



AUSTRALIAN INSTITUTE of  
SUPERANNUATION TRUSTEES

# Design and Distribution Obligations and Product Intervention Power – draft Legislation

## Submission 9 February 2018

## AIST Submission to Treasury

# Design and Distribution Obligations and Product Intervention Power – draft Legislation



## AIST

**The Australian Institute of Superannuation Trustees** is a national not-for-profit organisation whose membership consists of the trustee directors and staff of industry, corporate and public-sector funds.

As the principal advocate and peak representative body for the \$700 billion profit-to-members superannuation sector, AIST plays a key role in policy development and is a leading provider of research.

AIST provides professional training and support for trustees and fund staff to help them meet the challenges of managing superannuation funds and advancing the interests of their fund members. Each year, AIST hosts the Conference of Major Superannuation Funds (CMSF), in addition to numerous other industry conferences and events.

## Contact

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## Executive summary

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### **In brief:**

We strongly support the Bill and ASIC’s Product Intervention Powers. However, we recommend that the Bill be amended so that all stages of the intermediated models of production and distribution are captured. In particular, we recommend that product ‘manufacturers’ should be covered by the Bill: this would also better align the Bill with international disclosure trends. We support the exclusion of MySuper from the Bill, given MySuper requirements are more onerous. We are pleased to see the inclusion of Choice products. The complementary powers which would be provided to ASIC would lie on a regulatory framework from which there have been systemic carveouts. AIST appreciates fixing these is a longer-term project.

AIST welcomes the opportunity to respond to the *Design and Distribution Obligations and Product Intervention Power – draft Legislation*. The consultation includes the exposure draft of the *Treasury Laws Amendment (Design and Distribution Obligations and Product Intervention Powers) Bill 2017* (‘the Bill’). AIST supports the proposals as they will enhance ASIC’s powers to step in and protect consumers’ interests.

AIST has previously advocated that the extensive legislative requirements for MySuper be taken into account into developing the Bill. We support the exclusion of MySuper products from the Bill, given that the MySuper requirements are more onerous.

We also previously advocated that Choice products should be included within the Bill, and are pleased that this has occurred. However, the Bill would have the result of not covering the full chain of product ‘manufacture’ and distribution. AIST strongly recommends that the full chain be included. This would be in line with international regulatory developments. Our submission outlines the effect of not covering the full chain, as well as what entities do need to be included.

As a general concern, AIST notes that while the Bill complements ASIC’s current toolkit, it does not address the issue of fixing systemic regulatory carveouts, gaps and other exemptions. While AIST appreciates the intent of the Bill and strongly supports it, the Bill will not – and cannot – properly address the very issues which give rise to addressing key known problems. AIST appreciates that the job of addressing the systemic regulatory carveouts would be a longer-term initiative.

To further strengthen the proposals, we have included our recommendations in this submission. Additionally, AIST would be very pleased to be involved in subsequent consultations, including future draft ASIC guidance.

Our recommendations may be grouped under **four key themes**:

**1. Amend the Bill to make accountable the complete chain of product development and distribution**

All involved with product manufacture and distribution need to be both accountable and responsible. The Transparency Taskforce has developed a paper<sup>1</sup> examining ideas to help prevent the next Global Financial Crisis. One of these ideas is that a whole of system approach should be taken to systems governance and stewardship, ensuring that system ownership and responsibility are correctly allocated. AIST advocates that inclusion of the concept of ‘ownership’ of product manufacture and distribution within the Bill is essential. As the Transparency Taskforce comments, (T)oo often the ecosystem (of our financial services system) ... is behaving in a way which is sub-optimal or pro-cyclical at a systems level. Few organisations have the wherewithal to consider the system at a system level (even regulators are constrained and have their own objectives) and therefore ownership of the problem is lost.’

With the Bill drafted as it currently is, the opportunity to create a sense of ownership and responsibility on all responsible for product manufacture and distribution is lost. This is because the Bill places the target market and distribution obligations upon the entity which issues the Product Disclosure Statement (‘PDS’). In this submission, we include examples which both demonstrate the need to provide greater coverage, as well as the impact of the current lack of non-inclusion. The lack of including the full chain of all involved in designing and distribution products will lose an opportunity to better protect consumers as well encouraging the continuation of an overwhelming and obfuscating proliferation of choice.

**2. International transparency trends should be addressed**

AIST notes that the Markets in Financial Instrument Directive (‘MiFIDII’) which, while not applying in Australia, impacts entities in Australia which operate in Europe. AIST draws attention to MiFIDII’s requirement that all ‘manufacturers’ of financial services products will be captured by target market and distribution obligations for financial services products. One of the main reasons for this aspect of the MiFIDII requirements is that the full chain of manufacturers and distributors of products needs to take accountability and ownership for the product. The MiFIDII requirements give further weight to our recommendation that all entities involved in developing and distributing products should be included.

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<sup>1</sup> Transparency Task Force (2018). *Transparency Task Force White Paper - Ideas to help reduce the chance of another Global Financial Crisis*. [online] London: Transparency Task Force. Available at: <https://tinyurl.com/yarqeyjm> [Accessed 9 Feb. 2018].

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### 3. A further consultation is needed for industry to discuss cost impacts and integration with other regulator measures

AIST recommends that a further round of consultation regarding the Bill takes place. This would help industry assess the time and cost impact, as well as enabling industry to understand the interaction between the Bill proposals and the APRA member outcomes test. We are uncertain as to where the cost impact information contained in the proposals has been derived, as it is not from our member funds. Our member funds would appreciate a further consultation to discuss the potential impact of the Bill.

### 4. Fixing systemic regulatory carveouts should be addressed going forward

The complementary powers which would be provided to ASIC through the Bill would lie on a regulatory framework which needs fixing. There are a number of systemic carveouts from the current regulatory framework. AIST appreciates that fixing these issues is a more complex and longer-term project – one we would greatly appreciate being involved with.

The Bill is a starting point. The powers provided by the Bill would rely heavily on ASIC resourcing (for example, requesting necessary information and issuing stop orders). While we support the Bill, we also recognise that a preferred, longer-term solution would be that these gaps be closed through legislative and regulatory amendment. This would send a clear signal of requirements. The Bill can only sit on top of (and will not fix) defective legislative and regulatory provisions. The carveouts systemically favour investment management companies and superannuation funds operated by the banks. AIST recommends that these carveouts be addressed as a separate and longer-term project in order to create comparability, consistency, and a competitive level playing field.

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## AIST recommendations

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We have set out a number of recommendations in the following submission. In summary:

<p><b>1. All stages of the intermediated models of production and distribution must be captured within the Bill.</b></p>	<p>AIST advocates that this would:</p> <ul style="list-style-type: none"> <li>• Bring accountability to those entities manufacturing products.</li> <li>• Ensure proper accountability for product manufacture and distribution.</li> <li>• Enshrine a sense of ownership for product manufacture and distribution.</li> <li>• Assist reduce conflicts of interest in intermediated distribution models.</li> <li>• Bring the Bill proposals into better alignment with international trends.</li> </ul>
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	<p>AIST notes that this recommendation would involve:</p> <ul style="list-style-type: none"> <li>(i) Extending the coverage from only those entities issuing a PDS.</li> <li>(ii) Amending the type of factors an entity must take into account when determining the ‘target market’. MiFIDII examines this issue through providing factors which depend on whether the product manufacturer has either direct or indirect contact with the end client.</li> </ul>
<p><b>2. Greater guidance be given regarding the factors to determine ‘target markets’.</b></p>	<p>Greater guidance is needed regarding the determination of ‘target markets’. AIST notes that MiFIDII specifies factors which include both quantitative and qualitative factors. AIST recommends that greater guidance be provided within ASIC guidance and that this approach be mentioned in the Explanatory Memorandum.</p>
<p><b>3. A further consultation is needed to consult stakeholders about the proposals contained within the Bill, including cost impacts.</b></p>	<p>AIST recommends that there be a one further round of consultation regarding the Bill. This would help industry assess the time and cost impact, as well as enabling industry to understand the interaction between the Bill proposals and the APRA member outcomes test. We are uncertain where the cost impact information contained in the proposals has been derived. Our member funds would appreciate a further consultation to discuss the potential impact of the Bill.</p>
<p><b>4. ASIC guidance should contain principles for determining any exemptions to be granted by regulation.</b></p>	<p>AIST recommends that principles for determining exemptions should be mentioned within the Explanatory Memorandum or, preferably, within the Bill.</p> <p>Greater guidance regarding exemptions would better align the Bill with international trends.</p>
<p><b>5. Legacy products should be included (with a suitable transition period to be determined).</b></p>	<p>Inclusion would ensure that a sizeable proportion of APRA regulated fund products would be covered by the Bill and that consumers are better protected.</p>

<p><b>6. The Bill should be clarified regarding adviser recommendations.</b></p>	<p>AIST assumes that the ‘best interests’ test would be paramount if the adviser wishes to, for example, recommend a product outside the ‘target market’. The Bill should be clarified.</p>
<p><b>7. ASIC guidance should include principles for guiding triggers to target market reviews.</b></p>	<p>The Bill does not provide guidance regarding the triggers which may drive the need for target market reviews. ASIC Guidance needs to include principles and non-exclusory examples.</p> <p>We recommend that this solution be mentioned in the Explanatory Memorandum.</p>
<p><b>8. Target market reviews should include examining product take-up and consumer outcomes.</b></p>	<p>The concept of ‘target market’ is based on the assumption that the consumer is gaining a product which is suitable for them. Accordingly, target market reviews should include examining product take-up and consumer outcomes. AIST recommends that this be implemented either through amendments to the Bill (our preferred approach to better ensure consistency) or through ASIC guidance: if through ASIC guidance, AIST recommends that this solution be mentioned in the Explanatory Memorandum.</p> <p>This amendment would bring the package into better line with international trends.</p>
<p><b>9. Greater guidance should be given for triggers for the exercise of the Product Intervention Power.</b></p>	<p>Further direction should be included, eg the timeliness of ASIC intervention, the alteration or otherwise of consumer rights, and impacts on the competitiveness and stability of the system. AIST recommends that amendments be made to the Bill (our preferred option, to better ensure consistency) or through ASIC Guidance: if through ASIC guidance, AIST recommends that this solution be mentioned in the Explanatory Memorandum.</p> <p>ASIC guidance should include examples of ‘significant’ detriment based on the type of investors and consumers involved (sophisticated or otherwise). This recommendation also brings in our recommendation that all involved in the product manufacture and distribution chain should be included.</p>

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### 10. Systemic regulatory carveouts should be addressed.

Appendix A to this submission sets out a series of carveouts from the regulatory framework. AIST recommends that – as a separate and longer-term project - legislative change is needed to remove these carveouts.

AIST would greatly appreciate being involved in discussions regarding this issue.

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## 1. Principles underpinning our submission

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In providing our comments, AIST refers to (and obviously supports) the OECD's *G20 High Level Principles on Financial Consumer Protection*<sup>2</sup>. As far as disclosure is concerned, these Principles may be summarised as follows:

- Standardisation, comparability, and consumer testing are all desirable.
- A level playing field across financial services is to be encouraged.
- Furthering responsible business conduct is important, eg. ensuring that remuneration practices and conflicts are not detracting from proper disclosure.
- Remuneration/ conflicts of interests should be disclosed where conflicts cannot be avoided.
- Disclosure should help consumers distinguish between what is essential and what's less important.

We now turn to AIST's specific recommendations.

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## 2. Key theme 1 - Target markets and distributors

### Amend the Bill to make the *complete chain* of product development and distribution accountable and take ownership

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#### 2.1 Introduction

We underscore our advocacy that it is essential that the complete chain of product manufacturers and distributors are covered by the Bill. This is not currently the case: AIST believes that inclusion would lead to a better outcome through greater ownership and

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<sup>2</sup> Organisation for Economic Co-Operation and Development, (2011), *G20 High-Level Principles on Financial Consumer Protection*, Geneva: Organisation for Economic Co-operation and Development. (Endorsed by G20 Finance Ministers & Central Bank Governors 14-15 Oct 2011) Available at: <http://www.oecd.org/daf/fin/financial-markets/48892010.pdf>

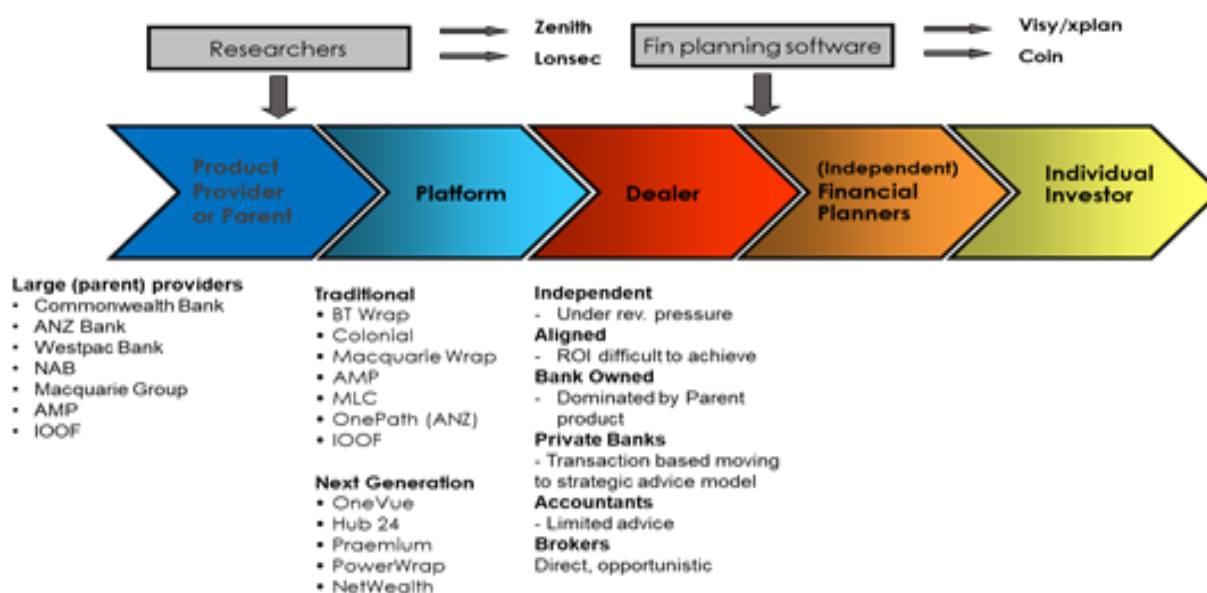


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accountability by the entities involved, as well as better entrenching the principle of furthering responsible business conduct.

The following diagram outlines the value chain for the Australian retail market:

Table one



Source: RiceWarner for AIST

AIST understands that the value chain above works as follows:

- The product provider or parent is **not** responsible for the production of a PDS. The product provider or parent provides information to the platform so that a PDS may be prepared.
- The platform is responsible for determining how the PDS should be articulated. The platform **is** responsible for the PDS.
- The dealer is **not** responsible for the production of a PDS. The dealer is responsible for how monitoring of advice provided under its AFSL.
- The financial planner is **not** responsible for the production of a PDS. The planner is responsible for how to provide its advice via its AFSL, which includes ensuring that a PDS is provided to the client.

AIST deals with these issues below, notes that MiFIDII would require the product provider or parent to determine 'target markets.' AIST deals with these issues below, and notes that MiFIDII would require the product provider or parent to determine 'target markets'. We use the term 'manufacturer' of product below, as that terminology is used within MiFIDII. In table one above, 'manufacturers' are referred to as 'product providers or parents.'

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AIST notes that while platforms have been included within the Bill, the information within PDSs renders these products as not capable of being compared with non-platform products as ASIC has exempted platforms from the definition of ‘interposed vehicle’ in Regulatory Guide 97, Fee and Cost Disclosure. In addition, we query what would happen to a consumer who has invested in a platform via a financial planner but then goes on to no longer use the services of that planner.

### 2.2 Making the full chain of designers and distributors responsible and accountable – ownership delivers better outcomes

#### Choice products

AIST is pleased that its advocacy has been heard and that Choice products would be subject to the proposals.

#### Obligations need to be broader than on PDS issuer

The Bill proposes that the design obligations would be linked to the entity providing the PDS. AIST strongly recommends that all product manufacturers and distributors should be included through amending the Bill. The volume of money involved in the products manufactured by product providers or parent and are which then are utilised by platforms in Australia is very large: [Annexure A](#) contains this information as prepared by RiceWarner for AIST.

- All stages of intermediated models of production and distribution must be captured to help address potential conflicts of interest. That such conflicts of interest exist is recognised by ASIC in its recent Report 562 *Financial advice: Vertically integrated institutions and conflicts of interest*<sup>3</sup>.
- All stages of production and distribution must be captured to ensure a sense of responsibility and ownership for product design and distribution.
- Inclusion of the product manufacturer would require a greater focus on whether to establish new products in the first place. AIST notes that with the Bill as framed, the product provider would not be required to undertake a target market consideration. Providers would not be placed under obligation to consider for whom the product would be appropriate, the riskiness of the product, etc. Inclusion of product providers would assist reduce the proliferation of new intermediated (and un-mediated) products.
- The overwhelming proliferation of products without due consideration is clear:
  - There are over 40,000 member investment choices in the superannuation system.

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<sup>3</sup> ASIC (2018). REP 562 *Financial advice: Vertically integrated institutions and conflicts of interest*. [online] ASIC. Available at: <https://tinyurl.com/yaqqI93o> [Accessed 7 Feb. 2018].

- The Productivity Commission in its draft report noted that:

**7.1.1.1 Product proliferation is confusing consumers and enabling price discrimination**

Across the financial system, there is a continual flow of new products and a re-packaging of existing products to appeal to specific groups of consumers. As a consequence, there is a very large number of products in financial markets, with sometimes only marginal differences between them: nearly 4000 differential residential property loans and 250 different credit cards are on offer, for example. The same situation is apparent in insurance markets: the largest 4 general insurers hold more than 30 brands between them.<sup>4</sup>

- The MiFIDII Product Governance Guidelines on Target Market Identification<sup>5</sup> states that distributors will often have ‘direct contact with investors who purchase the products. ... However, it is clear that firms who are ‘distributors to the distributors’ also fall within the ... requirements, seemingly with a view to ensuring an unbroken ‘chain’ from manufacturer through to end investors’.

Under the MiFIDII requirements, the manufacturers of products must ensure their products are designed to meet the needs of an identified target market within the relevant group of clients (retail, professional, and eligible counterparties). This is in recognition that manufacturers who distribute their products through other entities may not have a direct relationship with the end client. MiFIDII also recognises that the manufacturer therefore will not have first-hand information about the clients’ needs. Accordingly, manufacturers must assess the target market based on their theoretical knowledge and past experience of the product or similar products as well as financial markets in order to meet the needs of potential end-clients.

The same approach has been applied to distributors so that ‘distributors to distributors’ are also caught by the MiFIDII requirements.

AIST strongly recommends that this approach be adopted within the Bill. Failure to do so means that products are developed and handed through intermediated distribution without all parties involved taking responsibility.

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<sup>4</sup> Productivity Commission (2018). *Competition in the Financial System - draft report*. [online] Productivity Commission. Available at: <https://tinyurl.com/y8cf2j7o> [Accessed 7 Feb. 2018].

<sup>5</sup> MiFIDII Product Governance Guidelines on Target Market Identification, December 2017

### 2.3 Greater clarity is needed regarding the factors to determine target markets

The Bill involves setting broad objectives for the determination of ‘target markets’. AIST understands the concept of not having a standardised target market determination template. However, the factors involving meeting the objectives, financial situation and needs of people within the target market need greater guidance. Without this, a ‘tick-a-box’ approach could be the outcome, as well as delivering an inconsistent approach across financial services.

For example, MIFIDII specifies factors which relate to professional clients and includes both quantitative and qualitative factors. Under MIFIDII, all companies from asset managers to advisers must have a detailed understanding of their products and whether they are suitable for retail investors. This is closely related to another tenet of MIFIDII that the product must ‘provide you with appropriate and clear guidance’ about the risks associated with each.

MIFIDII has suggested ‘manufacturers’ should propose the type of investment service that the product could be sold through (eg. experts only, adviser): this assists with the ‘know your distributor’ process. Manufacturers also need to include risk assessments. This type of approach is needed so that the development of products has a greater link with the end-user.

Another example is the categories outlined by the European Securities and Market Authority (ESMA). ESMA aims to give additional clarity to entities seeking to identify target markets for products. The categories include to whom the product is targeted; the degree of knowledge and experience the client should have; the ability of the client to bear losses; the risk profile of the product compared with the target market; and the client’s objectives and needs.

Greater guidance is needed regarding the determination of ‘target markets’. AIST recommends that greater guidance be provided within ASIC guidance and that this approach be mentioned in the Explanatory Memorandum. AIST recommends that ASIC guidance includes principles to assist determine what issues should be taken into account as well as providing non-exclusory examples. AIST would be pleased to be involved in consultations.

### 2.4 Exemptions

#### Exemption by regulation

AIST strongly recommends that the principles for determining any exemptions by regulation should be included either within the Explanatory Memorandum or (preferably) within the Bill.

#### MySuper

In our March 2017 submission<sup>6</sup>, AIST highlighted its support for the proposition that products should be appropriate for their target market. We drew attention to the extensive regulatory overlay that applies to superannuation products and enhanced obligations applicable to MySuper products. AIST strongly advocates that the disclosure and reporting obligations for Choice products should be brought into line with those for MySuper. AIST notes the exemption

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<sup>6</sup> AIST and ISA, *Design and Distribution Obligations and Product Intervention Power*, 15 March 2017. Available at <https://tinyurl.com/k5r3ece>

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given for MySuper under the Bill and believes this is appropriate given that the legislative provisions relating to MySuper are stronger than both for Choice as exists and for Choice if the Bill is enacted.

### Legacy products

AIST strongly recommends that the Bill applies to legacy products.

The Bill provides that it will apply only new issuances. AIST is concerned that legacy products are consistently carved-out from disclosure, reporting, and ensuring that they meet consumer needs. The scale of legacy is sizeable: according to RiceWarner, around 30% of personal super assets are held in legacy products.

Legacy products need to be included within the Bill to ensure that:

- Consumers are suitably protected.
- A sizeable proportion of APRA regulated funds are covered.
- ASIC is provided with at least some better powers to investigate legacy products.

The effect of including legacy products would be to require firms to assess whether legacy products are still appropriate for those members invested within them or whether those members should be transitioned to a more appropriate product. Additionally, members need to be able to assess whether to leave the legacy product: currently, legacy products are neither required to produce a PDS nor are captured by the Bill.

## 2.5 Advisers

AIST seeks clarification regarding the Bill's potential impact upon advisers. Our query relates to instances where an adviser may wish to recommend a product to an individual which is outside the target market. The adviser may have good cause to believe that the alternate product is in the client's best interest. AIST seeks clarification as to whether the 'best interests' test would prevail over the target market considerations in such instances. We suggest that clarification could be either through mentioning this within the Explanatory Memorandum or within subsequent ASIC guidance.

## 2.6 Target market reviews

The Bill does not provide guidance regarding the triggers may drive the need for entities to undertake target market reviews. AIST recommends that ASIC guidance needs to provide guidance regarding these triggers, and that this approach be mentioned in the Explanatory Memorandum.

AIST recommends that the Guidance should include:

- A set of principles for driving reviews
- Non-exclusory examples.
- That target market reviews include an examination of the outcomes of the product upon consumers as well as product take-up rates. This would assist with ensuring both the suitability and any ongoing need for the product occurs. We understand that this is

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not currently envisaged.

In support of our recommendation, AIST draws attention to the fact that MiFIDII does include the concept of examining outcomes, eg. sales numbers. AIST strongly recommends that ASIC Guidance should include checking to see if the product is being used. Without this, the current problems surrounding the proliferation of products (over 40,000 member investment choices) will continue.

AIST would be pleased to be involved in any consultation regarding ASIC guidance.

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### 3. Key theme 2 – International transparency trends should be addressed

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AIST recommends that international transparency trends be taken into account. Throughout this submission, AIST has highlighted some key areas where the proposals contained in the Bill are not in line with international transparency trends. The following additions are needed to bring the Bill into better alignment with international transparency trends:

#### 3.1 Complete chain of product and distribution is covered

- Manufacturers of products should be included.
- The full distribution chain should be covered within the obligations. MiFIDII includes ‘distributors to the distributors’ with a view to ensuring an unbroken chain from product manufacturer through to end investors.

AIST recommends that these issues should be covered by amendments to the Bill.

#### 3.2 Factors for target market determinations must be clear

- The factors which manufacturers of products should take into account (given that often they distribute their products through other entities and may not have a direct relationship with the end client) should include assessments based on their knowledge and past experience of the product or similar products.
- Certainty must be provided regarding the factors which must be used in determining ‘target markets’. MiFIDII specifies factors which relate to professional clients and includes both quantitative and qualitative factors. AIST believes that the Bill provides insufficient guidance. Without certainty, there will be a lack of consistency across the financial services industry.
- The European Securities and Market Authority (ESMA) has outlined types of client categories in terms of who receives the product (professional, consumer, etc). ESMA’s target market guidance includes specifying which type of client is best suited to the product, the requisite degree of knowledge and experience the client of such a product should have, the ability of the client to bear losses, and the risk profile of the product compared with the risk profile of the target market.

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These factors are all critical in ensuring that target market assessments are focussed and are reasonably consistent across financial services. AIST recommends that these matters should be covered either by amendment to the Bill or through outlining in the Explanatory Memorandum that these factors will be introduced through ASIC Guidance.

### 3.3 Target market reviews include member outcomes

- MiFIDII requires target market reviews to include member outcomes, e.g. the volume of product sales.

AIST recommends that this matter should be covered either by amendment to the Bill or through outlining in the Explanatory Memorandum that these factors will be introduced through ASIC Guidance.

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## 4. Key theme 3 – A further consultation is needed for industry to discuss cost impacts and interaction with other regulator measures

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The superannuation industry has been under constant review. AIST is concerned that there has been insufficient consultation and time spent with stakeholders reviewing the proposals contained in the Bill. For example, AIST member funds wish to discuss the cost impact of the proposals. We note that cost impacts have been appended to the draft Explanatory Memorandum. We wish to understand the source of this data, since it is not from our member funds. We recommend that further time be spent to examine issues such as:

- How the proposals contained in the Bill would interact with the APRA member outcomes test. This is an issue which requires careful consideration, with input from Treasury, ASIC and APRA. To date, stakeholders have not been involved in consultations which simultaneously involve all three of these parties.
- What time and cost impact would the Bill have on entities.

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## 5. Key theme 4 - Fix regulatory framework gaps – a longer term project

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AIST reiterates its support for the Bill, subject to noting our recommendations to strengthen the Bill's coverage and impact. However, we note that the powers which would be provided by the Bill rely on ASIC undertaking reviews and funds reporting to ASIC. This means there is a great reliance on ASIC resourcing.

Accordingly – and as a separate longer-term project – the many gaps, carveouts and exemptions which have eroded the regulatory framework need addressing. Disclosure protects consumers, enables regulators to take action, and sends a clear signal to market participants. This is why disclosure must be fair and on a level playing field across products and services.

The superannuation system is compulsory and was established to provide a 'public good' to Australia and Australians. Given this and the need to protect members, disclosure and reporting must meet the consumer protection principles we have outlined above.

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Yet, the current regulatory framework does not meet basic consumer protection principles. A number of exemptions, gaps and carveouts have been introduced which fundamentally erode consumer protections. One key example is the regulatory differences between MySuper and Choice products. So called “Choice” products are frequently recommended under advisement. ASIC recently found that conflicted advice resulting in 68% of client funds being invested in in-house products. SuperRatings has found that on a like-for-like comparison, Choice products in the for profit sector (mainly run by banks) generally provide lower investment returns than profit-to-member funds and are between 53-280% more expensive. Yet, the legislative alignment of MySuper and Choice disclosure and reporting has not occurred. The Bill provides a ‘soft’ solution through reliance on ASIC intervention and entity reporting rather than through legislatively and systemically requiring Choice products to disclose and report transparently. The alignment of MySuper and Choice is but one gap which requires fixing.

AIST’s submission<sup>7</sup> to the Senate inquiry into consumer protection in the banking, insurance and financial sector included a detailed report on these various gaps, exemptions and inconsistencies. These may be summarised:

- Trustee Gaps in the ‘no employer kickback rule’.
- Trustee duties to promote the financial interests of beneficiaries and apply a scale test each year to ensure that the size of the product does not disadvantage consumers do not apply to choice products.
- Requirements to act in the best interests of the member when switching the member out of a MySuper product into a choice product or option do not apply to general advice and no advice business models.
- Standardised disclosure designed to allow consumers to compare products is not required for choice products or investment options, platforms or legacy products.
- Requirements designed to ensure that funds disclose all fees and costs, including indirect costs do not apply to platforms.
- Gaps in data reporting obligations result in gaps in APRA’s statistical collection relating to the performance, fees and costs on choice products and investment options, platforms and legacy products.

We understand from the draft Exposure Explanatory Memorandum (‘EM’) that the proposals are meant to overcome the shortcomings of the existing disclosure regime. Such shortcomings have been explained as including consumer disengagement, complexity of documents, behavioural biases, misaligned interests and low financial literacy. The proposals are to assist consumers to select appropriate financial products by requiring issuers and distributors to appropriately market and distribute financial products.

We note that the Financial System Inquiry (‘FSI’) suggests that there needs to be an alignment of governance and corporate culture of financial firms, employees and representatives. Recent

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<sup>7</sup> AIST, (2017). *Senate Inquiry into consumer protection in the banking, insurance and financial services sector*. AIST.



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examples suggest that the alignment needs to start at the point of product design. The FSI estimated that collapses in the retail financial services sector affected more than 80,000 consumers, with losses totalling more than \$5billion. This estimate did not include subsequent scandals which have affected Australia's four major banks.

These scandals raise the question as to what types of behaviours is the Bill seeking to address and is it sufficient to do so. The Bill is insufficient to address known detrimental-to-consumers forms of behaviour. Recent examples include:

- Conflicted advice resulting in 68% of client funds being invested in in-house products.
- Costs of Choice (non-MySuper) products – in which the majority of APRA regulated superannuation fund money is invested – are insufficiently disclosed and members are unable to compare products.
- Costs of platform products are virtually unknown – yet according to Rainmaker, over 70 percent of retail superannuation assets in Australia are held via platforms. This places investors in an unacceptable situation. The ever-present argument that platforms find it difficult to compile costs is unacceptable.
- Costs of legacy products are not disclosed to consumers. RiceWarner has estimated that approximately 30% of personal superannuation assets are held in legacy products. The ever-present argument that it is difficult for legacy products to disclose is unacceptable.

AIST strongly advocates that gaps in the regulatory framework must be fixed in order to address these detrimental-to-consumers forms of behaviour. While the Bill provides ASIC with complementary additional powers which AIST strongly supports, the Bill does not seek to address these gaps. AIST appreciates that the fixing of these gaps would need to be a separate and longer-term programme.

A detailed summary of key disclosure and reporting gaps, carveouts and inconsistencies in contained at [Annexure B](#).

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## 6. ASIC Product Intervention Powers

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### 6.1 Introduction

AIST supports the proposed power to provide ASIC with product intervention powers to enable ASIC to take a more proactive approach to reduce the risk of significant consumer detriment. AIST repeats our earlier advocacy that these powers need to be coupled with greater regulator accountability through the outcomes of the Regulator Performance Framework.

Additionally, AIST believes the Product Intervention Powers would be more effective if our recommendations regarding additions to the Bill were implemented.

It is critical that the target market and distribution obligations are extended to all manufacturers and distributors of product. Without this degree of responsibility and

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‘ownership’ for product, ASIC’s product intervention powers will not be as meaningful as they might otherwise be.

### 6.2 ASIC process

AIST supports the proposals requiring ASIC needing to consult both with entities/persons affected and APRA before ASIC issues an intervention order.

AIST notes that the Product Intervention Power is based on instances where a product (or class of products) has resulted or is likely to result in significant detriment to relevant persons. The term ‘significant’ has not been defined in the Bill.

The Bill provides some guidance regarding matters to be considered in determining ‘detriment’. AIST recommends that the Bill should include further guidance, including issues such as, the timeliness of ASIC intervening, the alteration or otherwise of existing consumer rights which may ensue, and impacts on the competitiveness, stability and integrity of the superannuation system.

AIST also recommends that ASIC guidance is needed to ensure public accountability. The guidance could be a mix of principles and non-exclusory examples. In line with our earlier comments, AIST recommends that Guidance should include examples of ‘significant’ detriment based on the types of investors and consumers involved (sophisticated or otherwise).

### 6.3 ASIC reporting

AIST strongly supports ASIC reporting on the exercise of its Product Intervention Power. AIST recommends that such reporting should include Interventions by entity classification using the APRA classifications (retail, profit-to-member, etc). This would aide a focus on where ASIC’s attention and resources are being used.

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## 7. Conclusions

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AIST supports the Bill. AIST strongly believes the Bill could be strengthened through making all parties to the chain of product manufacture and distribution subject to its provisions. This would render the Bill’s provisions more in line with international trends, as well as bringing to the fore a sense of requiring ownership of product manufacture and distribution. We firmly believe this would also assist in making the various points in the distribution chain more accountable, and aide greater consideration of the impact of conflicts of interest.

AIST would greatly appreciate a further consultation regarding the proposals contained in the Bill. We have raised a number of queries and have made recommendations which we believe would render the proposals more efficacious. We would also appreciate the opportunity to discuss the possible nature of future ASIC guidance.

## Annexure A

### Volume of money involved in product manufacture for platforms

The volume of money involved in the products manufactured by product providers or parent and are which then are utilised by platforms in Australia is very large.

All of the information contained in this Annexure is sourced: RiceWarner for AIST.

**Table A - Product and provider FUM overview, 30 June 2017 (\$ millions)**

Company Name	Super Wrap	Non Super Wrap	Super Master Trust	Non Super Master Trust	Total
BT	59,371	49,984	34,772	819	144,946
AMP	3,374	788	101,975	8,651	114,788
CFS	15,156	12,590	76,849	10,186	114,782
NAB	10,953	9,849	83,709	7,231	111,743
Macquarie	24,802	49,099	558	-	74,459
ANZ	9,651	2,970	26,261	-	38,882
IOOF	1,854	624	24,773	3,115	30,366
NetWealth	1,270	615	5,087	5,774	12,747
Suncorp	-	-	6,230	-	6,230
Hub24	-	-	2,895	2,614	5,509
Others	-	14,472	84,520	11,766	110,758
<b>Total</b>	<b>126,432</b>	<b>140,992</b>	<b>447,630</b>	<b>50,157</b>	<b>765,210</b>

Table B outlines the flows to this sector and identifies that it is highly contested by organisations including the:

- major banks including BT (Westpac), ANZ, CFS (CBA) and NAB
- other banking and financial institutions, including Macquarie and AMP
- emerging independent players which are predominantly supported by strong technological capabilities.

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**Table B - Aggregated flows by provider, 30 June 2017 (\$ millions)**

	FUM - Jul 2017	Net flow	Investment Income	FUM - Jul 2016
BT	144,946	4,942	8,885	131,119
AMP	114,788	2,961	7,818	104,009
CFS	114,782	4,111	8,326	102,345
NAB	111,743	-2,635	9,926	104,451
Macquarie	74,459	7,516	5,370	61,574
ANZ	38,882	502	1,729	36,651
IOOF	30,366	212	2,060	28,095
NetWealth	12,747	4,191	413	8,142
Suncorp	6,230	1,326	140	4,765
Hub24	5,509	2,176	16	3,317
Others	110,758	-2,424	7,735	105,447
<b>Total</b>	<b>765,210</b>	<b>22,877</b>	<b>52,418</b>	<b>689,915</b>

In attracting new business platform providers offer a range of services to both retail and institutional investors. Table C outlines these products as well as the channels through which they are sold to reflect that:

- Most providers are offering investment and insurance features as characteristics of their overall product offer, notwithstanding the increasing regulatory focus particularly in relation to insurance.
- Larger players, particularly the ‘Big Four’ banks, distribute products through advisor networks that are aligned with parent entities that create a vertically integrated business.
- Smaller players who typically transact through direct market channels or, in the case of Hub24, through mutual arrangements with independent financial advisors.

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**Table C - Provider product offering and distribution channel**

Company Name	Products Offered			Sales Channel		
	Investments	Insurance	SMSF Offering	Direct	IFA	Aligned Advisor
ANZ	Yes	Yes	Yes	Yes	Yes	Yes
BT	Yes	Yes	Yes	Yes	Yes	Yes
CFS	Yes	Yes	Yes	Yes	Yes	Yes
NAB	Yes	Yes	Yes	Yes	Yes	Yes
AMP	Yes	Yes	Yes	Yes	Yes	Yes
Macquarie	Yes	Yes	Yes	Yes	Yes	No*
IOOF	Yes	Yes	Yes	Yes	Yes	Yes
Suncorp	Yes	Yes	Yes	Yes	Yes	Yes
Hub24	Yes	Yes	Yes	No	Yes	No
NetWealth	Yes	Yes	Yes	No	Yes	No

\*Note that Macquarie in-house private client advisers use the Wrap platform.

**At a glance - inconsistent treatment of choice superannuation products**

This is an extract from AIST’s submission<sup>8</sup> to the Senate Inquiry into consumer protection in the banking, insurance and financial services sector:

The following table summarises the numerous exemptions, gaps and inconsistencies afforded through the legislative environment to choice superannuation products. At July 2017, choice superannuation products cover approximately \$832 billion compared with approximately \$594 billion in MySuper.

Different treatment	Comments	Impact on consumers
No explicit duties on trustees to promote the financial interests of beneficiaries, or apply a scale test for choice products/investment options.	<p>The value of retirement savings in pre-retirement choice products /investment options is double the value in MySuper products.</p> <p>In 2014 SuperRatings found substantial differences between fees for MySuper and choice products, particularly within retail superannuation funds – even when the underlying asset allocations were almost identical.</p> <p>According to APRA there are 120 MySuper products but over 40,000 member investment choices.</p>	<p>The compounding effect of higher fees over long term reduces retirement incomes for members of choice products.</p> <p>Choice overload baffles members.</p> <p>The choice sector of the superannuation system is not achieving efficiencies of scale.</p>
<p>The Government deferred the requirement for choice dashboards in 2014, 2015 and 2016.</p> <p>It plans to amend the law so funds would only need to produce dashboards for their 10 largest choice options.</p>	<p>The Super System Review, Financial System Inquiry, and the Grattan Institute have all concluded that the level of fees paid by members is too high.</p> <p>SuperRatings has criticised the poor level of disclosure of fees, noting there is still a long way to go to achieve comparability of fees across MySuper and choice products/investment options.</p>	<p>Members of choice products/investment options do not have a dashboard and so cannot easily compare their returns, fees or costs with MySuper products.</p> <p>Under the Government’s proposal, dashboards will not be required for most choice investment options.</p>
APRA does not collect or publish statistics on choice products/investment options equivalent to the comprehensive statistical	APRA deferred collecting data for choice products/investment options for consideration during the	Members rely on APRA, employers, advisers, Government, researchers, commentators and trustees to analyse the characteristics and performance of choice

<sup>8</sup> AIST, (2017). *Senate Inquiry into consumer protection in the banking, insurance and financial services sector.*

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Different treatment	Comments	Impact on consumers
collection derived from the MySuper reporting standards.	development of the requirements for choice dashboards.	products/investment options. Lack of data hampers this.
No requirement to ensure switching funds is in the best interests of the member when giving general advice or under no-advice business models.	ISA analysis of Roy Morgan research found an increase in cross-selling retail superannuation using general advice and no-advice business models.	Members are switched from a MySuper product to an inferior choice product/investment option, when it is not in the best interests of the member.
New fees and costs disclosure requirements do not apply to superannuation held via a platform.	<p>According to Rainmaker, over 70 per cent of retail superannuation assets in Australia are held via platforms.</p> <p>According to Lane Clark Peacock, UK members may be paying up to 20 basis points per annum to access an active fund through a platform when compared with the cos of going direct to the fund manager.</p> <p>According to the UK Financial Conduct Authority, platforms add 20-90 basis points to costs.</p>	<p>Disclosure for superannuation held via a platform understates fees and costs paid by the member.</p> <p>ASIC admits it would be misleading to compare the fees and costs of platforms and non-platform superannuation funds.</p> <p>The compounding effect of higher costs over long term reduces retirement incomes for members.</p>
The (unimplemented) dashboard regime for choice products/investment options will not include platforms.	While the Government amended the regime to require dashboards for products/investments held via a platform, platforms themselves will be exempt.	Members who hold their superannuation via a platform will not have a dashboard for it, compounding an existing difficulty comparing their returns, fees or costs with MySuper products.
APRA does not collect or publish statistics on platforms equivalent to the comprehensive statistical collection derived from the MySuper reporting standards.	APRA deferred collecting data for choice products/investment options for consideration during the development of the requirements for choice dashboards.	Members rely on APRA, employers, advisers, Government, researchers, commentators and trustees to analyse the characteristics and performance of superannuation held via a platform. Lack of data hampers this.
No requirement to produce a shorter PDS for legacy products.	According to Rice Warner, around 30% of personal superannuation assets are held in legacy products.	This makes it difficult for members in legacy products to compare the performance, fees or costs of the product with a contemporary product, understand the exit costs and assess whether they would be better off switching to a contemporary product.
The (unimplemented) dashboard regime for choice products/investment options will not include legacy products.	Rice Warner found fees and costs for legacy products are on average more than double those for contemporary products.	Members who hold legacy superannuation products will not have a dashboard, making it difficult

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Different treatment	Comments	Impact on consumers
	UK Independent Project Board found £26 billion in legacy pension schemes had investment manager fees above 1%, with nearly £1 billion exposed to fees over 300 basis points per annum.	to compare their returns, fees or costs with contemporary products.
APRA does not collect or publish statistics on legacy products equivalent to the comprehensive statistical collection derived from the MySuper reporting standards.	APRA deferred collecting data for choice products/investment options for consideration during the development of the requirements for choice dashboards.	Members rely on APRA, employers, advisers, Government, researchers, commentators and trustees to analyse the characteristics and performance of legacy products. Lack of data hampers this.
Conflicted remuneration is banned for most of the financial services industry, but there is an exemption for advice about retail life insurance.	<p>In 2014 ASIC found more than one third of advice about retail life insurance reviewed did not comply with the law.</p> <p>96% of non-compliant advice was given by advisers paid an upfront commission.</p>	<p>Consumers are at significant risk of being recommended a life insurance policy that is not in their best interests.</p> <p>Industry and Government proposals to address this do not include banning commissions.</p>

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