

From the Desk of Director Marija Pajeska



14 March 2017

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The Treasury
Langton Crescent
PARKES ACT 2600

DESIGN AND DISTRIBUTION OBLIGATIONS AND PRODUCT
INTERVENTION POWER

SUBMISSION BY THE ASSOCIATION OF SECURITIES AND DERIVATIVES
ADVISERS OF AUSTRALIA – ASDAA

The Association of Securities and Derivatives Advisers of Australia (ASDAA) appreciates the opportunity to provide these comments to Treasury in respect of the proposed Design and Distribution Obligations and Product Intervention Power.

ASDAA represents the interests of its members, who are from the Securities and Derivatives advisory profession. Its members are comprised of individuals who are either directors, or employees, of small to medium sized firms which hold an Australian Financial Services Licence (AFSL), but are not a Participant Member of the Australian Stock Exchange.

ASDAA has a strong desire to see that investor's receive sound investment advice and the appropriate investor protection. ASDAA members rely on the ongoing trust of their clients and on the integrity of the Australian financial markets, for their livelihood. Without both, clients wouldn't participate in the markets and trade in shares, exchange traded options and other listed financial products.

PROPOSED RECOMMENDATIONS VERSUS HUMAN RIGHTS

ASDAA agrees with the FSI's comments that:

'The financial system plays a vital role in meeting the financial needs of individual Australians. To fulfil this role effectively, consumers should be treated fairly and financial products and services should perform in the way consumers are led to believe they will. Consumers have a responsibility to accept their financial decisions, including market losses, when they have been treated fairly.'

In developing appropriate measures, the FSI, the Government and we as a community/ industry need to ensure that we respect the human rights of individuals, consumers and investors as defined in the Human Rights (Parliamentary Scrutiny) Act 2011. In particular, we refer to Section 3(1)(b) of the Human Rights (Parliamentary Scrutiny) Act 2011 which states:

'In this Act "human rights" means the rights and freedoms recognised or declared by the following international instruments:

(b) the International Covenant on Economic, Social and Cultural Rights done at New York on 16 December 1966 ([1976] ATS 5)'

Part I, Article 1, paragraph 2 of the International Covenant on Economic, Social and Cultural Rights states:

'All peoples may, for their own ends, freely dispose of their natural wealth and resources without prejudice to any obligations arising out of international economic co-operation, based upon the principle of mutual benefit, and international law. In no case may a people be deprived of its own means of subsistence.'

We need to be mindful of individuals, consumers and investor's right to freely dispose of their natural wealth when giving the power to ASIC to intervene in financial product development and distribution and introduce banning orders relating to financial products which have the effect of preventing certain classes of individuals, consumers and investors accessing various financial products.

Consumer protection is important however consumers need to retain their human rights and remain accountable for their decisions. It is not the duty of the government or ASIC to protect a consumer from themselves, in fact it is the duty of the government to empower consumers through education and rather than using banning orders to control how individuals, consumers and investors can dispose of their natural wealth, why not empower consumers to decipher through the disclosure and develop greater understanding of the material before them.

DESIGN AND DISTRIBUTION OBLIGATIONS

ASDAA is of the view that industry will benefit from the introduction of uniform design and distribution obligations. However, we believe that some refinement is required:

- One of the proposed measures is 'consumers should receive fair treatment from financial firms and that product issuers and distributors should design, target and distribute products that meet consumer needs'. We believe that product design, targeting and distribution should not be dependent on consumer needs. Product design, targeting and distribution should be dependent on the risk profile of the product. To take into consideration consumer needs will cloud the line between personal and general advice and would place product issuers and distributors at risk of being accused of providing personal advice as consumers and investors could form an argument that their needs were taken into consideration at the time an issuer or distributor presented the product to them.
- Further clarification is required regarding which financial products these requirements will cover. We understand that the idea is to cover all financial products (except ordinary shares) but find it difficult to understand, from a practical perspective, how these measures could easily be adapted to products traded on a market (such as futures, options on futures, exchange traded options, ETF's, etc) and OTC products traded on a platform (such as CFDs, Margin FX, etc).
- Further clarification is required regarding the definition of a distributor. The term distributor is regularly used in relation to managed investment schemes however in relation to other financial products not so much. If we take Exchange Traded Options traded on the ASX as an example, where clients will open an account with the ASX Participant and may deal with an advisor which works for another AFS Licensee. The ASX Participant is deemed the issuer, which gives rise to the question, is the AFS Licensee that the advisor works for, a distributor.
- We understand that the intent is to extend these requirements to distribution channels which are unregulated. We note that how ASIC will have jurisdictional power over unregulated distribution channels has not been addressed in this paper. This also gives rise to the question of whether the unregulated population will need to meet the minimum educational requirements to ensure that individuals, consumers and investors are receiving the right information via unregulated distribution channels. The key objective here is consumer protection, so having uneducated and unregulated distributors seems to defeat the purpose of consumer protection.
- Further consideration should be given to the merit of consumer education. One of the things that have evolved in the OTC derivatives sector, as a result of the client suitability requirements, is that education and training can be used as a tool to develop consumer understanding. Rather than banning certain classes of consumers from accessing certain products why not allow access on the condition that consumers are educated about the product, the objectives of the product, the risks of the product and the potential deliverables of a product (ie. in the case of insurance products under what conditions will a claim be made and what conditions will a claim be void). At the end of the day an informed investor is better positioned to protect themselves from an issuer, a distributor and themselves.

PRODUCT INTERVENTION POWERS

The regulatory framework and environment we are currently in strongly promotes financial service providers to be pro-active in developing their products and in mitigating their risks by requiring financial service providers to be pro-active rather than reactive through the implementation relevant policies and procedures that are designed to prevent certain behaviour.

ASDAA believes that there is merit in the argument that ASIC should be pro-active in relation to product development and if the true concern of this proposal is to protect consumers then why not implement pro-active measures designed to protect consumers. The most obvious one is to require ASIC to review disclosure documents and relevant policies and procedures before the release of a product to ensure that the target market and audience are appropriately defined taking into consideration the risk profile of the financial product and to ensure that the proposed measures for distribution of the financial product are appropriate taking into the target market and audience.

COMMENTS TO SPECIFIC QUESTIONS

We have included our response to the specific questions outlined in the paper as Annexure A.

ASDAA appreciates the opportunity to provide this Submission to Treasury on these significant proposals.

We would be happy to discuss any issues arising from our submissions on this issue, or to provide any further material that may assist.

Should you require any further information, please contact Brad Smoling, Communications Executive, on (07) 5532 3930 or email brad@asdaa.com.au

Yours sincerely,



Marija Pajeska
Compliance Director

ANNEXURE A: RESPONSE TO QUESTIONS

CHAPTER 2: PRODUCTS TO BE CAPTURED BY THESE MEASURES

2.1 FINANCIAL PRODUCTS

Question		Response
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)?	<p>No, as financial products traded on a regulated market (ie. exchange traded financial products such as futures contracts, ETO's, etc) and OTC financial products trading on a trading platform (ie. CFDs and Margin FX) should be excluded.</p> <p>Exchange Traded financial products – issuers, distributors, consumers and investors are subject to ASIC Market Supervision and Exchange oversight. Further, these contracts are pre-defined in Exchange regulations so issuers and distributors do not have much flexibility in terms of product design and development.</p> <p>OTC financial products – Issuers of OTC CFD's, Margin FX and similar products are required to comply with RG227 – Over-the-counter contracts for difference: Improving disclosure for retail investors. These requirements already include client protections in Benchmark 1: Client qualifications.</p>
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.	On the basis that most consumer protections apply to retail clients only then these requirements should apply to financial products designed to be distributed to retail clients.

2.2 CREDIT PRODUCTS

Question		Response
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.	<p>No, credit products should be subject to both the design and distribution obligations and the product intervention powers on the basis that the risks involved with credit products (ie. failure to make regular repayments and increases in interest rates) are not properly understood by all consumers and investors.</p> <p>One of the main issues that form part of product design and development is banks changing the terms of a contract after the contract has been signed such that the changes solely benefit the bank to the potential detriment of the consumer/ investor.</p>

Question	Response
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.	Where a credit facility is being provided to retail clients then those retail clients should be afforded the same protections as retail clients that acquire financial products and credit products.

CHAPTER 3: DESIGN AND DISTRIBUTION OBLIGATIONS

3.1 WHO WILL BE SUBJECT TO THE OBLIGATIONS

Question	Response
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?	Yes, we agree with the definition. However, we are of the view that issuers of the following products should be excluded: <ul style="list-style-type: none"> • Exchange Traded Derivatives (ie. Exchange Traded Options, Futures Contracts, etc) – these products are usually defined in the Exchange Rules under the contract specifications and issuers who are either the Exchange Participant or the entity that the client holds their account with have no or limited input into product design and distribution. • OTC derivatives contract issuers (ie. CFDs, Margin FX and similar products) – these contracts are already subject to RG227 – Over-the-counter contracts for difference: Improving disclosure for retail investors, which includes relevant consumer protections.

Question	Response
<p>6. Do you agree with defining distributors as entity that arranges for the issue of a product or that:</p> <p>(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</p> <p>(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).</p>	<p>In principle we agree with this definition.</p> <p>However, further consideration needs to be given to the definition of distributor in sectors that do not generally utilize distribution networks. If we take Exchange Traded Options traded on the ASX as an example, where clients will open an account with the ASX Participant and may deal with an advisor which works for another AFS Licensee. The ASX Participant is deemed the issuer, which gives rise to the question, is the AFS Licensee that the advisor works for, a distributor.</p> <p>The same issues arise in relation OTC derivatives traded on a platform. The entity that would be deemed a distributor is the Introducing Broker or Referral Agent.</p> <p>In both these cases the AFS Licensee, Introducing Broker or Referral Agent is there to provide a service to the client and inadvertently acts as a distributor.</p>
<p>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?</p>	<p>No specific examples come to mind.</p>
<p>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?</p>	<p>We do not agree with the exclusion of personal financial product advisers being excluded from the obligations placed on distributors as the information that needs to be provided to a client should be provided to the client regardless of the type of advice the client receives.</p> <p>In terms of entities that should be excluded we refer you to our response to question 6 above.</p>
<p>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?</p>	<p>We fail to see how these requirements could be applied to unlicensed issuers and distributors when they are generally exempt from the disclosure requirements.</p> <p>We are of the view that ASIC should be able to use its existing powers to grant exemptions whereby an applicant can make an appeal to the Administration Appeals Tribunal.</p>

3.2 WHAT WILL BE EXPECTED OF ISSUERS?

TARGET MARKET IDENTIFICATION

Question	Response
<p>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?</p>	<p>Yes, we agree that issuers should identify appropriate target and non-target markets.</p> <p>However, we do not agree that the consumer needs should form the basis of what is an appropriate target and non-target market. Instead the risk profile of the product should be used to define the appropriate target and non-target market.</p> <p>We refer to the examples of factors included in Detailed Proposal 1, in particular:</p> <p style="padding-left: 40px;">‘For investment products, the likely performance of the product taking into account market conditions and relevant economic factors to the extent they are reasonably known.’</p> <p>We do not agree that the likely performance should be included in the documentation as likely performance will generally be based on forecasting and simulated results which are built upon assumptions and hypotheticals. As the unpredictable economic environment changes so should this information and this makes relevant documentation administratively burdensome and increases the risk of consumers receiving misleading information as documentation was not updated on time or a consumer received an outdated version or a consumer acted on an outdated version as it had been updated since they originally received it.</p>
<p>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)?</p>	<p>We agree that the significant product features should be clearly outlined to consumers, such features being:</p> <ul style="list-style-type: none"> • What the insurance covers? • Conditions of a claim • Benefits that can be received; and • Who is entitled to receive the benefits?

APPROPRIATE DISTRIBUTION CHANNELS AND MARKETING

Question		Response
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.	Yes we agree
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?	<p>Yes we agree with this proposal.</p> <p>However, we believe that industry will benefit from further guidance regarding the terminology 'complex financial products' and complexity of the product'. Such terminology seems to be regularly used by ASIC to classify various financial products however no transparency is given as to what factors are used by ASIC to determine whether a product is complex.</p> <p>Simple products such as insurance contracts could be deemed complex at times as it may be near to impossible to make a claim against the insurance policy so further guidance would be warranted in this regard.</p>

POST-SALE REVIEW

Question		Response
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?	<p>We agree with the proposal that issuers must periodically review their products to ensure the identified target market and distribution channel continues to be appropriate.</p> <p>However, if ASIC is not prepared to engage in a product pre-approval process then we disagree with the additional requirement for issuers to advise ASIC if the review identifies that a distributor is selling the product outside of the intended target market. We are of the view that the significant breach reporting requirements are sufficient.</p>
15.	In relation to all the proposed issuer obligations, what level of detail should be prescribed in legislation versus being specified in ASIC guidance?	<p>All the proposed requirements should be specified in ASIC guidance to ensure the requirements are flexible and not overly burdensome.</p> <p>Further, this is consistent with all other consumer protections which are specified in ASIC guidance.</p>

3.3 WHAT WILL BE EXPECTED OF DISTRIBUTORS?

DISTRIBUTION CONTROLS

ASIC Question		Response
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?	<p>Yes we agree with these requirements.</p> <p>However, we do not agree that the controls should be included in the distribution agreement as this will create administrative burdens especially when controls need to be amended as a result of the changing environment.</p> <p>Further, we note that one of the controls appears to be the use of customer information to determine whether the product is appropriate for the customer. We note that entities collect customer information for a particular purpose, so due care should be given to ensure that:</p> <ul style="list-style-type: none"> • a customer's privacy is not breached; and • a customer does not perceive that they are receiving personal advice on the basis that the issuer/ distributor has assessed whether the product is appropriate for the customer
17.	To what extent should consumer be able to access a product outside of the identified target market?	<p>Consumers should be able to access whatever product they themselves determine is appropriate for them as long as they understand that they are making such decision at their own risk.</p> <p>No law should ever deny a person their human rights, one of which is the right to freely dispose of their natural wealth and resources.</p>
18.	What protections should there be for consumers who are aware they are outside the target market but choose to access a product regardless?	<p>A consumer should remain responsible for their decision and if they choose to invest in a product whereby they fall outside the target market then they should have access to the standard consumer protections currently available under law (ie. IDR, EDR and Civil Action).</p> <p>The consumer should have access to the new consumer protections discussed in this paper however the fact that they have chosen to invest knowing that they were not within the target market should be taken into consideration when assessing entitlement to any redress.</p>

POST-SALE REVIEW

ASIC Question		Response
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?	Yes we agree with these requirements. However, we note that the issuer may already have access to relevant information that will allow it to conduct the review (without breaching customer privacy requirements) as certain information about the customer would be included in the issuers application form.
20.	In relation to all the proposed distributor obligations, what level of detail should be prescribed in legislation versus being specified in ASIC guidance?	All the proposed requirements should be specified in ASIC guidance to ensure the requirements are flexible and not overly burdensome. Further, this is consistent with all other consumer protections which are specified in ASIC guidance.

3.4 PROPOSED COMMENCEMENT DATE

ASIC Question		Response
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.	No, we don't as ASIC needs to release its guidance so the obligations should apply 6 months after ASIC has released its guidance.
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.	No, we don't as ASIC needs to release its guidance so the obligations should apply 2 years after ASIC has released its guidance.

CHAPTER 4: PRODUCT INTERVENTION POWER

4.1 WHAT TYPES OF INTERVENTIONS CAN ASIC MAKE USING THE POWER?

Question		Response
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.	<p>Taking into consideration the process that ASIC would undertake prior to utilising its Product Intervention power then we can see the merits with the use of such powers. However, we are concerned with the power for ASIC to determine which consumers can access a product and the circumstances in which a consumer can access the product. In utilizing such a power ASIC needs to ensure that:</p> <ul style="list-style-type: none">• it respects a person's human right to freely dispose of their natural wealth and resources; and• it has the experience and expertise to assess what type of consumer should access the product and the circumstances in which a consumer can access a product.
24.	Are there any other types of interventions ASIC should be able to make (for example, remuneration)?	No

4.2 USE OF INTERVENTION POWER

Question		Response
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?	<p>We agree that they are relevant considerations, however believe that the most important consideration is cause of the detriment or product failure.</p> <p>The cause of the failure will determine which consumers were actually affected, especially if the cause is related to one particular distributor.</p>

PROCEDURAL STEPS

Question		Response
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?	Yes, we agree with this proposal. We also believe that ASIC should take into consideration the consequences of its intervention and actions to ensure that the primary goal being consumer protection is achieved.
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?	Yes, we agree with this proposal. In publishing information on intervention, ASIC should ensure it highlights the cause of the issue which led to the intervention and the objectives and outcomes of the intervention.

4.3 DURATION AND REVIEW OF AN INTERVENTION

Question		Response
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.	Yes, we agree with this proposal.
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?	Generally, ASIC's decision is binding unless the results of the appeal are against ASIC. Standard procedures that current apply for an appeal should apply in these circumstances. An appeal should not give rise for an extension in duration for the Government to make an intervention permanent.
30.	What mechanism should the Government use to make interventions permanent and should be 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?	To make an intervention permanent ASIC should use the judicial system, ie. Court Order.

4.4 INDUSTRY CLARITY

Question		Response
31.	Are there any other mechanisms that could be implemented to provide certainty around the use of the product intervention power?	ASIC Guidance should include details of the circumstances under which its product intervention powers will likely be used and the procedural steps that are to be undertaken by ASIC prior to using its product intervention powers. Further, how ASIC will use these powers and the communications it will engage in with affected parties should be outlined in the ASIC guidance.

4.5 PROPOSED COMMENCEMENT DATE

Question		Response
32.	Do you agree with the powers applying from the date of Royal Assent? If not, please explain why with relevant examples.	No, we don't as ASIC needs to release its guidance so the obligations should apply after ASIC has released its guidance.

CHAPTER 5: ENFORCEMENT AND CONSUMER REDRESS

5.1 WHAT REGULATORY TOOLS SHOULD BE USED TO ADDRESS NON-COMPLIANCE

Question		Response
33.	What enforcement arrangement should apply in relation to a breach of the design and distribution obligations or the requirements in an intervention?	Existing enforcement action available under law should apply to a breach of the design and distribution obligations or the requirements in an intervention.

5.2 CONSUMER REDRESS

Question		Response
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?	Existing consumer rights and redress avenues available under law should apply in relation to a breach of the design and distribution obligations or the requirements in an intervention.