FINANCIAL PLANNING
ASSOCIATION of AUSTRALIA

9 February 2017

Manager, Financial Services Unit, Financial System Division
The Treasury Langton Crescent
PARKES ACT 2600
Email: productregulation@treasury.gov.au

Re. Design and Distribution Obligations and Product Intervention Power

Dear Sir/Madam,

We welcome the opportunity to comment on the draft legislation for the design and distribution obligations and product intervention powers. We support requiring product providers to make commitments that are specific and legally enforceable about their products. By contrast and in line with our previous submissions, we are strongly opposed to using product providers to restrict advice.

Financial planners are in the best position to determine the appropriateness of advice for individual clients. Further, reflecting the relationship of trust between client and adviser, financial planners are already subject to a high legal standard. Restricting product advice to situations the product provider determines are generally appropriate, rules out some advice that benefits the individual client and adds an extra layer of costly regulation for advice clients.

If you have any queries or comments, please do not hesitate to contact me at policy@fpa.com.au or on 02 9220 4500.

Yours sincerely

Dimitri Diamantes CFP®
Policy Manager
Financial Planning Association of Australia[1]

[1] The Financial Planning Association (FPA) has more than 13,000 members and affiliates of whom 10,000 are practising financial planners and 5,600 CFP professionals. The FPA has taken a leadership role in the financial planning profession in Australia and globally:

- Our first "policy pillar" is to act in the public interest at all times.
- In 2009 we announced a remuneration policy banning all commissions and conflicted remuneration on investments and superannuation for our members – years ahead of FOFA.
- We have an independent conduct review panel, Chaired by Mark Vincent, dealing with investigations and complaints against our members for breaches of our professional rules.
- The first financial planning professional body in the world to have a full suite of professional regulations incorporating a set of ethical principles, practice standards and professional conduct rules that explain and underpin professional financial planning practices. This is being exported to 24 member countries and the 150,000 CFP practitioners that make up the FPSB globally.
- We have built a curriculum with 17 Australian Universities for degrees in financial planning. As at the 1st July 2013 all new members of the FPA will be required to hold, or working toward, as a minimum, an approved undergraduate degree.
- CFP certification is the pre-eminent certification in financial planning globally. The educational requirements and standards to attain CFP standing are equal to other professional bodies, eg CPA Australia.
- We are recognised as a professional body by the Tax Practitioners Board.

DESIGN AND DISTRIBUTION OBLIGATIONS AND PRODUCT INTERVENTION POWER – DRAFT LEGISLATION

FPA submission to:
Treasury

9 February 2018

INTRODUCTION

We support requiring by law that product providers make commitments that are specific and legally enforceable about their complex products. By contrast and in line with our previous submissions, we are strongly opposed to using product providers to restrict advice.

Financial planners are in the best position to determine the appropriateness of advice for individual clients. Further, reflecting the relationship of trust between client and adviser, financial planners are already subject to a high legal standard. Restricting product advice to situations the product provider determines are generally appropriate, rules out some advice that benefits the individual client and adds an extra layer of costly regulation for advice clients. This undermines the value of advice and reduces the potential for consumers to enhance their financial outcomes through engaging with a financial planner.

ISSUES AND CONCERNS

As stated in previous submissions, we strongly oppose the product design and distribution obligations and product intervention power applying in respect of financial advice. We propose that product providers should be legally obliged to make specific warranties to consumers about the characteristics of the product provider's product. The practical effect of our proposal is that consumers have an enhanced cause of legal action against product providers and, in turn, will have credible information to base their decisions on.

In the following sections we identify and recommend amendments to the draft bill to avoid undesirable consequences of the bill.

Undermines advice

The argument, in the case of complex financial products, for a mandatory rule to make and comply with an appropriate target market determination may be justified on the grounds that most consumers are not financially sophisticated. In turn, out of caution, consumers are presumed to minimise their exposure to potential harm. The cost to the few consumers who might benefit from acting inconsistently with the determination is outweighed by the benefit to the many consumers who would lose out if they were to act inconsistently with the target market determination.

However, the argument for a rule based on what is generally appropriate for a class of consumers (as opposed to what is appropriate for a person in a particular situation) is weak in the case of advice as financial planners have a separate statutory duty to act in the best interests of the particular client. This is because the best interests duty is expected to achieve the same outcome for typical clients of a class as the proposed legislation, while providing additional benefits for the few clients for whom advice that is inconsistent with what the product provider would consider generally appropriate for the class is nevertheless appropriate for these particular clients.

The product design and distribution obligations proposed in the draft bill make product providers (and not just intermediaries, such as advice providers) responsible for the distribution of the product provider's products. In turn, product providers will seek to manage their risk of financial liability. However, making and enforcing stand-alone compliance agreements with, and monitoring, dealers and advice providers is very costly.

Although the distribution obligations would also apply (however, with an additional civil liability provision for consumer loss) to dealers and advice providers, product providers still face a risk because they don't know exactly how dealers and advisers will act. In turn, in managing their risk of financial liability, product providers are likely to make target market determinations that severely restrict advice on and dealings in their products unless the product provider controls or significantly influences how the advice or dealing is done. Control would require the advice provider or the dealer

to be employed by; the authorised representative of; or subject to a distribution agreement with the product provider. Significant influence would require an ongoing relationship of sufficient scale between the product provider; and the advice provider or the dealer.

There is a risk that, as a consequence of the design and distribution obligations, intermediaries (especially small dealers and advice providers) will be pushed to align with product providers. This is because without the commercial benefits of alignment, there is unlikely to be an economically feasible way of ensuring that intermediaries will comply with the target market determination. This consequence is contrary to the presumed policy underlying the bill of better matching consumers to products.

Further, the product and design obligations could undermine parts of the advice sector by creating pressure for advice providers to disclose information about their client base to product providers. For example, introducing the design and distribution obligations will put pressure on advice providers who are unaligned with product providers to disclose commercially sensitive information (subject to legal constraints on sharing client information with third-parties: see e.g. *Tax Agent Services Act 2009*). This puts such advice providers at risk of anti-competitive behaviour, such as predatory pricing. Again, making the provision of professional advice more difficult is inconsistent with the presumed policy intent of the proposed law.

We are also concerned about how the regulator might interpret the requirement to take reasonable steps. We support a principles-based approach to drafting the legislation. However, especially considering that failing to meet the requirement to take reasonable care is an offence with significant penalties, and that if the client also suffers loss or damage because of the dealing or advice they may recover the loss or damage, we are concerned about how the regulator may interpret the requirement.

Finally, we a deeply concerned about the compliance costs of a new layer of regulation of financial advice. We implore Treasury to assess the effects of recent and imminent reforms of the regulation of the financial planning sector, before imposing an additional layer of compliance the cost of which may significantly outweigh the benefit (if any).

We acknowledge that the draft bill provides some scope for dealing in and advising on a product in a way that is inconsistent with the target market determination for the product. However, it would seem that it's not enough that the dealing or advice simply produces a benefit that offsets the harm that might result from going outside the target market determination. For example, the draft bill seems to require that, in order to meet the reasonable steps requirement, financial product advice that falls outside the relevant target market determination would need to include measures to at least minimise non-trivial harms resulting from the advice falling outside the determination. This would represent, in cases where product providers and advice providers disagree on the appropriateness of the product provider's product for a client, a shift away from the modern approach to financial planning, which

involves balancing benefits and costs. We oppose this shift and respectfully recommend that the draft bill be amended accordingly.

Recommendation

We strongly recommend that the requirement to take reasonable steps to comply with the target market determination not apply in respect of advice where certain disclosure and record-keeping requirements are met. Providers of financial product advice that is inconsistent with the target market determination would need to issue a warning to the client and record the fact that such advice has been given. The obligation to take reasonable steps to ensure advice on the product is consistent with the product provider's target market determination should not apply in respect of advice that meets these disclosure and record-keeping requirements.

In addition, the explanatory memorandum for the bill should be amended to provide certainty that

- financial product advice provided in line with the best interests duty and that is appropriate for the particular client would be compliant advice even if the advice does not fall within the target market determination for the recommended product; and
- financial product advice that doesn't fall within the target determination for the recommended product isn't non-compliant simply because there's an alternative product that's substantially similar to the recommended product but has a target market determination that the client does fall within

<u>Overlooks product warranties</u>

There is a separate argument that product providers should make specific warranties about the characteristics of their products to consumers and financial planners. These warranties should be of sufficient breadth, quality and specificity to allow them to make informed decisions about whether to acquire the product. We agree with this position. Product providers are in a better position to provide specific warranties about the characteristics of their own products than others.

Recommendation

We strongly recommend that product providers should make specific warranties to consumers about the characteristics of the product provider's product. These warranties should be of sufficient breadth, quality and specificity to allow them to make informed decisions about whether to acquire the product. We agree with this position. For example, a product provider might need to specify the target range of risk for their product and specify the circumstances in which the risk level of their investment product can go outside the range.

Overreaches

The proposed legislation would allow intervention orders to be made where a product has resulted in or will, or is likely to, result in significant detriment. We are concerned at the potential breadth of the concept of significant detriment. In addition, no real consultation is required for an intervention order to be made.

We find these elements of the intervention provisions extremely worrying. Consumers will take on more risk because they expect – despite having the benefit of all *ex-ante* precautions a cautious, financially sophisticated consumer would take – some level of *ex-post* protection from or due to the regulator. Product providers will seek to recoup potential losses from intervention by increasing fees or reducing service levels. This problem will be exacerbated by the potential for the intervention power to affect management of liquidity by product providers. The result is that consumers end up paying for the protection, which may not be the best use of their resources.

Recommendation

We recommend that the product intervention power only be available in situations where both:

- the product provider is acting, or there is an imminent threat that they will act, contrary to their contract with the consumer or the target market determination; and
- there is a resulting high risk of catastrophic harm to consumers