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15 March 2017

Financial Services Unit
Financial System Division
The Treasury
Langton Crescent
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**By email**

**ProductRegulation@treasury.gov.au**

Dear Colleagues

**Design and Distribution Obligations and Product Intervention Power Proposals Paper: December 2016**

Platinum Investment Management Limited welcomes the opportunity to comment on Treasury's Proposal Paper - Design and Distribution Obligations and Product Intervention Power – December 2016 (Proposal Paper).

Platinum Investment Management Limited (ABN 25 063 565 006), trading as Platinum Asset Management (Platinum), is an Australian based fund manager which specialises in investing in international equities. Platinum currently manages around A$23 billion in assets and issues, distributes and/or manages a wide range of investment products, including Australian registered managed investment schemes (including an ASX mFund), listed investment companies and an Irish domiciled UCITS.

Platinum is responding to the Proposal Paper as both an issuer and distributor of registered managed investment schemes (MIS).

Platinum is supportive of an effective investor protection regime which aims to reduce the risk of product mis-selling. This of course needs to be balanced appropriately with the potential costs of compliance and the preservation of a product provider's ability to innovate, to ensure that Australia remains a competitive funds market. We acknowledge the limitations of relying on product disclosure alone as a means of investor protection. We also believe that the responsibility for investor protection in the context of product design is a shared responsibility between industry and the government.

That said, it appears to us that Treasury is seeking to rest the product design obligations firmly and squarely on the shoulders of the product issuer alone, without acknowledging that the government has responsibilities in this space too. Treasury has assumed that ASIC only has a role to play after the fact, if the product issuer gets it wrong, in which case ASIC has the power to intervene with the benefit of hindsight. In the absence of any legal framework as to what constitutes a suitable managed investment product for a retail investor more generally, this approach poses an unacceptable risk for issuers of these products - particularly in light of the wide variety of investment strategies currently available to retail investors in this space.

Treasury notes that the "*introduction of the design and distribution obligations and product intervention powers in Australia is consistent with trends in comparable international jurisdictions*" such as the UK, Hong Kong, the European Union and the United States. However, Treasury omits to point out that the legislators in these jurisdictions have clearly defined their own retail funds regimes i.e. UCITS[1] regime for EU (including UK (for now)), the Hong Kong Collective Investment Scheme regime under the Securities and Futures Ordinance and the US mutual fund regime under the 1940 Act[2]. The Monetary Authority of

[1] Undertakings for Collective Investment in Transferable Securities
[2] Investment Company Act of 1940

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Singapore has also defined a retail funds regime under the CIS Regulations[3] and the CIS Code[4]. Therefore, we are concerned that Treasury's product design proposal, in the absence of a baseline legal framework for retail managed funds consistent with those found in other jurisdictions, means that the likelihood of MIS issuers getting it wrong will be high. This may drive MIS issuers to launch funds in jurisdictions where there is more regulatory certainty, relying on fund passports to sell product into Australia, thereby circumventing the onerous issuer obligations being proposed.

In our view, a proposal which essentially obliges regulators to regulate only "after the fact" with the benefit of "hindsight" is inequitable and inconsistent with global best practice. Such an approach will give rise to confusion, uncertainty and inconsistency amongst MIS issuers, inhibit innovation and ultimately result in Australia becoming a less competitive funds domicile location vis a vis its regional counterparts.

We also make the following comments on some of the specific topics explored by the proposal:

- Financial products caught under the product design and distribution regime

  We note that ordinary shares have been excluded from the product design and distribution obligations on the basis that they are deemed to be "widely understood by consumers". Whilst it probably safe to assume that many consumers understand how ordinary shares listed on a stock exchange are bought and sold, this does not by definition mean that the risks associated with ordinary shares are well understood, nor does it mean that such investments are any less risky than other types of investments which have not been excluded. For example, it is not clear to us why a single investment in an ordinary share should be deemed less risky for a retail investor than holding a unit in a MIS which gives an investor exposure to a diversified portfolio of ordinary shares.

  Furthermore, ordinary shares by definition include shares in listed investment companies (LICs). On the other hand, MIS (including managed fund products and exchange traded funds which are admitted to trading on the ASX, and managed fund products which are settled through the ASX mFund settlement service), which provide investors with exposure to a diversified portfolio of assets in the same way that a LIC does, have not been similarly excluded.

  Putting to one side our view that the introduction of a product design and distribution regime for MIS is premature in the absence of a legal framework for retail managed funds more generally, we are concerned that if MIS are not excluded from the proposed product design and distribution regime, opportunities for regulatory arbitrage will arise. For example, Platinum delivers its international investment strategy through the Platinum International Fund (an unlisted registered managed investment scheme) (PIF), and also through Platinum Capital Limited (a listed investment company) (PCL). The investment objectives, strategies and risk profiles of PIF and PCL are for all intents and purposes the same. The key difference is the manner in which these products can be accessed i.e. PIF is an unlisted product whilst PCL is exchange traded. Whether an investor chooses to invest in PIF or PCL comes down to nothing more than investor preference regarding a trust versus a corporate vehicle, and an unlisted versus a listed investment product.

  In any event, it is worth noting that managed fund products and exchange traded funds which are admitted to trading on the ASX are already subject to product design requirements by virtue of the ASX Operating Rules, which specify the types of permitted "Underlying Instruments" as well as specific investments which are prohibited (ASX Operating Rule Schedule 10A.3.3(c) and (d)). These rules seek to address transparency and price discovery. The ASX Operating Rules also set forth restrictions as to use of OTC derivatives for OTC Based Derivatives ETFs and OTC Derivatives Managed Funds, in terms of total counterparty exposure, permitted counterparties, permitted collateral and disclosure obligations (ASX Operating Rule Schedule 10A.4.6).

[3] Securities and Futures (Offers of Investments) (Collective Investment Schemes) Regulations 2005

[4] Monetary Authority of Singapore - Code on Collective Investment Schemes

Similarly, managed fund products which are settled through the ASX mFund settlement service are also subject to liquidity requirements under the ASX Operating Rules, since they must meet the following criteria:

- unit prices are published daily;
- at least 80% of the assets are invested (i) in a bank/deposit account, and are available immediately within 3 months OR (ii) the market value of the investments can reasonably be expected to be realised within 10 days;
- redemption must generally occur within 10 business days of a redemption request;
- no suspensions or cancellations on withdrawals must have occurred for at least two years prior to mFund application; and
- the scheme must be liquid (as defined in the Corporations Act 2001 (Cth).

That all said, from a broader public policy perspective, whilst liquidity and price transparency are factors in determining suitability of an MIS for a retail client, there are many other factors which should be considered i.e. diversification, nature of underlying investments, level of borrowings etc. Accordingly, in the absence of a clearly defined legal framework for retail managed funds more generally, we believe that the introduction of product design and distribution obligations for the issuers of these products is premature. As a result, we are of the view that MIS should be carved out of the product design and distribution regime as set forth in the Proposal Paper.

Similarly, both the corporate and limited partnership investment vehicles contemplated by Treasury under the new collective investment vehicle regime, should also be excluded (once introduced) for the same reasons.

- Ability of issuers of managed investment products to determine target and non-target markets

  Issuers of MIS will generally identify their target market and distribution channels broadly as part of the product design process. As AFSL holders, MIS issuers are required to act efficiently, honestly and fairly in doing so.

  Treasury proposes that "issuers should match products with target markets based on the needs the product satisfies and the target market's ability to understand the product." Treasury's proposal pre-supposes that an MIS issuer understands and has knowledge of the individual needs and objectives of potential investors. This is simply not so. For example, an individual's investment in an MIS will usually be part of an investor's broader investment portfolio, which is not visible to the MIS issuer. Accordingly, it will not be possible for the MIS issuer to assess how an MIS investment may fit in the context of an investor's overall investment objectives.

  The proposal suggests that the product issuer will also be required to asses a potential investor's financial literacy levels. However, financial literacy varies considerably from one person to another. MIS issuers will be required to make assumptions about certain classes or types of investors, which may well be unfounded.

  There is also the issue of "testing the selected target market to ensure they understand the key features of the product". The only real way that an MIS issuer could realistically "test" the target markets' ability to "understand the key features of the product" would be to embark on a fact finding exercise at an individual investor level. The costs of compliance would be burdensome, and would outweigh any perceived benefit for the vast majority of managed investment products being offered.

  The concept of consumer testing also assumes that MIS issuers actually know who their underlying investors are. MIS are sold through a variety of distribution channels, including investment platforms, where the holder on the MIS register is normally a custodian or nominee company. Accordingly, in many cases, an MIS issuer will have no visibility of its underlying investor base, let alone knowledge of investors' personal circumstances.

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Taking Treasury's proposal to its logical conclusion, in order to avoid the inevitably high compliance costs, we can foresee a scenario where only the simplest of financial products would be sold without personal financial product advice e.g. a basic deposit product. All other financial products that are not "simple" (including MIS, irrespective of the risk profile) would be sold with advice to avoid being caught by the regime. This cost of advice will be borne by investors, and for the vast majority of MIS offered, the costs will outweigh the benefits. This would have a negative impact on consumer autonomy and choice and may ultimately discourage investors, who would otherwise be capable of making their own investment decisions, from investing in MIS, as the same investment strategies can be accessed through other investment vehicles e.g. listed investment companies. This could drive investors away from the managed fund industry as a whole, an outcome which is counter-intuitive to the work that has been done to date to position Australia as a "funds hub" for the Asia Pacific region.

- Blurring the lines between issuance and personal financial product advice

  More generally, by suggesting the imposition of an obligation on an MIS issuer which is akin to a suitability obligation, Treasury is effectively blurring the lines between product issuance and the provision of personal financial product advice, since it is difficult to see how some of the obligations can be met without effectively giving personal financial product advice. This is confusing.

  On the other hand, we note that in the "high growth managed investment scheme" example provided by Treasury on page 27 of the Proposal Paper, the distribution controls cited include changing the application form such that an investor "attests that they fall within the desired target market" and including in the application form "sufficient information to enable a reasonable consumer to determine whether they fall within the target market, or whether they are excluded from it." We may be missing something, but doesn't this take us back to disclosure?

- Retrospective effect

  If Treasury is to introduce design and distribution obligations for MIS issuers, such obligations should not be applied on a retrospective basis. It is simply not practical for MIS issuers to revisit the past. To require MIS issuers to do so would be onerous.

- ASIC's powers of intervention

  Platinum does not believe that ASIC requires additional product intervention powers at this stage. ASIC already has sufficient powers at its disposal to take appropriate action where there has been a breach of the law and/or licence conditions. In the absence of a defined legal framework for retail managed funds, the introduction of additional intervention powers for ASIC as contemplated in the Proposal Paper, is inconsistent with global best practice and could potentially see ASIC taking on the role of a law maker to the extent that ASIC is able to make determinations around retail managed investment product suitability. This would be irregular and contrary to public policy.

In summary, the introduction of a product design and distribution regime for MIS issuers, in the absence of a legal framework for retail funds more broadly is, in our view, unfounded. Not only will it impose a significant compliance burden on MIS issuers but it will also stifle competition, product innovation and investor choice. The "distribution control" measures cited by Treasury in the Proposal Paper appear to amount to no more than a set of self-certifications, "ticking the box" and ultimately more of the same i.e. product disclosure. We believe this approach to regulation will ultimately generate nothing more than additional cost with no prospect of achieving its intended aim of protecting consumers.

Yours faithfully

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Chief Executive Officer