



9 February 2018

Manager
Financial Services Unit
Financial System Division
The Treasury
Langton Crescent
PARKES ACT 2600

Email: productregulation@treasury.gov.au

Dear Sir/Madam,

SMSF ASSOCIATION SUBMISSION ON DESIGN AND DISTRIBUTION OBLIGATIONS AND PRODUCT INTERVENTION POWER

The SMSF Association (SMSFA) welcomes the opportunity to make a submission on Treasury's design and distribution obligations and product intervention power draft legislation.

The introduction of these measures will help increase the standard of financial products as well as the culture surrounding their creation. We believe the measures will further align the interests of consumers with those of issuers and distributors of financial products but should not negatively affect firms striving to create innovative and valuable products.

The introduction of broader proactive powers for the Australian Securities Investment Commission (ASIC) will also provide an effective form of reducing significant consumer detriment. We believe the intervention power's main utility comes from its ability to influence product providers' behaviours and to be exercised swiftly when required. At the same time, it is imperative that this power should be exercised mainly as a last resort.

We recommend that this legislation be reviewed after its implementation in three to five years. We deem this essential to ensure the legislation is achieving the policy intent of the measures without having damaging effects on innovation and consumer choice. We would have concerns if more complex or higher risk financial products are no longer developed because of the complexity of meeting the target market requirements and the shadow of potential ASIC intervention, reducing choice for investors.

Design and distribution obligations

The SMSFA is supportive of the design and distribution regime which will promote the provision of financial products to suitable consumers. It should already be inherent in issuers' and distributors' behaviour to conduct themselves with the intent to appropriately market and distribute financial products.



We believe the draft legislation promotes the targeting of financial products to consumers who would benefit from them. In turn, this reduces the possibility of consumers buying products that they may not understand or may not match their needs. The legislation formalises and documents a process we believe occurs for the majority of product issuers. We recommend that 12 months is given from when regulations are finalised to implement these measures given they will materially affect the application of the legislation and processes for product issuers and distributors.

The obligations will also provide a level of further accountability to product creators. The SMSFA does not believe that the obligations will provide an onerous compliance burden as the principles can be factored into the current processes of issuers and distributors. We support that the guidance which facilitates the specific design and distribution obligations should be relatively minimal to avoid unnecessary red tape and not stifle current practical processes. This guidance should provide examples for key concepts such as what is an appropriate determination for a 'class of persons', 'reasonable steps' and 'review triggers'.

The SMSFA is supportive of the amount of obligations prescribed in the explanatory draft. We believe if issuers assess risks associated with distribution channels that this information will further assist the distributors and advisors who are recommending these products and provide a more complete financial market.

We believe the obligations are a further step in building consumer confidence in the financial system. We support the carve out for wholesale clients, listed securities and MySuper products as appropriate.

Clarity and distinction between obligations on issuers and distributors

The SMSFA believes that the legislation is not sufficiently clear on the specific obligations that must be met by an issuer and a distributor. Section 993DE(1) details that a person who makes a target market determination for a financial product must take reasonable steps to ensure that dealings in, and financial product advice provided in relation to, the product are consistent with the most recent determination, highlighting this is an issuer obligation. The Explanatory Memorandum for this section only states that regulated persons must take reasonable steps to ensure that they distribute a product in accordance with its target market determination, highlighting this is a distributor obligation rather than an issuer obligation.

We do not believe that issuers who set target markets must obtain records and monitor compliance with how distributors are aligning the product to the target market. Their obligation should only extend to how they market the product to distributors and how they market and sell the product to investors directly. It would be extremely difficult and onerous for an issuer to gather records from and monitor small businesses and independent financial advisors who are distributing their product.

Furthermore, we believe the standard set by the word 'ensure' imposes an unnecessarily high requirement. Issuers do not have total control over the ultimate distribution of their product by financial advisors or other institutions. We would support an amendment to 'best endeavours' or similar.

Consumers' access to markets



The SMSFA recommends in the interests of consumer choice that if a consumer wishes to access a financial product of which they are not in the targeted market that they be allowed to with the provision of financial advice. This should be supplemented by the distributor providing a sufficient warning to the consumer that they are outside the appropriate market for this product. In addition, defining products as either “simple” or “complex” products may assist consumers better understand when a product may be suitable for them. To further strengthen the law, “complex” products should require retail investors to seek financial advice before they access the product. Alternatively, investors can access “complex” products as wholesale or sophisticated investors. This approach would balance consumer choice with appropriate safeguards against investing in complex financial products they do not understand.

Personal financial advisors

The SMSFA recommends that financial advisors who provide personal advice to clients should not be subject to the distribution obligations. Financial advisors are subject to the best interests duty under the *Corporations Act 2001* which very closely replicate the distribution obligations for product distributors. Financial advisors who give personal financial advice should understand their clients through know your client and statement of advice requirements and whilst being able to utilise the obligation information from issuers they should not be constrained by the framework in the draft legislation. Furthermore, financial advisors have recently been regulated by Future of Financial Advice reforms and incoming financial advice education and ethical standards.

Intervention Powers

The SMSFA is supportive of introducing a power for ASIC to intervene where it identifies a financial product may cause significant consumer detriment. We believe a proactive power for ASIC is vital to support its ability to prevent consumer losses from occurring rather than merely taking action against product providers after the fact.

The product intervention measures will also encourage product makers to take responsibility for the suitability of their products in conjunction with the design obligations placed upon them in the draft legalisation. A proactive power in ASIC’s toolkit also paves the way for product makers to always be ‘aware’ of the potential for action which will help shape behaviours.

Despite our approval for the intervention power we believe that this power should only be used as a last resort when a significant risk arises. This will limit any uncertainty, restrictions on innovation and costs that may be borne out of excessive intervention.

We would also encourage ASIC in its regulatory guidance to explain when they would have issued an intervention order using case studies of previous real examples such as Storm Financial and Opes Prime to highlight its potential use.

The Association is also supportive of the safeguards which are in place to ensure ASIC is accountable in its application of an intervention order. We deem the consultation with parties likely to be affected by an order and the Australian Prudential Regulatory Authority (APRA) as essential



information needed by ASIC to ensure they have sufficient knowledge to carry out the responsibilities associated with the power.

The Association further recommends that a failure to comply with the consultation process should invalidate an intervention order. Therefore, we encourage ASIC to create processes that streamline the efficiency of any consultation to ensure the power is used correctly. We also believe all consultations should be kept confidential prior to any call for public comment giving product issuers a private right to reply. A public announcement from ASIC regarding a potential intervention order and public consultation may cause investors to panic and sell down the product, which could lead to significant detriment to consumers, product issuers and broader investment markets.

We are also supportive of the requirements in the public notice ASIC must publish after an intervention order and the 18 month maximum limit on an intervention order.

We recommend the legislation prescribes that anyone who believes they are incorrectly affected by an intervention order should be able to seek accelerated judicial review of the use of the power.

If you have any questions about our submission please do not hesitate in contacting us.

Yours sincerely,

A handwritten signature in black ink that reads 'John L. Maroney'. The signature is fluid and cursive, with a large initial 'J' and 'M'.

John Maroney
CEO
SMSF Association

ABOUT THE SMSF ASSOCIATION

The SMSF Association is the peak professional body representing SMSF sector which is comprised of over 1.1 million SMSF members who have \$701 billion of funds under management and a diverse range of financial professionals servicing SMSFs. The SMSF Association continues to build integrity through professional and education standards for advisors and education standards for trustees. The SMSF Association consists of professional members, principally accountants, auditors, lawyers, financial planners and other professionals such as tax professionals and actuaries. Additionally, the SMSF Association represents SMSF trustee members and provides them access to independent education materials to assist them in the running of their SMSF.