

Chapter 14

Unsafe products

Why are these products being allowed to be offered at a retail level to the person in the street?...the risk involved in agricultural investment is simply outside the grasp of your average person in the street.¹

14.1 In Australia, the conduct and disclosure regulatory regime for financial products does not rely on merit regulation, but focuses on 'the transparency of the sales process (through disclosure) and the conduct of the intermediaries involved in the sale'.² Based on a strong tradition, this approach means that regulations governing disclosure and conduct are generally not concerned with the substantive 'safety' or quality of a financial product and its associated services. According to ASIC, this reliance on transparency in disclosure documents was premised on the general acceptance that 'consumers must take on some level of risk for investment products'.³

14.2 Evidence before the committee raised a number of matters that question the overall effectiveness of this regulatory regime in protecting the interests of retail investors. In respect of MIS, they included: the adequacy of disclosure so that the investors were able to comprehend fully the risks of investing and, notwithstanding robust disclosure requirement, whether such complex products should have been marketed to retail investors in the first place.

14.3 Also, the arrangements for borrowing to invest were an important part of the overall investment package and consideration must be given to the appropriateness of these lending arrangements for retail investors. In this chapter, the committee considers the marketing of these complex and high risk products to retail investors and the financing arrangements that allowed growers to borrow to invest.

Promoting and selling complex financial products

14.4 The committee accepts that investment carries risk: that from time to time some investments will not produce the expected returns or simply fail. But some investments by their very nature are high risk.

14.5 In its June 2014 report on the performance of ASIC, the committee discussed some of the implications of the low levels of financial literacy in Australia. It noted that when this is combined with Australia's current disclosure-based regulatory approach, retail investors and consumers may be further disadvantaged when deciding on a financial product. In this context, the Consumer Action Law Centre cited a

1 Mr David Cornish, *Proof Committee Hansard*, 4 August 2015, p. 13.

2 ASIC, *Submission 34*, paragraphs 6 and 34.

3 *Submission 34*, paragraphs 6 and 34.

number of further complicating factors that pose a risk to the consumer. These included:

- extremely complex credit and financial products that non-experts would frequently misunderstand (including even the most important elements);
- people not necessarily choosing between products 'rationally', instead making quick decisions using mental shortcuts when dealing with unfamiliar topics or when limited by time; and
- people typically having trouble calculating costs and risks, especially when the cost or risk is temporally remote.⁴

14.6 These additional risk factors were present in abundance with regard to agribusiness MIS. The FPA described these schemes as 'particularly complex' products... 'at the higher end of the risk spectrum' and 'with a 'particularly complex financing arrangement'. It noted:

Many of our members have related to us that forestry and agribusiness MIS are so difficult to understand and justify as an investment option over alternative products that their licensees do not include them on their approved product lists and financial planners avoid them. Professional indemnity insurers likewise have begun to exclude such products from their policies, as a response to the perceived risk and opacity of the investment case for MIS recommendations.⁵

14.7 The ANZ also described a MIS RE, in this case Timbercorp, as a company that was complex with products at the higher risk end.⁶ The bank did not have Timbercorp on its approved product list because it did not fit the profile of its client base. Mr Graham Hodges, Deputy CEO of ANZ, explained:

Our adviser product teams deemed that it was not a product that our clients would be interested in, because it was known at the time to be a more tax driven, high-risk product.⁷

14.8 Yet these financial products were marketed and sold to a number of unwary investors who had not been properly informed of, or understood, the complexity, or inherent high risk of their investment or loan. As noted previously, these were retail investors relying heavily on the advice of their advisers and who, on their own admission, had limited capacity to understand or appreciate the risks posed by the

4 Consumer Action Law Centre, *Submission 120*, p. 7 to the committee's inquiry into the performance of the Australian Securities and Investments Commission.

5 *Submission 161*, p. 7.

6 Mr Graham Hodges, evidence to the committee's inquiry into Scrutiny of Financial Advice, *Proof Committee Hansard*, 21 April 2015, p. 26.

7 Evidence to the committee's inquiry into Scrutiny of Financial Advice, *Proof Committee Hansard*, 21 April 2015, p. 26.

investment. This situation raises the question whether such complex products should have been promoted and sold to retail investors.

Suitability for retail investors

14.9 Years before the MIS failures, concerns were expressed about the schemes being marketed to retail investors. In 2001, ASIC expressed frustration at the high proportion of remedial action and surveillance activity expended on the agribusiness managed investments sector. It posed the question whether these schemes should be regulated in some other way. At that time, Mr Ian Johnston, ASIC, said:

We note that, in some jurisdictions, public offering of these types of investments is not permitted. While not at this stage advocating such a position in Australia, we do note that as a regulator we conduct a policy, disclosure and conduct regime which achieves particular results in the case of much of the regulated managed investments population but which does not achieve those results with this sector.⁸

ASIC's oversight of financial products

14.10 ASIC, however, does not have legislative responsibilities for regulating financial products, only for the oversight of product providers. This responsibility focuses on 'matters of corporate governance and disclosure, and in the main not on the design and other issues related to the products they sell to consumers'.⁹

14.11 During its 2014 inquiry, the committee took evidence from a range of witnesses who advocated strongly for product regulation to address problems with complex products. In this regard, the consumer advocacy associations argued before the committee that unsafe products should be identified and a system introduced to restrict access to particular types of challenging products.¹⁰ For example, the Consumer Action Law Centre favoured an approach that would empower ASIC to regulate financial and credit products, which, in its view, would give the regulator more power to respond quickly to emerging problems before widespread consumer harm occurred.¹¹

14.12 At that time, Professor Dimity Kingsford Smith cited the Westpoint and Storm collapses and the associated investor losses from transactions that were

8 Senate Economics Committee, *Inquiry into mass marketed tax effective schemes and investor protection*, Final Report, February 2002, paragraph 4.75.

9 See Senate Economics References Committee, *Performance of the Australian Securities and Investments Commission*, June 2014, paragraph 27.6.

10 Consumer Credit Legal Centre (NSW) and Consumer Action Law Centre, evidence to the committee's inquiry into the performance of ASIC, *Committee Hansard*, 20 February 2014, pp. 41–42.

11 See Senate Economics References Committee, *Performance of the Australian Securities and Investments Commission*, June 2014, paragraph 27.13.

relatively complex when analysed in full. The agribusiness MIS would also fit this category. In her view, 'in some other countries such products would have been limited to sophisticated investors but in Australia they could be offered to consumers'.¹² She explained further:

The risk levels, the complexity, the consequent opacity of the advice and the fact that investors did not really understand the significance of the recommendations for their longer term financial welfare, all diminished the capacity of investors to make good investment decisions with properly informed consent.¹³

14.13 The Consumer Action Law Centre and Professor Kingsford Smith referred to the UK Financial Conduct Authority (FCA) model which allows the FCA to suspend or ban potentially harmful products.¹⁴ Professor Kingsford Smith noted:

In Britain the 'Treating Clients Fairly' program of the Financial Conduct Authority allows the regulator to intervene in the design of the product, not just place a stop order on disclosure. We think there is also room for ASIC to exercise powers to prohibit the issue of certain products in retail markets, if it is thought they are too complex, risky or leveraged to be appropriate.¹⁵

14.14 With the same idea in mind, the Law Council of Australia suggested that:

... 'merits' regulation of financial products for unsophisticated investors may need to be considered in Australia. That is, unsophisticated investors might need to have a limited range of investment choices that are limited to investments that are appropriate to their needs and circumstances or that have been approved by a regulator such as ASIC.¹⁶

14.15 The Rule of Law Institute of Australia contended that it was 'insufficient for government regulators to tell consumers and investors to be careful and self-educate themselves in the complex area of financial services, particularly when the ASIC Act

12 See Senate Economics References Committee, *Performance of the Australian Securities and Investments Commission*, June 2014, paragraph 27.14, p. 438. Dimity Kingsford Smith, 'ASIC regulation for the investor as consumer', *Company and Securities Law Journal*, 29:5, 2011, p. 336.

13 See Senate Economics References Committee, *Performance of the Australian Securities and Investments Commission*, June 2014, paragraph 27.14, p. 438. Dimity Kingsford Smith, 'ASIC regulation for the investor as consumer', *Company and Securities Law Journal*, 29:5, 2011, p. 336.

14 See Senate Economics References Committee, *Performance of the Australian Securities and Investments Commission*, June 2014, pp. 438–439. *Submission 120*, p. 8 and Professor Dimity Kingsford Smith, *Submission 153*, p. 8 to that inquiry.

15 See Senate Economics References Committee, *Performance of the Australian Securities and Investments Commission*, June 2014, paragraph 27.15, p. 438. Professor Dimity Kingsford Smith, *Submission 153*, p. 8 to that inquiry.

16 See Senate Economics References Committee, *Performance of the Australian Securities and Investments Commission*, June 2014, paragraph 27.16, p. 438. Corporations Committee, Business Law Section, Law Council of Australia, *Submission 150*, p. 4 to that inquiry.

itself was nearly 400 pages in length'.¹⁷ The FPA recommended that the laws be amended 'to oblige ASIC to take a larger role in the regulatory oversight of financial products before they are released for consumer investment'.¹⁸ For example, it argued:

Legislation must enable ASIC to effectively and proactively regulate product providers and the products they develop and sell to consumers. Product providers should be held accountable for failing to deliver on product benefits due to dishonest conduct, fraud or insolvency, or if there are fundamental flaws in products.¹⁹

14.16 ASIC can issue a stop order on a prospectus, where it determined that the document was deficient.²⁰ Even so, it has acknowledged the inherent limitations in a regulatory approach that relies solely on disclosure to address some of the problems investors face in financial markets. ASIC told the committee in 2014, that it understood that the effectiveness of disclosure can be undermined because:

- people may not read or understand mandated disclosure documents, due to factors such as inherent behavioural biases or a lack of financial literacy skills, motivation and time; and
- the complexity of many financial products may mean that disclosure for such products can also be lengthy and complex, or excessively simplified and generalised.²¹

14.17 ASIC also referred to the FCA's work in 'product intervention'. It noted that the FCA would 'periodically review particular financial services market sectors and examine how products are being developed, and the governance standards that firms have in place to ensure fairness to investors in the development and distribution of products'. To assist this process, the FCA had a spectrum of temporary 'product intervention' powers which may include rules:

- requiring providers to issue consumer or industry warnings;

17 See Senate Economics References Committee, *Performance of the Australian Securities and Investments Commission*, June 2014, paragraph 27.17, p. 439. Rule of Law Institute of Australia, *Submission 211*, p. 7 to that inquiry.

18 See Senate Economics References Committee, *Performance of the Australian Securities and Investments Commission*, June 2014, paragraph 27.18, p. 439. *Submission 234*, p. 31 to that inquiry.

19 Financial Planning Association of Australia, *Submission 234*, p. 26 to committee's inquiry into the performance of the Australian Securities and Investments Commission.

20 Mr Greg Medcraft, Chairman, ASIC, committee's inquiry into the Performance of the Australian Securities and Investments Commission, *Committee Hansard*, 19 February 2014, p. 19.

21 ASIC, answer to written question on notice No 9, p. 10 of 59, (received 21 May 2014), to committee's inquiry into the performance of the Australian Securities and Investments Commission.

- requiring that certain products are only sold by advisers with additional competence requirements;
- preventing non-advised sales or marketing of a product to some types of consumer;
- requiring providers to amend promotional materials;
- requiring providers to design appropriate charging structures;
- banning or mandating particular product features; and
- in rare cases, banning sales of the product altogether.²²

14.18 In ASIC's view, having a broader and more flexible regulatory toolkit would 'enhance its ability to foster effective competition and promote investor and consumer protection'. In its view, regulating product suitability was 'one type of approach that has been adopted internationally'. ASIC concluded:

As the FCA's regulatory approach is relatively new, at this stage, it is difficult to draw any settled conclusions about the positive or negative aspects of such an approach. However, the Government may wish to consider whether such a broader regulatory toolkit would be appropriate in the Australian financial regulatory system.²³

14.19 During its 2014 inquiry, the committee also drew attention to Mr Richard St. John's report on compensation arrangements for consumers of financial services and his reference to the international regulatory community's new focus on the adequacy of conduct and disclosure regimes. In his view, it would be timely 'to consider measures by which product issuers could assume more responsibility for the protection of consumers who look to invest in their products'.²⁴ He noted the consideration being given 'to the possibility of a more interventionist approach with product issuers'. In his words, the aim would be 'to catch problems early on in a financial product's life cycle as a means of preventing widespread detriment to consumers'.²⁵ Referring directly to agribusiness MIS, Mr St. John suggested that:

As a matter of strategic approach, it would be timely to review the present light-handed regulation of certain product issuers, in particular managed investment schemes, including the possible need, in accord with

22 ASIC, answer to written question on notice No. 9, p. 10 of 59, (received 21 May 2014), to committee's inquiry into the *Performance of the Australian Securities and Investments Commission*.

23 ASIC, answer to written question on notice No. 9, p. 11 of 59, (received 21 May 2014) to committee's inquiry into the *Performance of the Australian Securities and Investments Commission*.

24 Mr Richard St. John, *Compensation arrangements for consumers of financial services*, April 2012, p. 104.

25 Mr Richard St. John, *Compensation arrangements for consumers of financial services*, April 2012, p. 104.

developments at the international level, to move to a somewhat more interventionist approach.²⁶

14.20 As a first step, he suggested that consideration could be given to imposing on licensees who make products available for retail clients more responsibility for the suitability of those products for such investors, together with related disclosure obligations.²⁷

14.21 Having deliberated on the evidence before it, the committee, in its June 2014 report, expressed concern that Australia was out of step with international efforts to implement measures that would address problems associated with the marketing of unsafe financial products to retail investors.

14.22 At that time, the committee recommended that the government give urgent consideration to expanding ASIC's regulatory toolkit so that the regulator would be able to intervene in the marketing of unsafe or inappropriate products to retail investors. As a preliminary phase in this staged process, the committee noted that the FSI may have a role and recommended that it consider carefully the adequacy of Australia's conduct and disclosure approach to the regulation of financial product issuers as a means of protecting consumers. In particular, the committee recommended that the FSI consider the implementation of measures designed to protect unsophisticated investors from unsafe products, including matters such as:

- subjecting the product issuer to more positive obligations in regard to the suitability of their product;
- requiring the product issuer to state the particular classes of consumer for whom the product is suitable and the potential risks of investing in the product;
- standardised product labelling;
- restricting the range of investment choices to unsophisticated investors;
- allowing ASIC to intervene and prohibit the issue of certain products in retail markets.

14.23 The committee also recommended that the FSI assess the merits of the United Kingdom's Financial Conduct Authority model which allows the authority to suspend or ban potentially harmful products.²⁸

26 Mr Richard St. John, *Compensation arrangements for consumers of financial services*, April 2012, p. 113.

27 Mr Richard St. John, *Compensation arrangements for consumers of financial services*, April 2012, p. 146.

28 See Senate Economics References Committee, *Performance of the Australian Securities and Investments Commission*, June 2014, paragraph 27.32 (Recommendation 58).

14.24 The FSI did indeed look into this matter. In its final report, the FSI cited cases where ASIC lacked 'a broad toolkit to respond effectively, and in a timely way, to an emerging risk of significant consumer detriment and cited, in particular, instances where leveraged investment strategies exacerbated the loss for many consumers. Notably, the FSI referred to agribusiness MIS where the product 'did not perform in the way that consumers were led to believe, including schemes relying on ongoing sales to fund their operations.' It observed further:

Many consumers did not understand the potential risk of borrowing to invest in these products. In total, more than 65,000 consumers invested and lost close to \$3 billion.²⁹

14.25 In the FSI's view, targeted early intervention would be more effective in reducing harm to consumers rather than waiting until detriment occurred. It argued that the regulator should be able to be proactive in its supervision and enforcement. In its assessment, significant consumer harm could be reduced 'if ASIC had the power to stop a product from being sold or, where the product had already been sold, to prevent the problem from affecting a larger group of consumers'.³⁰ The FSI recommended that the government should amend the law to provide ASIC with a product intervention power. It stated:

ASIC should be equipped to take a more proactive approach to reducing the risk of significant detriment to consumers with a new power to allow for more timely and targeted intervention. This power should be used as a last resort or pre-emptive measure where there is risk of significant detriment to a class of consumers. This power would enable intervention without a demonstrated or suspected breach of the law. Given the potential significant commercial impact of this power, the regulator should be held to a high level of accountability for its use.³¹

14.26 The FSI explained further that this power would allow the regulator to intervene to require or impose:

- amendments to marketing and disclosure materials;
- warnings to consumers, and labelling or terminology changes;
- distribution restrictions; and
- product banning.

29 *Financial System Inquiry*, Final Report, Commonwealth of Australia, November 2014, p. 208, http://fsi.gov.au/files/2014/12/FSI_Final_Report_Consolidated20141210.pdf (accessed 4 December 2014).

30 *Financial System Inquiry*, Final Report, Commonwealth of Australia, November 2014, p. 209, http://fsi.gov.au/files/2014/12/FSI_Final_Report_Consolidated20141210.pdf (accessed 4 December 2014).

31 *Financial System Inquiry*, Final Report, Commonwealth of Australia, November 2014, p. 206, http://fsi.gov.au/files/2014/12/FSI_Final_Report_Consolidated20141210.pdf (accessed 4 December 2014).

14.27 The power would be limited to temporary intervention for 12 months, with the option for government to grant an extension, and a provision for the intervention to be subject to a judicial review mechanism.³²

Strengthen product issuer and distributor accountability

14.28 Turning to the product manufacturer, the FSI stated that product regulation and product issuer regulation needed to be considered more carefully in order that those entities bear the appropriate responsibility for a fair, safe, and efficient financial services system.³³ The report recommended that a principles-based product design and distribution obligation be implemented for product issuers, explaining further:

During product design, product issuers should identify target and non-target markets, taking into account the product's intended risk/return profile and other characteristics. Where the nature of the product warrants it, issuers should stress-test the product to assess how consumers may be affected in different circumstances. They should also consumer-test products to make key features clear and easy to understand.

During the product distribution process, issuers should agree with distributors on how a product should be distributed to consumers. Where applicable, distributors should have controls in place to act in accordance with the issuer's expectations for distribution to target markets.

After the sale of a product, the issuer and distributor should periodically review whether the product still meets the needs of the target market and whether its risk profile is consistent with its distribution. The results of this review should inform future product design and distribution processes. This kind of review would not be required for closed products.³⁴

14.29 According to the FSI, a serious breach of this obligation should be subject to 'a significant penalty'.³⁵ The FSI formed the view that 'better aligning the interests of financial firms with consumer interests, combined with stronger and better resourced regulators with access to higher penalties, should lead to better consumer outcomes'.³⁶

32 *Financial System Inquiry*, Final Report, Commonwealth of Australia, November 2014, p. 206, http://fsi.gov.au/files/2014/12/FSI_Final_Report_Consolidated20141210.pdf (accessed 4 December 2014).

33 *Submission 161*, p. 4.

34 *Financial System Inquiry*, Final Report, Commonwealth of Australia, November 2014, p. 198, http://fsi.gov.au/files/2014/12/FSI_Final_Report_Consolidated20141210.pdf (accessed 4 December 2014) and *Submission 161*, p. 5.

35 *Financial System Inquiry*, Final Report, Commonwealth of Australia, November 2014, p. 199, http://fsi.gov.au/files/2014/12/FSI_Final_Report_Consolidated20141210.pdf (accessed 4 December 2014).

36 *Financial System Inquiry*, Final Report, Commonwealth of Australia, November 2014, pp. 221 and 236, http://fsi.gov.au/files/2014/12/FSI_Final_Report_Consolidated20141210.pdf (accessed 4 December 2014).

14.30 Consistent with its evidence to the committee's 2014 inquiry, ASIC informed the committee that it supported a shift to 'a regulatory philosophy that acknowledges that different tools will be needed to address different problems'. It suggested that this regime would focus on the development of a detailed understanding of specific market problems as they arise—often referred to as 'a product intervention approach'.³⁷

Product and product issuer regulation

14.31 Evidence taken as part of the committee's inquiry into MIS builds on the strong case supporting the committee's initial 2014 recommendations and those of the FSI for ASIC to have a financial product intervention power and for product issuers to be subject to greater obligations relating to consumer protection.

14.32 For example, as noted earlier, many members of the FPA did not include agribusiness MIS on their approved product list. The FPA, which held the view that forestry and agribusiness projects, as well as the underlying MIS structure, were very complex, asked whether retail investors could reasonably be expected to understand these structures.³⁸ In its assessment, part of this bias towards regulating the distribution end of a financial product was due to Australia's disclosure-oriented regulatory focus which 'explicitly excludes financial product quality and research quality from scrutiny'.³⁹ According to FPA, consumer protection would be significantly strengthened if ASIC were to have the power to 'step in early, in a proactive sense where it can see things are not in the consumers' best interest' and to take action against the managers of the scheme.⁴⁰ The FPA recommended that Treasury review the Corporations Act and/or the ASIC Act to consider how product intervention powers for ASIC could be implemented.⁴¹ AgriWealth, which operates a traditional forestry business and a MIS forestry business, also noted that there could be a restriction on MIS products being offered to wholesale investors only.⁴²

14.33 Mr David Cornish, who has been involved in assessing rural investments for the past 25 years, also questioned why these products were 'allowed to be offered at a retail level to the person in the street?'⁴³ He concurred with the view that investments in products that are not traditional 'securities' as the underlying investment should not be marketed directly to retail investors. Mr Cornish maintained:

Agricultural investment for the general public should only be available through the wholesale or professional market. This would provide the

37 *Submission 34*, paragraph 7.

38 *Submission 161*, p. 7.

39 *Submission 161*, p. 4.

40 Mr Mark Rantall, *Proof Committee Hansard*, 6 August 2015, p. 26.

41 *Submission 161*, p. 9.

42 *Submission 138*, p. 2.

43 *Proof Committee Hansard*, 4 August 2015, p. 13.

individual investor the protection of a wholesale institution that will do the correct due-diligence on their behalf and the ability to spread risk across a number of investments.⁴⁴

14.34 According to Mr Cornish, because the complexity and the risk involved in agricultural investment was 'simply outside the grasp of your average person in the street', the UK had 'wisely decided their marketing should be limited'.⁴⁵ Consistent with this approach, Mr Cornish recommended that legislation be introduced in Australia disallowing investments, other than those retail investments that can be considered traditional 'securities', being marketed directly to the retail investor.⁴⁶

14.35 Mr Mervin Reed, a Chartered Financial Adviser with 25 years' experience in the industry, argued that basically ASIC produced the product failures—it was a regulator that 'allowed the product onto the market and it is the regulator of the market product'.⁴⁷ He explained:

Presently the regulator does not essentially review the product, merely that the product provider or the new product has to meet basic requirements of the prospectus, and as long as it fits then it's an administrative function, the regulator gives it its authorisation code, and a way it goes into the market.

There is no detailed understanding by the regulator of what the product is, whether it will deliver what its prospectus says it will; how well it will deliver this; who will deliver this outcome for investors; and what is their background experience and capacity to make such statements in the prospectus.⁴⁸

14.36 Mr Reed suggested:

...the regulator should engage a panel of external auditors, develop a new product approval matrix, that deals with the basis of the product, the legal structures involved, the bankers involved, the management team involved, their experience over time, the administrative arrangements, and the fund management specialisation and internal skill bases, that will allow the product provider to actually deliver on the prospectus.⁴⁹

14.37 In Mr Reed's view, once the product had been allowed onto the market, another audit should be conducted 18 months after the product's initial release to the market, which would be provided to ASIC 'in order for the product to continue to be on the market'.⁵⁰ Mr Reed reasoned that this process would remove the requirement

44 *Submission 60*, p. 10.

45 *Proof Committee Hansard*, 4 August 2015, p. 13.

46 *Submission 60*, pp. 2, 11 and 20.

47 *Submission 20*, p. [2].

48 *Submission 20*, p. [2].

49 *Submission 20*, p. [2].

50 *Submission 20*, p. [2].

for ASIC to have in-house specialisation and that expertise existed 'in abundance in the major auditing firms'.⁵¹ He argued:

There are numerous examples that all would have been cut off at the knees and been stillborn, and thus not a problem if this process of ASIC employing external auditors and new matrix structures on which to assess managed investment product prior to product meeting the market.⁵²

14.38 Most recently, Mr Greg Medcraft, Chairman ASIC, indicated that the push for greater product intervention had not subsided and highlighted the importance of implementing stronger regulations to govern product designers. He spoke of regulators throughout the world considering 'a broader toolkit to address market problems, including moving away from purely disclosure-based regulation'. Mr Medcraft referred to the International Organization of Securities Commissions (IOSCO), which has recommended that regulators look across the financial product value chain, rather than simply disclosure at the point of sale. He explained:

A product intervention power would give ASIC a greater capacity to apply regulatory interventions in a timely and responsive way. It would allow ASIC to intervene in a range of ways where there is a risk of significant consumer detriment.⁵³

14.39 According to Mr Medcraft, if ASIC had product intervention power it would be able to undertake a range of actions, including simple 'nudges', right through to product bans, though noting:

Most interventions would likely fall well short of product banning. For example, we might be able to require amendments to marketing materials, or additional warnings. In more extreme cases, we might be able to require a change in the way a product is distributed or, in rare cases, ban a particular product feature.⁵⁴

14.40 Mr Medcraft also responded to the FSI's recommendation for placing a broad-based obligation on financial institutions to have regard to the needs of their customers in designing and targeting their products. In his view:

51 *Submission 20*, p. [3].

52 *Submission 20*, p. [3].

53 Greg Medcraft, Chairman, Australian Securities and Investments Commission, 'The Financial System Inquiry: A regulator's perspective', 32nd annual conference of the Banking and Financial Services Law Association (Brisbane), 4 September 2015, p. 3, <http://download.asic.gov.au/media/3343239/bfsla-the-financial-system-inquiry-a-regulators-perspective-4-september-2015.pdf> (accessed 7 September 2015).

54 Greg Medcraft, Chairman, Australian Securities and Investments Commission, 'The Financial System Inquiry: A regulator's perspective', 32nd annual conference of the Banking and Financial Services Law Association (Brisbane), 4 September 2015, p. 3, <http://download.asic.gov.au/media/3343239/bfsla-the-financial-system-inquiry-a-regulators-perspective-4-september-2015.pdf> (accessed 7 September 2015).

...the FSI's recommendation aligns very closely with the theme of culture. Product manufacturers should design and distribute products with the best interests of the investor or financial consumer in mind. This is part of having a customer-focused culture.⁵⁵

14.41 On the call for increasing the penalties for contravening ASIC legislation, Mr Medcraft observed, as did the FSI, that:

Comparatively, the maximum civil penalties available to us in Australia are lower than those available to other regulators internationally. And they are fixed amounts, not multiples of the financial benefit obtained from misconduct.⁵⁶

14.42 The government agreed with the FSI's recommendation to provide ASIC with a financial product intervention power to enable it to modify, or if necessary, ban harmful financial products where there is a risk of significant consumer detriment. The government plans to consult with stakeholders to ensure that the power strikes the right balance—providing ASIC with a tool to enable it to take action in exceptional circumstances but without stifling industry innovation.⁵⁷

14.43 Similarly, the government agreed with FSI's recommendation to introduce a 'targeted and principles-based product design and distribution obligation'. Again the government undertook to consult with stakeholders on the implementation of this recommendation.⁵⁸ The government also supported the FSI's call for industry-led initiatives to improve disclosure of risk and fees.⁵⁹

Conclusion

14.44 There can be no doubt that much stronger measures are needed to protect retail investors from the promotion and marketing of high risk products. A number of inquiries, including the committee's 2014 inquiry into the performance of ASIC and

55 Greg Medcraft, Chairman, Australian Securities and Investments Commission, 'The Financial System Inquiry: A regulator's perspective', 32nd annual conference of the Banking and Financial Services Law Association (Brisbane), 4 September 2015, p. 4, <http://download.asic.gov.au/media/3343239/bfsla-the-financial-system-inquiry-a-regulators-perspective-4-september-2015.pdf> (accessed 7 September 2015).

56 Greg Medcraft, Chairman, Australian Securities and Investments Commission, 'The Financial System Inquiry: A regulator's perspective', 32nd annual conference of the Banking and Financial Services Law Association (Brisbane), 4 September 2015, p. 4, <http://download.asic.gov.au/media/3343239/bfsla-the-financial-system-inquiry-a-regulators-perspective-4-september-2015.pdf> (accessed 7 September 2015).

57 Australian Government, *Improving Australia's financial systems*, Government response to the Financial System Inquiry, p. 19.

58 Australian Government, *Improving Australia's financial systems*, Government response to the Financial System Inquiry, p. 19.

59 Australian Government, *Improving Australia's financial systems*, Government response to the Financial System Inquiry, p. 19.

the FSI have mounted a compelling argument for such action. Agribusiness MIS is a clear example of where, based on the evidence before the committee, disclosure was inadequate; information was confusing rather than instructive for retail investors; and oral advice either misinterpreted the disclosure documents, downplayed risks, or selectively presented positive messages. Clearly, improved regulation could have prevented many unwary investors from entering into unsafe financial arrangements.

14.45 The committee is of the view that Australia's financial services regulatory regime has not served Australian investors well and can no longer be relied as a means of consumer protection. While improved disclosure and education are necessary, they must be accompanied by other measures. Attention must also be given to product issuers and their obligation to act in the best interests of investors.

14.46 The committee welcomes the government's endorsement of the FSI's recommendation to confer on ASIC a product intervention power and an obligation on product issuers to ensure that the products they are marketing to retail investors are appropriate. The committee is firmly of the view that penalties commensurate with the offence are needed to send a strong message to product issuers to act responsibly when marketing products to retail investors. In light of the FSI and ASIC's observation regarding the importance of having higher penalties, the committee calls on the government to consider increased penalties for serious breaches.

Recommendation 19

14.47 To augment ASIC's product intervention power, the committee recommends that the government review the penalties for breaches of advisers and AFS Licensees' obligations and, under the proposed legislation governing product issuers, ensure that the penalties align with the seriousness of the breach and serve as an effective deterrent.