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Committee Secretary
Senate Economics Legislation Committee
PO Box 6100
Parliament House
Canberra ACT

Dear Committee Secretary,

Please find below answers to two questions on notice arising from my appearance representing Industry Super Australia (ISA) before the Committee on 1/11/2018.

As requested by the Committee Chair we have considered the the Financial Services Council's (FSC) submission to this Committee.

Financial Advice and Reasonable Steps s994E(4)

The FSC's proposal that all dealings related, and subsequent, to personal financial advice should be exempt from the design and distribution obligations (DDOs) is problematic.

A successful DDO regime is philosophically designed to place shared obligations for the responsible provision of financial products on entities across the entire 'design–distribution' continuum. By exempting personal financial advice, this continuum of responsibility is broken. A disconnect would arise between the issuing of a product and its distribution. An issuer would need to apply a target market determination (TMD) to a product – however, the actual distributor would not be required to consider whether the consumer falls in or out of the target market. We believe this would create gaps in the way the obligations operate in practice. While the problems with such an approach might be less evident in cases where the designer and distributor of a product hold the same Australian Financial Services License (and are therefore bound by the target market determination throughout), they become more obvious and more critical when distribution occurs as a result of advice provided by a third party.

The key justification for a personal financial advice exemption is that advisers are already covered by the best interest duty under the Corporations Act. It is a mistake to assume the best interest duty would provide a similar or comparable test to a target market determination. Given the financial advice case studies before the recent Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry, the limitations and problems with the Best Interest Duty have been fully exposed.

The argument that a DDO would create confusion with personal advice obligations is also irrelevant. The target market determination is intended to define a class of consumers, not individual consumers.

Wealth Management Platforms and Reasonable Steps s994E(4)

The FSC submission further proposes that the reasonable steps provision be changed to allow for the fact that platforms operators may 'not know' the end client who is advised.

With respect, the technological sophistication of wealth management platforms has increased dramatically in the last five years, with the development of data-pools and look-through data on customers and their underlying investments. Most of this data is now already provided to third party advisers and dealer groups as part of the platforms service obligation to the advice group. It is also now commercially crucial that platform operators have as much customer information including investment history on even advised third party clients from both a risk and servicing perspective.

They are capable of defining and keeping records on their target market determinations, and some of the platform operators already do this as matter of good practice. Contrary to the FSC's recommendation, platform operators should be subject to DDO in two respects.

Firstly, the DDO would cover consideration of the type of consumer that enters the platform investment environment. Platforms can be complex, with a wide variety of investment profiles and complex underlying investments. Given this inherent complexity and cost, a DDO should require the platform operator to determine which classes of customers would and wouldn't be suitable for entering that investment environment. Increasingly with technological developments there are also an increasing number of unadvised customers investing through platforms, emphasising from a consumer protection standpoint the need for DDOs to apply.

Secondly, the DDO would make platforms providers responsible for ensuring that each of the underlying products on the platform are only distributed to investors who fall inside the appropriate TMD. To be frank, a platform operator will be more careful about listing an investment at the request of a dealer group if the operator is responsible for a target market determination. If this requirement was in place, it may have resulted in failed agribusiness schemes like Great Southern and Timbercorp being less widely listed.

Currently, the inclusion of platforms in the DDO regime is not entirely clear to ISA. The Explanatory Memorandum states that the DDO regime includes custodial arrangements of investor directed portfolio services. This seems to mean the custody of the assets are included. ISA would like it clarified whether the DDO would cover a customer's on-boarding onto a platform, including decisions about which types of investments are listed on the platform.

Additional Commentary

In addition to these specific issues, ISA notes the following FSC recommendations which would, if enacted, result in a weakening of the DDO regime and question its enforceability.

- These include the request for greater scalability with respect to record keeping obligations covering the identification and review of target markets. Affording entities the ability to make such subjective interpretations, particularly in the absence of applicable penalties for not having sufficient information, will weaken ASIC's enforcement ability.
- The FSC's request for an extension to the transition period for compliance with the DDOs – from two to three years. The proposed transition period is adequate in ISA's view.
- The FSC further submits that Treasury should reconsider whether all the information related to the making of a TMD must necessarily be included in disclosure to

consumers. We support customers having access to the full target market determination in their own best interest. This would facilitate self-identification if the product is right or wrong for them.

Retrospectivity

ISA was asked an additional question on notice by Senator Ketter. This related to a potential amendment raised by another stakeholder, which would enable consumers to retrospectively have recourse to an evidence base when in receipt of adverse findings as to whether they should be remediated. At this stage, ISA does not have a position on this issue but we note it would impact on old legacy products.

Thank you for the opportunity to respond to these two questions on notice.

Dr. Nick Coates
Head of Research and Campaigns