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Product Regulation
Strategic Policy
Australian Securities and Investments Commission (ASIC)
GPO Box 9827
Brisbane QLD 4001

By email: product.regulation@asic.gov.au

Dear ASIC,

AFA Submission – CP 325: Guidance for New Product Design and Distribution Obligations

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 their wealth.

Introduction

The AFA welcome the opportunity to make a submission in response to this consultation.

We recognise that this regime has been in the planning phase for some time and that we are now approaching the commencement in a little over 12 months time. Whilst we are broadly supportive of the objectives of this legislation, we feel that the value will be greater where the products are higher risk, rather than standard banking, investment and insurance products. We are somewhat more cautious than some with respect to the likely benefits of this regime. In our view, the benefits will be in the peripheral products segment of the market and not the mainstream. The suggestions that this new regime will be a game changer, are in our view a little overstated.

We also, however, believe that it is important to ensure that the cost of this regime does not unreasonably impact on the cost of financial products and therefore detract from the value that

consumers achieve. This issue is further complicated by the fact that some products, such as MySuper, will be excluded from the regime and this will provide them with a competitive advantage that will be greater, the more that the Design and Distribution Obligations (DDO) regime costs those who are covered. Wherever a regulatory regime results in an unlevel playing field, we think that this needs to be carefully considered and carefully managed. We are also conscious of the reduced consumer protection that is arguably available for MySuper members.

It is likely that this regime will have a broad impact on the financial services markets, in terms of new processes, additional workload and extra management responsibilities. It is also likely that there could be some unintended consequences, and it will be important to identify these early and respond in an appropriate manner.

We note that these obligations are not intended to apply to the purchase of exchange traded investment products on the secondary market. It would be beneficial if this was more clearly articulated.

We have not responded to all questions and have excluded the questions that we have chosen not to respond to.

Response to Questions Raised in the Consultation Paper

B1Q1. Is our guidance on a robust product governance framework useful? What additional matters, if any, do you think are important in ensuring that a product governance framework will be effective and support compliance with the design and distribution obligations?

We agree that the guidance on product governance framework is useful. We expect that more will come to light as this regime is implemented and it will be appropriate to update this section as more learnings are achieved and best practice emerges.

B2Q1. Is our guidance on the consumer-centric approach issuers and distributors should take to deliver good consumer outcomes useful?

Whilst we are supportive of the need to take a consumer-centric approach, the guidance does not provide any detail on what this might involve. Paragraph 56 describes how a failure to take a consumer-centric approach will result in the entity being at risk of breaching the Design and Distribution Obligations. In the absence of an adequate explanation of what the consumer-centric approach might require, this is a challenging expectation.

C1Q1. Do you agree with our approach to guidance on the form and content of a target market determination? If not, why not?

Whilst the requirements for a target market determination have been set out in paragraph 61, we do not feel that there is enough guidance to assist in the preparation of a target market determination. It would be beneficial to include an example target market determination.

C3Q1. Do you have any comments on our approach to guidance on identifying and describing the target market?

We believe that it would be beneficial to provide more definitive guidance. It may be that ASIC intends to leave this to other bodies, however in the absence of more definitive guidance, we are likely to see a lot of variability in target market determinations, which will cause confusion for financial advisers and other distributors.

C3Q2. Do you have any comments on the following examples, which we have used in our

guidance to illustrate key principles set out in RG 000.66–RG 000.89:
(a) Example 1: Credit cards;
(b) Example 2: Reverse mortgages;
(c) Example 3: Cash options in superannuation;
(d) Example 4: Consumer credit insurance;
(e) Example 5: Low-value products; and
(f) Example 6: Basic banking products?

We think that it is important to include examples, however our feedback is as follows:

- Some of the examples relate to products that are fundamentally unsuitable, rather than not appropriate for some segments of the market. This is less helpful.
- Some of the examples seem to imply a need to have specific knowledge of the client's circumstances (i.e. reverse mortgage). Whilst this might be possible to obtain in the context of a credit product, where a loan application form is required, it seems that this is an unreasonable expectation for other products and poses genuine complications for products that are being distributed in the absence of personal advice.
- Whilst a negative effective return on a cash account is certainly undesirable, it is important to note that cash accounts serve more purposes than just as an investment option. They are also important as a parking place during times of high uncertainty and volatility (as has been experienced in early 2020). This consideration needs to take into account the prevailing market interest rates and other competitive pressures. With official interest rates at 0.5% and expectations of further reductions in the official rate, this seems to be an increasing prospect. Interest rates are cyclical and they can be expected to go back up. In the meantime, it is not appropriate to suggest that no cash accounts should exist, if the effective return is negative.

C4Q1. Do you have any comments on our proposed guidance for issuers considering the role of diversification as it relates to their identification of the target market?

Diversification is going to be an important issue and is going to pose a number of challenges for parties who do not have visibility of the client's full circumstances. We do not consider the discussion on Diversification to have provided sufficient guidance in this area.

C5Q1. Do you agree that consumer understanding of a product does not necessarily equate to the product being likely to be consistent with the likely objectives, financial situation and needs of consumers in the target market? If not, why not?

We agree that an understanding of the product does not mean that the product is suitable for the consumer, however it is one of the factors that would provide greater confidence for the issuer. Importantly also, previous experience with the product does not necessarily imply an understanding of the product.

C6Q1. Do you agree that it may also be useful for an issuer to describe the negative target market for its financial product? If not, why not?

We support the suggestion that a product issuer should give consideration to a negative target market. Whilst this is not a mandatory requirement, it would be a useful step to take as part of the process to establish the target market determination.

C6Q2. Is our guidance on the role of describing a negative target market adequate and useful? If not, please explain why, giving examples.

The examples of a person unable to claim under an insurance policy and a client with a low risk tolerance not being suitable for investment in a high risk product are too obvious to be of any great benefit. Examples that are less black and white would be more beneficial.

C7Q1. In relation to our guidance on how a target market determination should be approached for superannuation products, as set out in Example 7:
(d) How should a trustee take into account insurance in making a target market determination for a Choice product?

We are very conscious of the exclusion of MySuper from the Design and Distribution Obligations regime, however we are concerned about the inconsistency in the requirement to consider the Design and Distribution Obligations for insurance with a Choice fund, but not with a MySuper product, when it may be exactly the same insurance product. We do have a major concern about the lack of consistency as it applies to MySuper products. We also ask the question of what happens with respect to the insurance where a member has insurance, but also both a MySuper and a Choice investment option? Is the insurance covered in this context or not?

C7Q2. Do you agree with our guidance on the application of the target market determination obligation to IDPS?

We agree that the obligations need to apply at the IDPS platform level and the investment option level, however the product providers do not have client level information and it seems unreasonable for them to take on the full Design and Distribution Obligations, when they do not have visibility of the end client.

We are not certain that it makes sense for the investment option providers to be required to take additional steps to consider if the platform is an appropriate distribution channel. We would expect them to already have processes in place to determine which platforms they should seek to be available on.

C8Q1. Do you have any comments on the following examples, which we have used in our guidance to illustrate key principles set out in RG 000.107–RG 000.120: (a) Example 7: Superannuation products;
(b) Example 8: Investor directed portfolio services;
(c) Example 9: Superannuation;
(d) Example 10: Mortgage fund; and
(e) Example 11: Listed investment companies?

We question the expectation that product providers will need to develop functionality to prevent certain clients from accessing investment options where there is a prospect that they might be assessed as not within the target market. In most situations, the selection of the product will be done by a financial adviser, however if the client makes their own decision, then is it reasonable to have the product system prevent them from investing in an option that is detailed in the PDS and otherwise available to other consumers. In our view, this is simply going beyond what is reasonable and will cause concern and confusion for some clients and significant costs for product providers.

It is certainly not acceptable for a distributor to use the terms ‘cash’ or ‘cash like’ in the promotion of a mortgage fund. It did not take the Design and Distribution Obligations to make this point clear.

C8Q2. Do you agree with the factors listed in Table 3 of draft RG 000 that we expect will be relevant when considering whether an issuer has met the reasonable steps obligation? If not, why not?

We agree with the factors listed in Table 3. We are also very conscious that the requirements set out in Table 3 could involve significant cost for the product issuer and we would not want to see this DDO regime significantly pushing up the cost of financial products.

C9Q1. Do you have any comments on our guidance on setting appropriate review triggers and maximum review periods?

We do not believe that sufficient clarity has been provided with respect to review triggers. Examples 12 on insurance and 13 on managed funds do not provide much additional context around this, although some of the specific items are useful. It is also important to ensure that a trigger, such as an economic downturn or a significant decline in the investment markets, does not result in virtually all investment products hitting a review trigger at the same time. This would be unmanageable.

We would also question whether the emergence of review triggers should automatically lead to a product being closed until the review has been undertaken. We would suggest that this needs to be contingent upon the actual trigger and the scale of the movement in the trigger.

The guidance on the frequency of reviews did not provide a sensible conclusion. It states that super fund trustees have certain obligations to undertake a review on an annual basis. This appears to imply a certain standard and then refers to high risk products being assessed more frequently. The point about the review being built into other product reviews is sensible.

When it comes to low risk products, such as index funds, we do not believe that a review any more frequently than once every three years should be required. These obligations need to be considered in a pragmatic manner, noting that they will increase the cost of the financial product.

C10Q1. Do you have any comments on our guidance on the issuer's obligation to specify information it requires from its distributors?

We are particularly concerned that these obligations on distributors to provide information to issuers, on the basis of the requirements, as defined by the issuer, is going to create a great deal of inconsistency and confusion. This will particularly be the case for a small financial advice licensee who has a broad Approved Product List, and would need to collect a lot of information and all in very different formats and content. This could add significantly to the workload of the licensee and increase the risk of non-compliance with some of these requirements. We would certainly be arguing for a more standardised approach and provision for this distribution reporting obligation to not apply for some more basic or standard products, where no complaints have arisen.

Some of the items listed in paragraph 139 do not seem to be reasonable. As an example, requests for information from consumers. This is a huge task for an AFS licensee operating a self-employed financial adviser model. Also, data like web analytics does not seem to be meaningful in the absence of other information. We question the suggestion of samples of recorded sales calls, noting that this obligation also applies to financial advisers and is it really necessary for the issuer to get copies of discussions between financial advisers and their clients, whether that is on the phone or face to face. Some of the proposed data will already be held by the product issuer, such as volume of sales.

There is no real guidance on the frequency of the collection of this information, other than the suggestion that every five years is not frequent enough.

C10Q3. In addition to the information set out at RG 000.139, are there other types of information an issuer should collect from distributors? If so, please describe the type of information you think would be relevant.

We believe that information collected from distributors should be prioritised to the information that is most significant, and directly relevant to genuine issues of client detriment and not just background information. There is a cost in preparing this information and also in analysing it. In our

view it should be focussed upon high priority specific information not general background information.

C10Q4. What potential effects on competition may occur as a result of the issuer's right to set the information the distributor must provide?

We fear that this right to set information requirements could significantly increase the cost for the Distributor. In the financial advice sector, this additional cost sits alongside a range of other cost increases that are fundamentally impacting the cost of providing financial advice and impacting both accessibility and affordability of financial advice for everyday Australians.

C10Q5. Do you have any comments on our guidance on the issuer's obligation to specify the reporting period in relation to the number of complaints?

We would favour a standardised period, rather than one that is defined differently by each product provider or for each different product. We would also suggest that it is for a standard period, such as the financial year(s) or the calendar year(s), rather than a fixed length period commencing from the day the product is launched.

C11Q1. Do you consider our guidance on the types of information issuers should have regard to (described at RG 000.143) to be useful? If not, why not?

Whilst we do not fundamentally disagree with any of this information listed in paragraph 143, particularly for complex products, we question the necessity to follow such a structured and comprehensive process for standard and basic products.

C12Q1. Are there any additional factors that issuers should consider? If yes, please provide details.

We are concerned that this obligation to report significant dealings is based upon an assumption that issuers and distributors would be able to readily identify customers who are not in the target market. It is our view that they are unlikely, in most cases, to be totally certain that individual customers or groups of customers are definitively outside the target market. This will make the assessment of significant dealing very difficult. It also may not be apparent to the product issuer or the distributor whether there has been any client loss or the amount of that loss.

In this context, and the lack of any real guidance on assessing significant dealing, we feel that there is a need for more guidance.

D1Q1. Do you agree with the factors listed in Table 5 of draft RG 000 that we will take into account when considering whether a distributor has met the reasonable steps obligation? If not, why not?

We do not oppose any of the factors listed in Table 5, however we recognise that this will be particularly challenging for distributors (other than financial adviser, who are in any case largely excluded), since they are unlikely to have that much information on consumers and it will be costly to obtain the information that would otherwise appear to be required.

It is apparent that in many cases, consideration will need to be given as to whether it remains appropriate to operate a non financial advice distribution model for some products. We envisage that most of the more complex products will no longer be sold in a non personal advice model.

D1Q2. What additional factors, if any, do you consider should be included in Table 5 of draft RG 000?

We do not have any additional factors to propose.

D2Q1. Do you have any comments on our proposed guidance for distributors in Example 14 of draft RG 000?

We ask the question with respect to what extent consumers should reasonably be responsible for their decision to renewal an existing insurance policy, rather than what appears to be proposed here in that an insurer would need to go back to the consumer to ask a bunch of questions before confirming that the policy remains appropriate. It inevitably would require a level of understanding of the client's circumstances to make any of these calls. In terms of the question about the point at which a car owner no longer needs insurance, is particularly concerning. In the absence of comprehensive insurance, they should have third party property insurance. How will an insurer know when they might think this switch is appropriate? This is a matter of personal preference and a judgement call that only the client can make.

Once again, we are concerned about the additional cost that will be incurred in the pursuit of additional information. This additional cost will ultimately flow through to the customer in terms of increased premiums.

D3Q1. Do you agree that, in most cases, a distributor would have sufficient information about a consumer through its existing sales processes to form a reasonable view on whether the consumer is reasonably likely to be in the target market for a financial product?

We question this assumption, particular with respect to investment products and general insurance products. Credit products may be somewhat different, as the application needs to contain sufficient financial position questions to enable the credit approval decision to be made.

D3Q2. What data do you consider would help distributors reasonably conclude that a consumer is reasonably likely to be in the target market for a financial product?

The answer to this question will vary from one product to the next.

D3Q3. Do you consider our guidance should identify (in draft RG 000 at RG 000.168) other ways that a distributor's sales processes can assist it to form a reasonable view that a consumer is reasonably likely to be in the target market for a financial product? What other approaches can be taken?

The prospect of knock-out questions may be a suitable option in some cases, however it may also provide some false negatives and may fail to adequately take into account personal preferences. For most products, there will not be a simple knock-out question like whether the client would be eligible to claim on the policy.

It is less likely that historical data will provide the necessary information to assess whether a clients circumstances have changed to the extent where they are no longer in the target market.

The key issue with asking direct questions, is the risk that the advice may appear to be personal advice. As discussed below it is difficult to see how this can be effectively avoided.

D3Q4. Do you have any comments on our proposed guidance (in draft RG 000 at RG 000.169) on how a distributor could reduce the likelihood of leaving a consumer with the impression that their personal circumstances have been considered?

The suggestion that financial advisers should not be involved in the process is probably not relevant as this requires an understanding by the consumer of who a relevant provider is. The other suggestion about not asking specific questions in the later stages of the sales process also seems to be of limited value in providing the impression that this is not personal advice.

We remain concerned about how this issue of managing the impression that the advice has taken into account personal circumstances can be achieved if the questions are going to be with respect to the consumer's personal circumstances. It is difficult to see a sensible solution for this issue.

D4Q1. Do you have any comments on our proposed guidance on the content of the reasonable steps obligation in these circumstances?

No.

D5Q1. Do you agree that a target market determination for a financial product should be considered by a financial adviser in providing the advice and meeting their best interests duty? If not, please explain.

We would agree that the target market determination should be considered when recommending a higher risk product. Where the product is a more basic or standard product, then it may be more reasonable to expect that the financial adviser has given consideration to the types of issues that would generally be taken into account in recommending that type of product. Financial advisers need to understand any product that they recommend, and licensees need to assess the product before putting the product on the approved product list. An understanding is important before providing the advice. This does not mean that each time they recommend the product they should be required to re-read the target market determination or place a copy of the target market determination on the client's file.

D6Q1. Do you have any comments on our proposed guidance on using information gathered for the purpose of meeting responsible lending obligations in order to assist a distributor to form a reasonable view on whether a consumer is reasonably likely to be in a target market for a financial product?

We believe that it is appropriate to place reliance on information gathered for the purposes of responsible lending to be used to meet the distributor's obligations under the DDO regime.

Concluding Remarks

The AFA acknowledges the implementation of the Design and Distribution Obligations regime. We are keen to see these obligations work to the benefit of consumers, without adding excessive costs.

The AFA welcomes further consultation with ASIC should clarification of anything in this submission be required. Please contact us on 02 9267 4003.

Yours sincerely,

Phil Anderson
General manager Policy and Professionalism
Association of Financial Advisers Ltd