, to approach ASIC (should the product issuer wish to do so) for prior confirmation that ASIC will not exercise its product intervention power.

We note that rapid change can make it difficult for regulators to keep pace with technological developments or market innovations. However this is a perennial issue that faces all governments, and not peculiar to financial services. Such a fear must be balanced against the need for industry to harness technology and promote innovative products/services. A common theme in the FSI report is that government should encourage, rather than stifle innovation. Were a product intervention power is introduced, it is important that it not be exercised merely in circumstances where the product is new or innovative.

We agree that if a Financial Regulator Assessment Board were to be introduced (see FSI Recommendation 27), it will be important that the Board carefully consider ASIC's exercise of such a power. Reporting to Parliament and in ASIC's Annual Report should be additional accountability mechanisms to ensure that the power is used appropriately, and only in exceptional circumstances, were the power to be introduced.

RECOMMENDATION:

The FSC recommends that the Government not provide ASIC with a product intervention power given ASIC already has wide-ranging powers which allow it to act where there have been breaches of the law or license conditions. The introduction of a new discretionary power would see ASIC stray into the field of mandating permissible products, a role which is properly the responsibility of the legislature. If introduced, the FSC recommends that the power only be exercised as a last resort, be constrained through robust accountability and oversight mechanisms, and that clear guidance be provided regarding the circumstances in which ASIC might exercise the discretion.