

9 February 2018

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

Via email: productregulation@treasury.gov.au

Dear Sir/Madam

Draft Legislation - Design & Distribution Obligations and Product Intervention

Thank you for the opportunity for Morgans Financial Limited ("Morgans") to provide feedback on the proposed Draft Legislation regarding the design and distribution of financial products and the introduction of product intervention powers for ASIC.

We acknowledge the intent of the proposed legislation and support ASIC in its efforts to improve investor protections and education. We view this to be of particular importance where investors have not sought advice or lack sufficient information or skills to make a fully informed decision.

Having said that, we are strongly of the opinion that Australia's legal framework should continue to provide an open environment where quality financial advice is available to investors and similarly all investors have the opportunity to seek advice where appropriate.

Having reviewed the proposed legislation, we have a number of concerns and observations which we welcome the opportunity to put before you.

- 1. The new laws appear to be much broader in their effect than just targeting those providers offering complex products which we understood to be the focus and concern. We do not believe a blanket coverage will benefit Australia's financial markets and will have the opposite effect of reducing the availability of quality advice for investors and will have the effect of driving investors into non-advised channels**

Our understanding of the intent of the legislation was to capture "complex" products only but under the description of "**To which products do the new obligations apply**" in the Explanatory Statement it appears to contain a catch all: - "*1.26 The second anti-avoidance provision ensures that the new regime can apply where a company issues ordinary shares to carry on a business of investing in financial products or other investments. This prevents a person avoiding the new regime by effectively selling a product through an investment company. It also ensures the new regime extends to issues of ordinary shares in investment companies more generally, in recognition of the derivative nature of their business model. [Schedule 1, item 3, paragraph 993DB(3)(b) of the Corporations Act] "*

Australia has a highly regulated and sophisticated funds management industry that has a long and successful track record of investing in general equities strategies. These strategies have been well communicated and well understood by the investment community and investors alike.

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Investors have a choice of investing in equities directly or gaining exposure through professionally managed funds (including ASX listed Listed Investment Companies or Trusts). Managed funds provide a credible alternative for investors and financial advisers (particularly less qualified or inexperienced investors and advisers).

If the strategy is well articulated – “growth, income, balanced, long only, total return etc.” we do not believe these strategies should be regarded as complex products and should be excluded from the proposed legislation.

We believe that the breadth of products that the legislation will capture is too broad and should not relate to financial products that many investors can access themselves (e.g. general equities strategies, income strategies, REITs etc.) and only relate to complex products (options, warrants, etc.).

- 2. The greatest uncertainty is how Target Market Determinations will be drafted. If they are too broad they will not achieve the desired outcome of the proposed legislation. If they are too narrow, they may preclude many investors at a technical level (who historically have participated without issue) and provide a disincentive for credible Distributors to offer financial products with the effect of moving investors into non-advised or direct channels**

We are concerned that the impact of the proposed legislation will be for all parties to focus on minimising risk to themselves in compliance with the legislation rather than a focus on improving investor outcomes. It will be a natural focus for Offerors to be “tighter” in their determination so as to reduce their “risk” meaning the pool of potential investors available to Distributors may fall. Distributors with additional administrative and compliance burdens will be dis-incentivised to offer the financial product to clients.

Historically, Distributors have had responsibility for the advice they provide and advisers providing *personal advice*, having considered their best interest obligations and taken all circumstances into account, determined whether a product suits the needs and objectives of a client. To further ensure the advice is appropriate, existing legislation requires AFSL holders to ensure that authorised representatives hold appropriate qualifications to provide advice and ensure they collect relevant information from investors to provide said advice. This obligation is enshrined in an advisor’s best interest duty and FOFA.

Successful investment does require an accurate assessment of risk and return and **our strong view is that this is something that should be assessed at the individual investor’s level and not governed by a one size fits all approach of the Target Market Determination structure.**

We think there is a risk the proposed legislation will potentially limit the advice that will be available to investors with too restrictive Target Market Determinations and costs of compliance to Distributors meaning they will not offer the financial product at all. Investors will then access the product directly or through non-advised channels or turn to alternative unregulated products like direct property. This exposes investors to increased risk which is counter to the objectives of the proposed legislation.

Summary & Recommendations

The depth and breadth of the proposed legislation to us seems to be a very heavy handed approach to solving a relatively small number of issues historically and goes well beyond dealing with “complex” products as the market understands them.

We are concerned the proposed legislation will prove to be a very expensive data collection exercise without contributing to the protection of investors, improving the quality of investment advice. It also serves to work against the goal of ensuring Australia maintains an efficient and globally competitive financial services market.

Investors should be encouraged to seek professional investment advice for their financial health as they are encouraged to seek medical advice for their ongoing physical health and not rely on other unqualified sources (e.g. the internet).

We are concerned the impact of this proposed legislation will have the opposite effect of reducing the availability of advice to retail investors and reduce the range of investment opportunities available to them.

Our key recommendations are as follows:

1. Legislation Overreach – should apply to true complex products only

We believe that the breadth of products that the proposed legislation will capture is too broad and should not relate to financial products that many investors can access directly (including, general equities strategies, income strategies, REITs etc.) and only apply to financial products offering complex products (including, options, warrants, synthetics and other financially engineered products etc.).

2. Target Market Determination – acknowledgement that assessment of risk is subjective and encouraging retail investors to seek professional advice

In our view, assessment of a client’s risk profile is subjective and whether a product is appropriate is best determined at the individual client level with personalised advice and not purely governed by a Target Market Determination, essentially, a one size fits all approach.

We believe any legislation should set out the basis on which the Target Market Determination is structured including clear reference to the following:

- what the financial product is intended to deliver investors (growth, income, combination);
- acknowledgement of the complex nature of the financial product and what makes it complex;
- setting out likely risk factors impacting the future performance of the financial product, including identifying any structural or product risk(s) unique to the product; and
- a direction to retail investors to seek personalised advice as to whether the financial product is suitable for their profile and circumstances.

Investors have a choice whether to seek advice or not but if they do seek personal advice on the financial product, Distributors obligations under the legislation is only to report that personal advice has been provided not the nature of the advice.

What we believe more relevant to issuers of complex products is what proportion of issues are being subscribed for by retail investors who are not seeking any advice.

In our view this will still enable legislation provide the desired outcomes while ensuring retail investors have broad access to personal financial advice.

Thank you for the opportunity to provide feedback on the draft legislation. We would welcome the opportunity to discuss our feedback and recommendations with you to ensure a sensible outcome for the investing public, offerors of financial products and the financial advisory industry.

Yours sincerely

MORGANS FINANCIAL IMITED

A handwritten signature in black ink, appearing to read 'B. Sheahan', followed by a period.

BRIAN SHEAHAN
Executive Chairman

A handwritten signature in black ink, appearing to read 'Philip Lee', followed by a period.

PHILIP LEE
Executive Director, Corporate Advisory