

## **CHAPTER 5: REGULATORY SETTINGS**

The Final Report made nine relevant recommendations in relation to the overall regulatory system. The FSC's response to each of those recommendations is set out below.

### **FSI RECOMMENDATION 21:**

Introduce a targeted and principles-based product design and distribution obligation.

A proposed obligation would apply to both product manufacturers and distributors, and require compliance at various stages of the product life cycle, including after the point of sale.

The FSC has concerns that such an obligation will be uncertain in its application; impose a significant compliance burden; and unnecessarily limit consumer autonomy and choice. Accordingly, the FSC does not support the Government adopting FSI recommendation 21.

In addition to existing disclosure obligations (in particular, the requirement for information to be 'clear, concise and effective'), financial services licensees are already subject to an extensive range of obligations including section 912A of the *Corporations Act 2001* (Corporations Act) which requires licensees, amongst other things, to do all things necessary to ensure that the financial services they offer are provided 'efficiently, honestly and fairly', and that any conflicts of interest are adequately managed. These provisions exist to help ensure consumers are treated fairly and have adequate information to make informed financial decisions. Of course, no law can prevent unethical or fraudulent behaviour. Instead, a combination of adequate disclosure, improved financial literacy, compliance with the law, and regulator enforcement is critical to ensure positive consumer outcomes.

To create an additional product design and distribution obligation would be to impose a significant compliance burden on financial services providers (FSPs), as it is proposed that the product be assessed for suitability, by *both* the product manufacturer and distributor, during the product design phase, product distribution process, *and* after the sale of a product. A continual cycle of product review is impractical, costly and will stifle productivity and innovation.

For example, a situation could arise in a post sale review whereby a product issuer no longer considers the product to be 'suitable' for a class of consumer, whilst a distributor, takes the opposite view. Similarly, there may be circumstances where a consumer wishes to purchase a product or

service despite the provider and/or distributor not believing it is suitable for a consumer within that class – would the consumer be prevented from purchasing the product?

The person best placed to determine whether a product is suitable for a client is the consumer and/or their financial advisor. In the case of advisers, they are already required to act at all times in the ‘best interests’ of their clients (section 961B, Corporations Act), and provide ‘appropriate advice’ (section 961G, Corporations Act). The ‘FOFA’ reforms are already being implemented, and should not be supplanted by additional, potentially conflicting and unclear obligations.

Further, the introduction of a product design and distribution obligation is likely to engender uncertainty as to its application and may lead to litigation as to the obligation’s exact parameters.

The FSC notes that the proposed obligation is intended to cover both complex *and* non-complex products. We believe that for non-complex products in particular, the introduction of such an obligation is not justified. Indeed ASIC’s discussion of product suitability is limited to complex products in its Report 384 (Regulating Complex Products), released in January 2014, recognising that complex products, due to their nature, can be difficult for investors to understand, which can lead to them being mis-sold (see also ASIC Report 400: Responses to Feedback on Report 384). Such risks are significantly reduced where the product is non-complex, and therefore do not warrant additional government regulation.

Product suitability type obligations already exist in some areas, for example in credit (responsible lending rules) and superannuation (default/MySuper products). However these areas, which involve individuals consuming compulsory or otherwise essential products, can be contrasted to wealth management products, which fundamentally involve an investor assessing how they wish to utilise their disposable income. Additional regulatory intervention is not warranted where the transaction is fundamentally one of choice rather than need (credit) or compulsion (superannuation), and particularly given the obligations of AFSL holders under the Corporations Act. Where a product or service is considered ‘too risky’, it is open to the Parliament to legislate to prevent it being offered to consumers.

**RECOMMENDATION:**

The FSC recommends that the Government not introduce a new and unnecessary product design and distribution obligation given: existing multi-layered obligations on financial services providers; implementation risks associated with the proposed obligation; the significant compliance burden it would impose; and the negative impact such an obligation would have on consumer autonomy and choice.

**FSI RECOMMENDATION 22:**

Introduce a proactive product intervention power that would enhance the regulatory toolkit available where there is risk of significant consumer detriment.

This proposed product intervention power would allow: product banning; distribution restrictions; warnings/labelling; and amendments to marketing and disclosure materials.

The FSC has concerns regarding ASIC being given such a wide-ranging power, and does not support FSI recommendation 22. In our view, a strong enough case has not been made that ASIC is unable to carry out its mandate with the powers which it is already has. Currently, ASIC can intervene where license conditions/law has been breached. In particular, a stop order is an administrative mechanism that allows ASIC to prevent offers being made under a disclosure document where ASIC believes it contains: a misleading or deceptive statement; an omission of information required to be provided under the legislation, or a new circumstance has arisen since the disclosure document was lodged. Such stop orders have been utilised by ASIC, for example in the area of mortgage funds.

Further, we note that the proposed new discretionary power could be exercisable by ASIC even where there has *not* been a suspected breach of the law. In practice this means that a FSP could issue a product which complies with the law, but ASIC could nonetheless, exercise its intervention power. Such ASIC action could have a major market and reputational impact on the FSP.

We believe that the scope of permitted products or characteristics is not a matter which should be delegated beyond Government/Parliament – rather, to the extent it was considered necessary to proscribe a product or product characteristic, for certainty it should be set out in legislation or regulations, and not a matter for regulator discretion.

There is also a potential moral hazard, in that ASIC may feel obliged to exercise the power or risk consumers viewing a lack of ASIC action as an implied endorsement of a product's suitability for them.

Although we understand it is intended that such a significant power, if introduced, only be exercised as a 'last resort', it is important that it be constrained through appropriate accountability and oversight mechanisms, including judicial review. If such a power is introduced, in order to ensure procedural fairness, and prevent wasted resources, potentially affected FSPs must be afforded the opportunity to present their position prior to any ASIC decision to exercise the power.

It would also be appropriate to consult with APRA, where the affected entity is APRA-regulated. Further, in the interests of transparency, ASIC should be required to provide clear guidance to industry regarding the instances where ASIC may consider using such a power.

In relation to the launch of new product types, if ASIC is provided with a product intervention power, there should be an arrangement for a product issuer, *prior to issuing the product*, to approach ASIC (should the product issuer wish to do so) for prior confirmation that ASIC will not exercise its product intervention power.

We note that rapid change can make it difficult for regulators to keep pace with technological developments or market innovations. However this is a perennial issue that faces all governments, and not peculiar to financial services. Such a fear must be balanced against the need for industry to harness technology and promote innovative products/services. A common theme in the FSI report is that government should encourage, rather than stifle innovation. Were a product intervention power is introduced, it is important that it not be exercised merely in circumstances where the product is new or innovative.

We agree that if a Financial Regulator Assessment Board were to be introduced (see FSI Recommendation 27), it will be important that the Board carefully consider ASIC's exercise of such a power. Reporting to Parliament and in ASIC's Annual Report should be additional accountability mechanisms to ensure that the power is used appropriately, and only in exceptional circumstances, were the power to be introduced.

**RECOMMENDATION:**

The FSC recommends that the Government not provide ASIC with a product intervention power given ASIC already has wide-ranging powers which allow it to act where there have been breaches of the law or license conditions. The introduction of a new discretionary power would see ASIC stray into the field of mandating permissible products, a role which is properly the responsibility of the legislature. If introduced, the FSC recommends that the power only be exercised as a last resort, be constrained through robust accountability and oversight mechanisms, and that clear guidance be provided regarding the circumstances in which ASIC might exercise the discretion.