

15 August 2018

Manager - Consumer and Corporations Policy Division  
The Treasury  
Langton Crescent  
PARKES ACT 2600  
Australia

By email: [ProductRegulation@treasury.gov.au](mailto:ProductRegulation@treasury.gov.au)

Dear Sir/Madam,

**Treasury Laws Amendment (Design and Distribution Obligations and Product Intervention Power) Bill 2018**

The PFA welcomes this opportunity to make a submission to Treasury in relation to the Treasury Laws Amendment (Design and Distribution Obligations and Product Intervention Power) Bill 2018.

The PFA is an industry body representing the Australian unlisted wholesale and retail property funds sector, currently some \$79 billion in size.

The PFA's members consist of Australian Financial Services Licensed property fund managers, their advisors, consultants and representatives.

The PFA supports the establishment of the CCIV regime in Australia. This new investment vehicle has the potential to introduce fund structuring alternatives to local unlisted property fund managers and increase Australia's international competitiveness.

1. This letter sets out the submissions of the Property Funds Association of Australia (**PFA**) in relation to the design and distribution obligations and the product intervention power proposed in the Treasury Laws Amendment (Design and Distribution Obligations and

Product Intervention Power) Bill 2018 (the **Bill**) and as explained in the Exposure Draft Explanatory Memorandum (the **EM**).

2. The PFA appreciates the need for consumer protection and we note the revised drafting in respect of the initial exposure draft of the Bill in January 2018.
3. In our view some drafting of provisions in the Bill, however, could be improved and/or clarified and raise operational considerations for issuers and distributors that should be clarified or in relation to which regulatory guidance should be given.
4. We set out our proposed recommendations throughout this letter for the consideration of the Treasury.

### ***Product Design and Distribution Obligations***

#### *Target market determination (TMD) format*

5. The Bill currently provides several requirements for the contents of the TMD without proper guidance on the required form. Neither the Bill nor the EM set out a sample TMD that satisfies all of the requirements of proposed section 994B(5).
6. It appears from paragraph 1.47 of the EM that the drafters of the legislation have deliberately decided against having a prescribed form of TMD, opting instead only to have the TMD to be in writing on the basis that this approach allows the issuer to 'determine the most effective and efficient form for a determination given the particular product involved and their existing systems and processes.'
7. Given any specific issuer's existing systems and processes were not designed with the requirements pursuant to this Bill in mind, a TMD document from one issuer has the potential to be inconsistent with the TMD of another issuer for the same retail product class.
8. A sample TMD, or a pro forma TMD, would be useful as it would, among other things, assist promoting consistency across the industry. Different styles of TMDs will not promote consumer understanding or confidence in the funds management industry.

9. While we understand that an important plank of the legislation is to require a product issuer to turn its mind to consider its product's target market it is crucial that an appropriate framework and guidance is provided to promote a common approach. Failing this will only create confusion for consumers and unhelpful complexity.

*Likely objectives, financial situation and needs of the retail client*

10. Despite the revised wording in the Bill, proposed section 994B(8)(b) requires the issuer to issue a TMD on terms that it would be reasonable to conclude that, if an issue, or a regulated sale, of the product were to occur to a retail client in the target market, it would likely be consistent with the likely objectives, financial situation and needs of the retail client likely objectives, financial situation and needs of the retail client.

11. We submit that this will still create difficulties in practice. The wording implies that the issuer must have undertaken some kind of assessment of the objectives, financial situation and needs of the retail person acquiring the product.

12. Whilst a general determination in relation to a class may be possible as to the objectives or needs of an investor that could be met through a particular product, it is unclear how a standardised approach to an investor's likely 'financial situation' could be achieved in any practical or meaningful way. There are many potential variations to a person's financial situation. For example, when an investor is considering an investment into an unlisted property fund, some of the financial circumstances / situation that may be relevant to their investment decisions include:

- a. current income of the investor;
- b. free cash flow of the investor;
- c. the investor's debt levels – direct and on a look through basis;
- d. current access to capital and how that aligns with investor needs;
- e. ability to withstand reductions or suspensions of distribution;
- f. specific tax circumstances;
- g. family circumstances;
- h. current exposure to property (including residential);
- i. whether the investor has an investment portfolio;
- j. current portfolio construction and alignment of the portfolio to any target asset allocations pre and post investment;
- k. whether the investor is pre / post retirement;

- l. tolerance of the investor to risk;
- m. investment vehicle (e.g. SMSF, trust, direct);
- n. certainty of employment;
- o. whether there are any upcoming life events that need to be planned for;
- p. whether the investor receives a pension or other government benefits that may be impacted by the investment; and
- q. any estate planning considerations

13. In addition, the three variables of objectives, financial situation and needs can combine in a large number of ways, making it difficult to set a TMD on terms that it would be reasonable to conclude that, if an issue, or a regulated sale, of the product were to occur to a retail client in the target market, it would likely be consistent with the likely objectives, financial situation and needs of the retail client.

14. This kind of assessment may be beyond the competence of the issuer, and the issuer may be removed from the objectives, financial situation and needs of any potential investor, as this is the competence and role of the investor's adviser.

15. Smaller product issuers that are not part of a broader financial service group will also not have the ability to leverage off other areas of the business to meet the requirement to determine whether an investor falls within a TMD, thereby creating an unequal cost of implementation. For example, a smaller product issuer that is only able to provide general advice in relation to its own products will have a clear differential in cost of implementation to a larger financial group that has access to financial planning / advice divisions or provides a broad suite of products and services to its customers with an established customer relationship. Some product issuers may not have the current competence or resourcing to determine an investor's objectives, circumstances and needs and will need to build or outsource this capability.

16. In addition to the clear difficulty in developing a single TMD that covers a large number of possible variations to a retail clients objectives, financial situation and needs, without detailed guidance, it is also unlikely that a practical, efficient or common approach could be taken to assessing whether an investor meets the TMD. In the absence of guidance, a product issuer may have to take the precaution of extensive and investor specific on boarding requirements. This may require a process along the lines of fact finding in a statement of advice for each and every prospective investor along with a detailed assessment and sign-off process. In such circumstances, issuers may be forced to outsource

this aspect of the creation of TMDs to third parties, and to avoid the trap of providing product advice, such persons may in turn rely on and provide the issuer with generic market-based information about consumers based on hypothetical scenarios and assumptions about consumer behaviour and about the kinds of Australians that belong in classes of persons identified by the issuer. Such data will be so generalised as to be useful. Further, the current wording of this proposed section does not refer to a ‘class’ of retail client but ‘the retail client’, which suggests a kind of non-existent intimacy between issuers and potential retail investors.

17. A further complexity in setting the TMD and assessing prospective investors against the TMD relates to entities making an investment. Investors who invest through investment vehicles such as a SMSF or a family trust must be treated as a retail client unless they meet wholesale tests. Investment entities will add a further potential variable to a prospective investor’s objectives, financial situation and needs.

18. We submit that proposed section 994B(8) could achieve its regulatory aim without the problematic proposed section 994B(8)(b) as proposed section 994B(8)(a) achieves the desired aim.

#### *Review triggers for a TMD*

19. In our view the Bill does not provide enough clarity for the relevant events and circumstances that would reasonably suggest the determination is no longer appropriate (review triggers) in proposed section 994B(5)(d). The definition of review triggers is vague, allowing for any number of interpretations imposed in an issuer’s TMD that may be significantly inconsistent from TMDs in respect of similar products issued by different issuers.

20. The requirement also extends to imposing requirements on issuers to specify kinds of information needed to promptly determine that a TMD may no longer be appropriate. Without a sufficient definition as to what constitutes a review trigger, the required information that would render a TMD no longer appropriate is also open to vastly differing interpretations by issuers.

#### *Making TMDs public*

21. Proposed section 994B(9) imposes an obligation on an issuer to make the TMD publicly available, free of charge. The EM (at paragraph 1.45) provides reasoning for this obligation based on the intended mitigation of ‘evidential difficulties with substantiating

non-compliance with target market determinations' and ease of access to the public. In our view, the publication of an issuer's TMD may contain significant amounts of intellectual property or other commercial sensitive information in regards to an issuer's operational product design for the retail market in respect of that product, and therefore could stifle innovation and undermine trade secrets. Instead, we submit that TMDs should be given or made available free of charge by issuers to prospective investors only.

#### *Process timeframes for TMDs*

22. The process of establishing a TMD, appropriate review triggers and the publication of the TMD present significant operational timeframe issues for retail product issuers. We have identified this as a potential problem in the case of unlisted property retail fund products. These product classes will often have short capital raising periods for property acquisitions, in order to settle acquisitions and ensure that deposits are not forfeited or further costs incurred. During capital raising periods, a large number of retail clients will sought to be engaged, with whom the product issuer will have no existing relationship. Without detailed guidance or safe harbour provisions, the proposed approach would not provide a practical, efficient or common approach to engaging retail clients. This would substantially increase the risk of an unsuccessful capital raise and potentially limit investment opportunities where retail client applications cannot be processed in time.

#### *Recommendations*

- a. Issue a prescribed form of target market determination in the Bill, or a sample TMD in the Bill or the EM so as to promote consistency across the industry;
- b. Give examples of 'review triggers' in the EM;
- c. Reduce the requirement for public disclosure to be upon request by the consumer; and
- d. Delete the requirement in proposed section 994B(8)(b) as it is unnecessary to achieve the desired aim.

#### **ASIC Product Intervention Power**

##### *Significant detriment*

23. The product intervention powers provided for in schedule 2 of the Bill allow ASIC to make a range of prohibitive orders in relation to retail financial products. The intended purpose of these as stated in the EM (at paragraph 2.8) is to reduce the risk of consumers suffering significant detriment from retail products.



24. Neither the Bill nor the EM provides sufficient clarity around the term ‘significant detriment’ in proposed sections 1023A and 1023E. The EM has states (at paragraph 2.31) that the omission of the relevant definition for ‘significant’ is deliberate to provide for this to take its ‘ordinary meaning’. Rather, proposed section 1023E states a few matters to be taken into account in determining whether there has been or will be ‘significant detriment’ to consumers.

25. Without guidance, the product intervention power may unwittingly stifle product innovation. This is because product issuers may regard products as ‘too risky’, and subject to closure by ASIC, merely because they are novel or present unusual features in the Australian market.

#### *Recommendations*

- a. Provide further guidance in the EM on the meaning of ‘significant’ or ‘significant detriment’; and
- b. Alternatively, require ASIC to provide guidance on this term provided that the regime does not commence until 2 years after the issue of ASIC’s guidance.

#### **Implementation**

##### *Implementation timeframe*

26. The current timeframe for the implementation of the design and distribution obligations pursuant to this Bill is scheduled for two years from the date of Royal Assent pursuant to section 2. This poses numerous timeliness concerns for issuers, as the current internal compliance framework for issuers of systems, policies and processes will need a substantial redesign to ensure compliance with the provisions.

27. Product intervention powers are provided in the Bill to commence from the date of Royal Assent of the Bill pursuant to section 2. This proposed timeframe is not suitable for the redesign and renegotiation of any non-conforming retail financial products with distributors and retail consumers for existing products.

28. Any internal review and redesign of issuer compliance framework will be exacerbated without the requested guidance and clarifications set out in this submission. This internal review and redesign timeframe will vary greatly depending on the resources, competency and service offering of individual issuers.

29. Should the requested guidance and clarification not be provided in the Bill or the EM, then ASIC should provide that guidance upon the passing of the Bill with the regimes not commencing until 2 years after ASIC issuing that guidance.

*Recommendation*

a. Extend the implementation date for both the design and distribution obligations and product intervention powers to three years from the date of Royal Assent or, alternatively, to two years from the date that ASIC issues its regulatory guidance.

*Release of regulations and ASIC regulatory guidance*

30. Furthermore, the redesign of products, as well as internal review and implementation will not be possible without the enactment or issue of regulations and ASIC regulatory guidance (including potentially legislative instruments of relief or modification). It is difficult for industry to implement such significant reforms in the absence of being able to take into account all of the regulations and regulatory guidance. It may aid the transition if ASIC were to prepare draft regulatory guides for public consultation prior to the issue of regulations, particularly in relation to the exercise of the product intervention power, so that industry could see the full suite of regulatory settings.

*Recommendation*

a. Commence public consultation process for the ASIC regulatory guidance prior to further progress to the review of the Bill, particularly in relation to the product intervention power.

**Conclusion**

31. These reforms seek to better match retail financial products by issuers to retail consumers. The unintended effect of the legislative framework will be the increased cost and operational resource required for compliance and will act as a deterrent for issuers and distributors to create suitable retail financial service products.

32. This may also act as an incentive to financial advisers and retail clients to invest with larger issuers and institutions that cover broader asset classes, directing investment away from smaller or more specialised issuers. This may lead to further vertical integration in the financial services industry due to the cost of implementation of compliance measures. We believe this would lead to a reduction in choice and unsatisfactory outcomes for retail clients, which is counterintuitive to the objectives of the Bill.



33. The increased costs, risks and complexity of raising capital from retail investors will lead to property fund managers considering issuing wholesale funds as the default position for new assets, thereby reducing the availability of unlisted property funds for investment by retail clients. This could reduce the ability of retail investors to diversify their portfolios by the inclusion of unlisted property, a key asset class in a well-diversified portfolio.

34. We welcome the opportunity to discuss the above comments and the submission further, or to provide any additional information the Treasury may require for its process of deliberation.

Yours sincerely



**Paul Healy**

Chief Executive Officer

Property Funds Association