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Manager
Consumer and Corporations Policy Division
The Treasury
Langton Crescent
Parkes ACT 2600

By email: productregulation@treasury.gov.au

Dear Treasury,

AFA Submission: Design and Distribution Obligations and Product Intervention Power

The Association of Financial Advisers Limited (**AFA**) has served the financial advice industry for over 70 years. Our objective is to achieve *Great Advice for More Australians* and we do this through:

- advocating for appropriate policy settings for financial advice
- enforcing a Code of Ethical Conduct
- investing in consumer-based research
- developing professional development pathways for financial advisers
- connecting key stakeholders within the financial advice community
- educating consumers around the importance of financial advice

The Board of the AFA is elected by the Membership and all Directors are currently practicing financial advisers. This ensures that the policy positions taken by the AFA are framed with practical, workable outcomes in mind, but are also aligned to achieving our vision of having the quality of relationships shared between advisers and their clients understood and valued throughout society. This will play a vital role in helping Australians reach their potential through building, managing and protecting wealth.

Introduction

The AFA recognises the policy intent of the Design and Distribution Obligations and Product Intervention Power legislation, particularly in the context of higher risk products. Whilst we are supportive of the Product Intervention Power for ASIC, as a reserve power, we do not actually believe that the product intervention power would have had much impact in the context of the Global Financial Crisis. We suspect that this is a power that might appear more beneficial with the benefit of hindsight.

We are concerned that this legislation would be more effective and deliver an overall benefit for the community if it was focussed on high risk products. We do not accept that the benefit from this legislation for low risk products will exceed the cost. These costs need to be passed on to consumers in the medium to long term and therefore we do not accept that this is in their best interest for consumers with respect to low risk products. The impact of this legislation will be greatest with

respect to the record keeping obligations. This will have a particularly big impact upon those who have been classified as distributors, including financial advisers. We are particularly concerned about the proposal that the product issuers will decide what information needs to be recorded and how it will be provided. This will cause a great deal of uncertainty and cost for distributors. Importantly they will not know what they need to do until the product issuers decide as part of their Target Market Determination process. This is simply unreasonable for distributors and particularly those AFSLs with broad Approved Product Lists. We would like to see the Government do more to reduce the impact of the record keeping requirement for low risk products.

We question the intent to apply the provisions of this legislation to virtually all financial products. From our perspective it would seem to make greater sense and be more practical to limit the application of this legislation to higher risk investment products.

We continue to believe that the extensive scope of the legislation, in terms of products incorporated, impacts upon the clarity of the purpose of this legislation. Further clarification is required to explain why this will be beneficial for low risk products.

We are concerned that the impact of this legislation will be a reduction in the breadth of Approved Product Lists as AFSL's seek to avoid the unnecessary complexity that will arise in having a broad Approved Product List and where an adviser might want to recommend a non-approved product. The impact of this is a reduction in competition and choice for consumers.

There is repeated use of the word 'significant' in the obligations, that is not adequately explained (i.e. significant dealings and significant detriment). Whilst this might be left to the regulations or ASIC regulatory guidance to clarify, we are of the view that it should be more clearly explained in either the legislation or the Explanatory Memorandum (EM).

We express concern about the impact of these measures on the cost of providing financial advice. This is particularly the case with respect to the record keeping obligations, but also more broadly in the additional actions that this legislation may require. We note that the Regulatory Impact statement demonstrates a cost to business of \$94.7m, which is a significant reduction on the \$239m set out in the December 2017 version. We remain disappointed that there is a total lack of detail in terms of the breakdown of this \$94.7m and we are concerned that the majority of it will sit with distributors and financial advisers in particular. The cost increase from this legislation comes on top of a number of other recent regulatory driven increases which will impact upon the cost of providing financial advice to Australian consumers and will therefore negatively influence access to financial advice for average Australians.

Design Obligations

Obligation to Make a Target Market Determination

The AFA, in principle, supports the introduction of an obligation for product issuers to identify the target market that is suitable for their products. We believe that this will have benefits for products that are either complex or high risk. With simple products that have broad client application, we anticipate that the benefits will be very limited for consumers.

We remain concerned that the draft legislation and the EM fail to provide adequate explanation of what a Target Market Determination is and as a result there will be a lack of consistency across the market, with reduced benefits to consumers. The legislation states that the product issuer needs to describe the class of person who comprise the target market for the product. When it comes to investment products, this exercise needs to consider the amount of exposure that might be considered appropriate for different consumer segments. We are conscious of the risks of viewing

everyone in a particular demographic based consumer group as being the same. This regime should not disenfranchise people from making their own decisions, where they are informed.

We note the change to require the Target Market Determination to be publicly available, however we think that the legislation should go further and include it in Product Disclosure Statements (PDSs) and Prospectuses. It is our view that this is information that is useful for clients and that they should have the opportunity to participate in the process of deciding whether the product is suitable for them. This is particularly the case with clients who purchase investment products directly. It is noted that it needs to be including or referred to in advertising, so it should also be included in PDSs.

Obligation to Review a Target Market Determination

The AFA supports the requirement to review Target Market Determinations over time. This is sensible as some key factors may change over time. We note that review triggers need to be defined at the time the Target Market Determination is made and that a timeframe for review also needs to be established. We note the explanation on review triggers, however feel that further guidance is required. The same applies with respect to the timeframe for review, which we assume will be addressed in ASIC's regulatory guidance. We would expect that the timeframe could be quite extended for low risk products (maybe as long as 5 years).

Record Keeping Obligation

The AFA supports the proposal with respect to record keeping obligations for product issuers. These obligations seem sensible and achievable. As discussed below, the record keeping obligations for distributors are significantly greater and substantially more expensive to implement and maintain.

Obligation to Notify ASIC of Significant Dealings that are not Consistent with a Product's Target Market Determination

Whilst the AFA is supportive of this requirement, we are of the view that there is a complete lack of clarity of what "significant dealings" may involve. Does this need to be assessed in terms of the number of clients or the dollars involved. We question this in the context that a client with a large individual transaction is most likely to be treated as wholesale, and therefore excluded from the scope of this legislation.

Greater clarification is required in either the legislation or the Explanatory Memorandum (EM) for what "significant dealings" means.

Distribution Obligations

We note the addition of a new term 'retail product distribution conduct' and the exclusion of financial advisers from all obligations except the record keeping obligation and the ASIC notification obligation. We support the exclusion of financial advisers from the other obligations.

Obligation not to Engage in 'Retail Product Distribution Conduct' Unless a Target Market Determination has been Made

The AFA is supportive of the requirement for distributors to not engage in retail 'product distribution conduct' when a Target Market Determination has not been made.

We are very conscious that agreements between product issuers and distributors will need to be much more formal in order to address all the additional obligations (particularly record keeping). In our view this is likely to be very time consuming when the regime commences. We would recommend that the Government seeks to minimize the extent of distributor record keeping in order to simplify the complexity of putting these distributor agreements in place. Otherwise the likely impact is that distributors will cut back on which products they distribute, which will impact the amount of choice for consumers.

Obligation not to Engage in ‘Retail Product Distribution Conduct’ Where a Target Market Determination may not be Appropriate

In the context that this obligation will not apply to financial advisers, and there has been more allowance for the protection of distributors who have acted on reasonable grounds, we do not have concerns with this requirement.

Obligation to take Reasonable Steps to Ensure Compliance with a Target Market Determination

On the basis that financial advisers are excluded from this obligation, we are broadly in agreement, however noting potential concerns with respect to the treatment of both giving a PDS/disclosure document and Execution Only Transactions.

Product issuers typically make their PDS available on their website for both current and potential consumers to read. The inclusion of giving a PDS or disclosure document in the definition of ‘retail product distribution conduct’ will result in product issuers needing to screen who can access these documents, which may result in them not being available to people who need them. We believe that this will have a number of unintended consequences.

Execution Only Transactions occur where a financial advice client, specifically requests that their financial adviser implement a particular product chosen by the client. As is expressed in the name for this type of transaction, this is a no-advice pathway, however it is the vehicle for the financial adviser to implement the instructions of their client. We are concerned that the inclusion of this in the definition of ‘retail product distribution conduct’ will result in financial advisers being prevented from providing this service in some cases. This might mean that the client would need to pay for financial advice, in order to acquire the product via their financial adviser.

Obligation to Collect, Keep and Provide Distribution Information

We note the significant change that has been made to this part of the legislation, with the requirements for the collection of information and provision of this information being set by the product issuer. Whilst this might facilitate a reduced amount of information and frequency of the provision of the information for low risk products, the obligation still exists and is now more complex as it could vary from one product issuer to another. This will make it very challenging and uncertain for financial advisers, particularly where they have broad Approved Product Lists and work with a wide range of product issuers. The requirements for each product will not be known until the Target Market Determination is required and the product issuers have commenced negotiating product distribution agreements with each AFSL that includes their product on their Approved Product List. It also needs to be appreciated that this requirement will make it much more difficult for an adviser to recommend a product that is not on their Approved Product List, since no distribution agreement will exist. This will potentially impact upon an adviser’s ability to meet their Best Interest Duty obligation.

We question the intent of the obligation to collect distribution information. These obligations will apply to financial advisers who already have obligations to document their advice, including through the preparation of Statements of Advice. Depending upon what information is required, this might require financial advisers to maintain an active consolidated record of all clients in each applicable financial product.

Whilst some advisers may have a system for understanding, on a consolidated basis, the investment holdings of each client, this is certainly not universal and such systems are often not 100% reliable. This is further complicated by the proposal to include life insurance products in this regime, when they are often on separate systems. It will not be practical to rely upon the product issuer systems and there are typically a number of complexities in using financial planning software solutions. It is also the case that some clients might hold products, which they want their adviser to have oversight on, but where the adviser is not recorded with the product issuer as the adviser.

We do not accept that record keeping of individual holdings of each client for each product is reasonable. It is our view that this requirement should be limited to higher risk products that could be specified through the regulations.

When it comes to lower risk products, we believe that product issuers could get the information that they require to oversight their products through a range of other means, including through holding regular focus group meetings with financial advisers. They could also collect information from financial advisers who utilise their products by on-line surveys. They could also collect information on a sample basis seeking specific information that might be contained on the financial adviser's client file.

Obligation to Notify Issuer of Significant Dealings that are not Consistent with a Product's Target Market Determination

We do not believe that financial advisers should have to provide this information if they are bound by the Best Interest Duty and have done an assessment of the client's needs, objectives and personal circumstances. If the product is a high-risk product then such information could be captured through the ongoing record keeping obligation.

Once again greater clarification is required in either the legislation or the EM for what "significant dealings" are.

Promotional Material Must Refer to the Target Market

The AFA supports the requirement to refer to the target market in any advertising, however believes that the Target Market Determination should be set out in the PDS so that the client does not need to review both the PDS and another separate place for the Target Market Determination.

ASIC Powers and Associated Matters

Whilst we are broadly supportive of the proposed powers for ASIC, this is subject to our concerns expressed above with respect to the record keeping obligations for distributors.

Information Gathering Powers

Whilst we recognise the need for ASIC to have information gathering powers, we refer to our feedback above on the impractical nature of the record keeping obligations for distributors. It would be extremely difficult for AFSLs and financial advisers to comply with these obligations and impossible for them to do it in the timeframe proposed.

Stop Order Power

The AFA supports the stop order power.

Exemption and Modification Powers

The AFA supports exemption and modification powers for ASIC.

Consequences of Breaching the New Provisions

As discussed above with respect to record keeping, we have major concerns about the ability for financial advisers (and AFSLs) to comply with these requirements and we therefore oppose the scale of penalties proposed for failing to collect, keep and provide distribution information. We also question the penalty for failing to notify an issuer of significant distributions (dealing) that are not consistent with a products target market determination, when there is a lack of clarity on what significant dealings are.

Application and Transitional Provisions

Whilst the 24 month timeframe may be reasonable for product issuers, we have particular concerns about the timeframe for distributors with respect to the record keeping obligations. There will be a significant amount of work involved in the negotiations of product distribution agreements with the product issuers. In terms of the record keeping requirements, the fact that each product issuer will potentially have different requirements and the distributors will not know these requirements until they have negotiated the distribution agreement, makes this whole arrangement unreasonable and unachievable.

As discussed above, we strongly recommend that record keeping obligations for distributors only apply to high risk products. Should the Government not accept this position, then we would suggest that product distributors be given another two years (a total of four years from Royal Assent) to commence the record keeping obligation. This would allow them to build the systems that they would need to collect the information that different product issuers require them to collect.

Product Intervention Power

Intervention Orders

The AFA is broadly supportive of the intervention powers as proposed.

We question the circumstances where ASIC has issued an intervention order and requires persons who have dealt in or provided financial advice with respect to the product to notify the clients. It is our view that the product issuer should have this obligation. The person who dealt in the product or advised on the product may no longer be in business or may no longer have the contact details of the clients. Another adviser may have purchased that business or book of clients.

The product issuer should have the contact details and should be primarily responsible for communicating with the client. We would also suggest that the product issuer will have access to better information on the intervention order and the issues behind the order, that would be necessary to frame the communication. We recommend that this element of the legislation be modified to remove the potential obligation for the distributor/adviser to communicate with the client on an intervention order.

Consequences of Contravening the New Power

As discussed above we do not agree that a person who dealt in a product or advised on the product should have responsibility for communicating with clients as a result of an intervention order. We therefore oppose the penalty for “failure to notify consumers of the intervention order” applying to financial advisers.

Regulation Impact Statement

Our feedback on the Regulation Impact Statement is as follows:

- All the product collapse examples used are either GFC or pre GFC. Matters such as Storm Financial, Opes Prime, Westpoint, agribusiness schemes, unlisted debentures and mortgage funds did result in significant losses for consumers, however it is not apparent that these product intervention powers would have enabled these losses to be avoided. One example that is discussed is the mortgage funds that were frozen during the GFC. This happened very shortly after and most probably in part as a result of the Government putting in place the bank guarantee. There would not have been enough time to act and the outcome would not have changed as a result. We need to be careful in assessing product collapses with the benefit of hindsight and assuming that something different might have been done in the lead up to the collapse. It is important for the Australian community to understand that these new powers will not prevent collapses in the future.
- We take exception to the statements made in paragraph 3.15, and particularly “Despite efforts over many years, the financial advice industry failed to improve financial advisers’ conduct leaving it unable to prevent or reduce the effect of recent serious cases of poor advice”. The examples that are referred to in this section are all at least seven years ago and in large part they primarily reflect product failures, not advice failures.
- We believe that the Regulation Impact Statement should set out the breakdown of the impact of this legislation in more detail to assist the industry to understand the consequences. This is expressed as an annual compliance cost, however there is no reference to initial implementation costs, which should be shown separately. This appears to be a very superficial exercise for what is obviously a very substantial commitment and cost for industry. Surprisingly there is no reference to the expected financial benefit from the legislation. Treasury should be talking to the financial services industry and AFSL’s in particular, to better understand the impact of this reform.

Concluding Remarks

The AFA recognises the intention of the introduction of these new obligations and powers, however we do have particular concerns as raised above and ask Treasury and the Government to take these into account in finalising the legislation and the EM. The proposal for record keeping by distributors (including financial advisers) is unworkable and unnecessary.

AFA Submission – Design and Distribution Obligations and Product Intervention Power

The AFA welcomes further consultation with Treasury should it require clarification of anything in this submission. If required, please contact us on [REDACTED]

Yours faithfully,

A handwritten signature in black ink, appearing to read 'P. Kewin'.

Philip Kewin
Chief Executive Officer
Association of Financial Advisers Ltd