



Design and Distribution Obligations and Product Intervention Power

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Joint AIST and ISA Submission

Industry Super Australia
Level 39, 2 Lonsdale Street
Melbourne VIC 3000

P: +61 3 9657 4321
F: + 61 3 9657 4322
E: admin@industriysuper.com
W: www.industriysuperaustralia.com
T: [@IndustrySuper](https://twitter.com/IndustrySuper)

Australian Institute of Superannuation Trustees
Ground floor, 215 Spring Street
Melbourne VIC 3000

P: +61 3 8677 3800
F: +61 3 8677 3801
E: info@aist.asn.au
W: www.aist.asn.au
T: [@aistbuzz](https://twitter.com/aistbuzz)

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.

ISA

Industry Super Australia manages collective projects on behalf of Industry SuperFunds with the objective of maximising the retirement savings of five million industry super members. These projects include research, policy development, government relations and advocacy as well as the well-known Industry SuperFunds Joint Marketing Campaign.

Contact

Karen Volpato, Senior Policy Advisor, AIST	0419 127 496
David Haynes, Executive Manager, Policy and Research, AIST	03 8677 3800
Richard Watts, Consultant, ISA	0458 029 830

1 Executive summary

In these joint submissions AIST and ISA generally welcome the proposals to impose obligations upon financial product issuers and distributors and to provide ASIC with product intervention powers to reduce the likelihood of consumers being mis-sold products that are not aligned with their financial situation, objectives and needs.

There are existing regulatory gaps that should be filled to better protect consumers.

The proposals regarding target market identification are supported. We also suggest that there should be a further consideration regarding the level of sophistication of the relevant consumers.

We propose that the obligations as they apply to existing products should apply 12 months following Royal Assent.

2 Introduction

AIST and ISA thank the Government for the opportunity to comment on the Proposals Paper *Design and Distribution Obligations and Product Intervention Power* ('the Proposals'). Within this submission, we are confining our comments to the superannuation sector of the financial system.

We endorse the comments made by the Financial System Inquiry (FSI)¹ that 'The financial system plays a vital role in meeting the financial needs of individual Australians. To fulfil this role effectively, consumers should be treated fairly and financial products and services should perform in a way consumers are led to believe they will.'

The FSI goes on to comment that the current regulatory framework focusses on disclosure, advice and financial literacy and that there is a need for the framework to more effectively align the governance and corporate culture of financial firms, employees and representatives. Further, recent examples suggest 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 totaling more than \$5 billion. This estimate did not include subsequent scandals which have affected Australia's four major banks.

We welcome the proposals seeking to have greater product issuer and distributor accountability. We strongly support that products must be appropriate for their target market. The profit-to-member superannuation funds have had a long history of developing products and services which are specific to the membership demographics. Profit-to-member superannuation funds have also had a long history of providing products which delivered superior long-term good performance, compared with the for-profit sector which has conflicted interests due to the need to deliver returns to shareholders. These conflicts have resulted in retail products being frequently closed and new replacements products opened (thus not enabling consumers to see long-term investment performance). This - along with disclosure and reporting differences by Choice (non-MySuper) products – has led to being over 40,000² member investment choices which surely cannot be said to be in the 'best interests of members'.

Whilst we generally welcome the proposals, we suggest that it is appropriate that where there are existing processes and obligations which impose an obligation to ensure financial products are not mis-sold, these obligations should continue and, if needed, are strengthened.

¹ Commonwealth of Australia, (2015). *Financial System Inquiry Final Report*. [online] Commonwealth of Australia. Available at: <http://tinyurl.com/nx768z8> [Accessed 13 March 2017].

² Derived from comments made: Rowell, H. (2015). *Governing Superannuation in 2015 and beyond: Facts, Fallacies and the Future*. [online] APRA. Available at: <http://tinyurl.com/hla6osb> [Accessed 13 March 2017].

There are existing product design and distribution obligations in the superannuation industry and clear duties upon the trustees of superannuation funds to ensure that they promote the financial interests of beneficiaries ahead of the interests of others, including, it is argued, shareholders.

We believe that the conflicts inherent in the retail superannuation sector, which manifest themselves in the extended use of related parties; the diversion of profit to shareholders; mis-selling and ultimately on average significantly poorer returns to members, will not be resolved via these proposals alone. Change is required to ensure all superannuation product providers are accountable and that the fiduciary obligations of trustees are adhered to.

Australia's four largest banks hold 80 percent market share of Australia's superannuation assets. Notwithstanding this market dominance, on average bank-owned superannuation funds have underperformed industry super funds by 2.26 per cent a year over 10 years.³

We support enhanced consumer protections and an enhanced enforcement role for ASIC to act on behalf of consumers, including those who may not be sufficiently engaged to commence action or do not have sufficient resources to do so. We do not argue that consumers should be responsible for their financial decisions. However, we do strongly believe that consumer decisions should be based on informed choice provided within an appropriate regulatory environment.

There remain four key existing issues which need addressing before adding further requirements flowing from the Proposals.

2.1 Address failures evident in current laws and regulatory framework as the priority

To adequately ensure products are designed with consumer needs in mind and are marketed at appropriate sections of the population, there must be sufficient disclosure and reporting requirements.

The current regulatory framework has introduced numerous exemptions, gaps and inconsistencies for Choice products and investment options compared with MySuper products. Yet, the value of retirement savings in pre-retirement Choice products / investment options is double the value in MySuper products. The FSI's objective for the introduction of product intervention powers included providing ASIC additional powers to deal with stubbornly unsuitable products, distribution and recommendations by advisers continuing to be made to retail clients⁴.

³ SuperRatings SR50 Balanced Survey data to January 2017.

⁴ As summarized by University of NSW, (2015). *Product Intervention Powers: a Legal, Comparative & Policy Analysis*. [online] Sydney: University of NSW. Available at: <https://tinyurl.com/zrnh8f3> [Accessed 13 Mar. 2017].

We believe that the lack of disclosure and reporting alignment between Choice and MySuper products has led to there being over 40,000⁵ member investment choices – an outcome which surely does not meet the objectives outlined within the Proposals paper. This lack of alignment has also led to the ongoing existence of ‘stubbornly unsuitable products’ (eg. legacy products, which according to RiceWarner⁶ hold around 30% of personal superannuation assets and which UK research⁷ indicates cost over 1% in fees in the UK).

We strongly recommend that the many gaps, exemptions and inconsistencies in the current laws and regulatory framework need redressing in tandem with the implementation of the proposed changes.

AIST’s recent submission⁸ 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.

There is no justification for these exemptions, gaps and inconsistencies. Their existence facilitates cross-selling of retail superannuation to employers and employees and makes it difficult for consumers who hold these products to compare products. These issues need to be resolved as a matter of priority. While the FSI has commented that the effectiveness of disclosure as the main

⁵ Derived from comments made: Rowell, H. (2015). *Governing Superannuation in 2015 and beyond: Facts, Fallacies and the Future*. [online] APRA. Available at: <http://tinyurl.com/hla6osb> [Accessed 13 March 2017].

⁶ Rice Warner, *Superannuation Fees Report 2014* FSC, 2014, 54. Available at: <https://tinyurl.com/zkg93ol> [Accessed 13 March 2017].

⁷ LCP, *Investment Management Fees Survey 2015*, 6. Available at: <https://tinyurl.com/zvzx3kl> [Accessed 13 March 2017].

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

source of consumer protection can be limited when consumers are disengaged, we strongly believe that disclosure (which is also an enabler for regulator action) must be fair and on a level-playing field across products and services.

2.2 MySuper – is unique

The issue of whether to exclude MySuper from the Proposals was raised within the Proposals paper. We strongly agree with the Proposals paper in that products should be appropriate for their target market. It is submitted that there is an extensive regulatory overlay that applies to superannuation products and enhanced obligations that apply to MySuper products. The proposed design and distribution obligations do not add any additional obligations to trustees offering MySuper products. It should also be recognised that ASIC currently has appropriate product intervention powers. AIST and ISA are of the view that MySuper products are highly regulated and have delivered superior outcomes for consumers. Those MySuper products that are nominated as default funds within modern awards have consistently outperformed.

Work by SuperRatings⁹ also confirms that since the commencement of MySuper, all the top 10 best performing funds are profit-to-members MySuper products which operate as default funds in modern awards. Importantly, when considering net returns to members, those products that are currently used as default funds under the existing default allocation arrangements are almost exclusively found in the top quartile of performing funds.

This over-performance has remained relatively consistent over the short, medium and long-term; pre and post the introduction of the MySuper regime.

It is submitted that there are benefits derived from the allocation of MySuper products via an industrial relations process that is currently used to distribute funds via the inclusion of default fund status in Modern Awards.

MySuper provides a minimum standard but does not regulate fees or outcomes. There continues to be a wide spread in fees and returns among MySuper products and, as such, the standard or operating filters for default fund selection should be higher.

There is an existing process within the Fair Work Commission that applies additional quality filters which are designed to ensure a MySuper product is best suited to the relevant demographic employed under the terms of a modern award. An appointed Expert Panel is deemed with the task of producing a Default Superannuation List. The Expert Panel must not include a MySuper product on the default fund list unless it is satisfied that it would be in the best interest of default fund employees modern awards apply to. Considerations, include, but need not be limited to:

⁹ SuperRatings returns as of 31 January 2017.

- The appropriateness of the product's investment return target and risk profile;
- Its expected ability to deliver on the product's return target;
- Fees and costs;
- Net returns;
- Governance practices; and
- Administrative efficiency and quality of advice.

Other relevant considerations that are not specifically included are insurance fees and coverage, the availability and relevance of income retirement products and member services.

The failure of the Government to appoint Expert Panel replacements and the establishment of a Productivity Commission Inquiry into the process by which default funds are allocated has delayed the introduction of the additional quality filters into the MySuper default fund allocation process.

Consumers would be better served if steps were taken to allow the additional quality filters to be applied to the default fund selection process.

2.3 Comprehensive Income Products for Retirement requirements should be more settled

The Proposals paper raises whether Comprehensive Income Products for Retirement (CIPRs) should be excluded.

Based on our member funds' strong emphasis on value for money and targeted products and services, we strongly support the development of post-retirement frameworks by funds. Such frameworks should include profiling of member demographics and outcomes which are in the best interests of a sizeable majority of the fund's membership base. We do not support a situation where trustees are forced to implement a particular product or type of product in their CIPR strategy.

Because the nature of CIPRs is still being debated, we recommend that the outcome of the Proposals paper defer resolving any matters regarding CIPRs.

2.4 ASIC's funding model and focus needs settling

We strongly support focused and properly resourced regulators. This support includes that regulators are also suitably enabled to act where needed. To date, there has been no transparency regarding either how ASIC levies are raised or how they are spent. We have been advocating that sufficient detail should be included so that both the Government and stakeholders can see how ASIC activities, resources and funding are aligned.

We are pleased that our advocacy has been heard. The *ASIC Supervisory Cost Recovery Levy Bill 2017* and Related Bills ('the Bills') will, on the whole, deliver such transparency. Only once these

measures have been implemented will we know how ASIC is focused and whether it is sufficiently resourced. In AIST's submission¹⁰ regarding the Bills, AIST advocated that the levies raised need to reflect the volume of ASIC's focus on particular entities and sub-sectors (including profit-to-members and for-profit subsectors).

The Proposals would potentially place even greater demand on ASIC's resources. In order for us (and the Government) to assess whether ASIC is sufficiently resourced to take on these additional demands, we first need transparency around ASIC's focus and how the levies are used.

¹⁰ AIST, *ASIC Supervisory Cost Recovery Levy Bill 2017 and Related Bills* 10 March 2017 <https://tinyurl.com/z3rxbd7> accessed 13 March 2017).

3 Objectives

The OECD's *G20 High Level Principles on Financial Consumer Protection*¹¹ may be summarised, in part, 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; and
- Remuneration/ conflicts of interests should be disclosed where conflicts cannot be avoided.

The current legislative and regulatory framework does not meet these objectives, a situation not rectified by the proposals. As the FSI puts it, consumers can be put in the position of bear(ing) responsibility for their financial decisions. Nor is the system within which they invest 'fair' – another key principle raised by the FSI.

We now turn to each of the Proposal paper's chapters and the questions raised within each chapter.

¹¹ 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>

4 Products to be captured by these Measures (chapter 2)

4.1 Overview

We support the broad coverage of financial products, but recognition needs to be given to the fiduciary and other responsibilities of the trustees of superannuation funds. It is critical to ensure that products are in the best interests of members and are not being mis-sold. We therefore also strongly support the product intervention powers. We find it difficult to see how banks, when selling retail superannuation over the counter, can deliver a product in the best interests of members.

MySuper has delivered superior outcomes, but there is a range of fees, costs, and net returns. Because of this, we believe that additional filters should be applied to MySuper, and that the Productivity Commission should be tasked with an Inquiry to examine what these filters should be.

4.2 Questions raised and AIST-ISA response

- 1. Do you agree with all financial products except for ordinary shares being subject to both the design and distribution obligations and the product intervention power? Are there any financial products where the existing level of consumer protections means they should be excluded from the measures (for example, default (MySuper) or mass-customised (comprehensive income products for retirement) superannuation products)?***

AIST-ISA response

All financial products, except for ordinary shares, should be the subject of product design and distribution obligations. Notwithstanding this, it should be recognised that there is in place an existing regulatory regime that applies to superannuation product design and distribution. The fiduciary relationship between a fund's trustees and its members and the obligations imposed by both the *Corporations Act 2001* and The *Superannuation Industry (Supervision) Act 1993* ("the SIS Act") create an environment where there are duties on trustees that do not necessarily apply to the producer and distributor of ordinary financial products.

Trustees of MySuper products have additional or enhanced obligations imposed upon them by way of covenants in section 52 of the Act as enhanced by the obligations imposed under section 29VN and the covenants prescribed under section 54A of the SIS Act that relate to the enhanced trustee obligations which are specified in the regulations.

It is a requirement that fund trustees operate a fund in the best financial interests of the members of the fund. This includes the obligations under section 29VN and 29VO (the later applying to a director of a corporate trustee in relation to a MySuper product), to promote the financial interests of the fund beneficiaries; including a requirement to assess on an annual basis if their

membership of the fund does promote their financial interests and to develop investment, risk and insurance strategies that are appropriate for funds demographic composition.

It should also be recognised that compulsory superannuation is far from an ordinary financial product, the product design and distribution arrangements are highly regulated. There is currently product intervention powers available to ASIC. Whilst it is not suggested that the regulatory protections within the superannuation sector entirely avoid product mis-selling or that consumers financial situation, objectives and needs are in all instances appropriately catered for; the existing level of consumer protections are in most instances adequate.

We do however suggest that there is often a mis-alignment of interests of consumers and the producers and distributors of retail superannuation products which are sold to a general market and are not subjected to the additional appropriateness tests applied through the Fair Work Commission Process when naming MySuper default fund products within Modern Awards.

It is suggested that all trustees of superannuation products have an obligation to ensure that their products are designed to promote the financial interests of the fund's members and potential members and that the product is not mis-sold. It is difficult to see how a bank, when selling its retail superannuation product over the counter to all customers regardless of their circumstances, can easily conform to product design and distribution obligations.

Further, it is suggested that the trustees of a superannuation product produced and distributed by a bank and operated for the profit of shareholders can not readily meet their existing legal obligations¹² and that the mis-selling of product is inevitable.

We support that intervention powers are available across a broad range of financial products – both simple and more complex products. As Kingsford Smith notes, ‘The high concentration of ownership, control, product recommendation and bundling of products into strategies with other services (e.g. platforms) in Australia commends this (broad) approach even more.’ In any event, Kingsford Smith goes on to note that according to the IOSCO definition, most interests in superannuation funds in Australia would qualify as ‘complex’.

MySuper has delivered superior outcomes to consumers, particularly for employees subject to the terms of a modern award. The application of the additional quality filters within the Fair Work

¹² The interests of beneficiaries is central to the superannuation system and the reason why fund trustees have a range of interrelated duties under the SIS Act, Corporations Act, and Common Law duties including:

- Maintaining a fund for the sole purpose for members on retirement (SIS Act S 62);
- Prioritising the interests of beneficiaries over all others (SIS Act SIS 52 (2))
- That obligations to beneficiaries override obligations under other acts (SIS Act 52 (3) (4))
- The trustee and beneficiary relationship includes fiduciary obligations including a ‘no conflict’ and ‘no profit rule’ (Common Law).

Commission would further enhance product suitability. As noted above existing default funds have consistently, over a long period, delivered significantly superior returns and appropriate services to consumers. MySuper provides a minimum standard but does not regulate fees or outcomes. There continues to be a wide spread in fees and returns among MySuper products and, as such, the standard or operating filters for default fund selection should be higher

Regarding CIPRs, it is suggested that the implementation of the paper's proposals will not adequately address outstanding issues relating to CIPRs. Based on our member funds' strong emphasis on value for money, targeted products and services, we strongly support the development of post-retirement frameworks. Such frameworks should include profiling of member demographics and outcomes which are in the best interests of a sizeable majority of the fund's membership base. We would not support a situation where trustees are forced to implement a CIPR solution as a pre-selected strategy, or that any type of product is mandated.

2. Do you agree with the design and distribution obligations and the product intervention power only applying to products made available to retail clients? If not, please explain why with relevant examples.

AIST-ISA response

We are of the view that the obligations should apply generally. Notwithstanding, it should be recognised that there are obligations in parts of the non-retail environment, which are consistent with or even exceed the proposed obligations. For the reasons outlined above it is argued that the superannuation market, in particular the MySuper section of the market, has in place superior, but not inconsistent obligations. We see no harm in the proposed obligations overlaying these obligations to ensure there are no gaps and that there can be uniform expectations of consistent behaviour.

We would suggest that there be a formal recognition by ASIC that the obligations upon those offering MySuper products, has been met by their adherence to the existing regulatory regime.

3. Do you agree that regulated credit products should be subject to the product intervention power but not the design and distribution obligations? If not, please explain why with relevant examples.

AIST-ISA response

We support that regulated credit products should be subject to the product intervention power. As a University of New South Wales paper notes, internationally there is an overall picture of product intervention powers being available across a wide range of financial products, including credit. The paper goes on to comment that the inclusion of credit seems particularly appropriate in Australia given the 'high concentration of ownership, control, product recommendation and bundling of products into strategies (eg platforms) in Australia.'

Because of the highly concentrated financial sector in Australia, we believe that regulated credit products should also be subject to the design and distribution obligations. Because of all of the numerous current carve-outs, gaps and inconsistencies in consumer protection legislation and regulation which keep growing, we cannot support any carve-outs from proposals which are designed to enhance consumer protection.

4. Do you consider the product intervention power should be broader than regulated credit products? For example, 'credit facilities' covered by the unconscionable conduct provisions in the ASIC Act. If so, please explain why with relevant examples.

AIST-ISA response

As noted above, we hold the general view that all financial products should be included.

5 Design and Distribution Obligations (chapter 3)

5.1 Overview

We broadly support the concept of ‘target market’. However, clarity needs to be gained as to what a ‘target market’ comprises, and what factors to take into account. We strongly believe that long-term net returns and services to consumers are key. The definition of ‘distributor’ is unclear – does it include employers providing employees with Superannuation Choice forms, or to sales desk personnel, or to brokers? The due diligence requirements of ensuring products are suitably distributed is also unclear.

5.2 Questions raised and AIST-ISA response

5. Do you agree with defining issuers as the entity that is responsible for the obligations owed under the terms of the facility that is the product? If not, please explain why with relevant examples. Are there any entities that you consider should be excluded from the definition of issuer?

AIST-ISA response

We agree with maintaining the definition of ‘issuer’ as set out in section 761E(4) of the Corporations Act. We also recommend that there are no exclusions from the definition of ‘issuer’.

6. Do you agree with defining distributors as entity that arranges for the issue of a product or that:

(i) advertise a product, publish a statement that is reasonable likely to induce people as retail clients to acquire the product or make available a product disclosure document for a product; and
(ii) receive a benefit from the issuer of the product for engaging in the conduct referred to in (i) or for the issue of the product arising from that conduct (if the entity is not the issuer).

AIST-ISA response

Our general response is that the definition of ‘distributor’ is unclear, as are the implications flowing from the responsibilities of being a ‘distributor’.

We note that there is currently no definition of ‘distributor’ within the Corporations Act. The Proposals set out a very broad definition which potentially covers entities that are responsible for the acquisition of the product by consumers or influencing consumers to acquire the product. The Proposals also state that the intention is to cover entities that either arrange for the issue of the product (e.g. accepting the relevant application form from the consumer and organising for the consumer to obtain the product) or market the product to the consumer. We agree that the definition should be sufficiently broad so as not to enable unintended gaps in the regulatory

framework, as such the obligations should not be restricted to those entities holding an Australian Financial Services Licence.

Given the breadth of the definition it should be clarified that the definition of distributor does not include an employer meeting their obligations to provide information or applications relating to superannuation products or any other process that is relevantly prescribed by the superannuation regulatory regime.

We recognise that the second limb of the proposed definition of distributor requires the distributor receives a benefit from the issuer and we note that superannuation product issuers are prohibited from offering inducements to employers. Although it is not illegal for an employer to receive a benefit.

7. Are there any situations where an entity (other than the issuer) should be included in the definition of distributor if it engages in the conduct in limb (i) but does not receive a benefit from the issuer?

AIST-ISA response

Given our earlier responses regarding the aggregated ownership and control of financial products in Australia, we believe the definition of 'benefit' needs to be examined. For example, does 'benefit' include the benefits of cross-subsidisation.

8. Do you agree with excluding personal financial product advisers from the obligations placed on distributors? If not, please explain why with relevant examples. Are there any other entities that you consider should be excluded from the definition of distributor?

AIST-ISA response

We are of the view that distributors who provide personal financial product advice should be captured under the proposed distribution obligations. To the extent that existing obligations apply, such as the advisers requirement to act in the best interests of the client, we see no harm in the proposed obligations overlaying these obligations to ensure there are no gaps and that there can be uniform expectations of consistent behaviour.

9. Do you agree with the obligations applying to both licensed and unlicensed product issuers and distributors? If they do apply to unlicensed issuers and distributors, are there any unlicensed entities that should be excluded from the obligations (for example, entities covered by the regulatory sandbox exemption)? Who should be empowered to grant exemptions and in what circumstances?

AIST-ISA response

We agree that the obligations should apply to licensed and unlicensed product issuers and distributors. Before we can fully answer this, the definition of 'distributor' needs to be examined. See our response to question 6.

10. Do you agree with the proposal that issuers should identify appropriate target and non-target markets for their products? What factors should issuers have regard to when determining target markets?

AIST-ISA response

While we at a high level support the concept of 'target market', the Proposals paper provides insufficient detail. We note that the Proposals paper that the 'target market' would need to take into account the issue of reasonableness (objective criteria) and robust (maximising sales – v- consumer needs).

It is not uncommon for retail financial products will be sold to a target market of consumers with an expectation that the relationship will facilitate a longer-term higher value relationship. In banking for example, initially simple non-complex banking products can be sold to low-value customers with the relationship thereafter enabling the direct promotion of more complex and profitable financial products.

A target-market for an uncomplicated product can be financially unsophisticated consumers with a view to selling more sophisticated products. It is important that issuers make it clear who is not a target market, including whether the target market is a sophisticated consumer.

In the context of superannuation, it is suggested that there is a significant difference between the wholesale delivery of a MySuper default product which is steered through a comprehensive regulatory regime designed to protect beneficiaries and ensure appropriate products are distributed; and retail superannuation products that are often on sold to consumers who have an existing relationship with a financial services provider such as a bank.

We repeat our earlier comments: The principle requirement when considering the appropriateness of a product for an identified target market should be long-term net-returns and services to consumers. A range of other quality filters could include, but not be limited to:

- The long-term net returns delivered by the fund or its successor;
- The appropriateness of the fund's investment return target and risk profile;
- The fund's past and expected ability to deliver on its return target;
- Fees and costs charged;
- Insurance coverage and cost;
- Governance practices;
- Administrative efficiency;
- The availability and relevance of retirement income products;
- Member services, including information services; and
- The quality, availability and cost of advice.

Accordingly, we repeat our earlier comments that the failure of the Government to appoint Expert Panel replacements on the Fair Work Commission has delayed the introduction of the additional quality filters into the MySuper default fund allocation process and this should be rectified.

As discussed earlier there are obligations on superannuation fund trustees to ensure the superannuation product is appropriate. MySuper trustees have enhanced obligations which require a consideration of the demographics of the fund membership, or in effect, the fund's existing and target membership.

11. For insurance products, do you agree the factors requiring consumers in the target market to benefit from the significant features of the product? What do you think are significant features for different product types (for example, general insurance versus life insurance)?

AIST-ISA response

We agree that it is inappropriate to target a sub-market within the insurance market where the consumer may not benefit from the product or where the product is of marginal benefit to a consumer. The example given in the proposals paper of income protection insurance being sold to a target of self-employed persons who ordinarily would be ineligible to claim a benefit from the terms of the insurance product would be a clear case of mis-selling. In instances where a target market is likely to derive marginal benefit or no benefit from a product, including insurance, it sold be identified as a non-target market.

There are certain insurance requirements imposed upon superannuation trustees, including a requirement that a default level of Total and Permanent Disability and Life insurance is provided to members of the fund on an opt-out basis. Trustees are required to have in place an insurance management plan or strategy which takes into consideration the relevant demographic of the fund.

The superannuation industry associations, in association with insurers and consumer representatives are currently in the process of undertaking a significant review into the group

insurance offering within superannuation and are in the process of releasing discussion papers, which, in part, discuss the need to better design product to sub-sections of the market, an example of which is younger superannuation fund members and low income earners.

12. Do you agree with the proposal that issuers should select distribution channels and marketing approaches for the product that are appropriate for the identified target market? If not, please explain why with relevant examples.

AIST-ISA response

Conceptually, we agree with the proposal that issuers must select distribution channels and marketing approaches for a product that are appropriate for the target market and the matters which the issuers must have regard to. We would suggest that both the complexity of the product and the financial sophistication of the target market should be considered.

13. Do you agree that issuers must have regard to the customers a distribution channel will reach, the risks associated with a distribution channel, steps to mitigate those risks and the complexity of the product when determining an appropriate target market? Are there any other factors that issuers should have regard to when determining appropriate distribution channels and market approach?

AIST-ISA response

We agree with the proposal.

We also repeat our major concern that the key risk underpinning the various issues raised within the Proposal is that associated with the various gaps, inconsistencies and carve-outs currently within legislation and the regulatory framework. The need to fix these is the first priority.

14. Do you agree with the proposal that issuers must periodically review their products to ensure the identified target market and distribution channel continues to be appropriate and advise ASIC if the review identifies that a distributor is selling the product outside of the intended target market?

AIST-ISA response

We agree with the proposal.

15. In relation to all the proposed issuer obligations, what level of detail should be prescribed in legislation versus being specified in ASIC guidance?

AIST-ISA response

We would need to have further details about the Proposals before providing specific comments.

As a general comment, we support prescription either in the form of legislation or regulatory guidance in order to better protect consumers. As the International Organisation of Pension Supervisors says:

...the limited capacity of individuals to choose what is best for them means that competition and markets rarely work effectively within pension systems – leaving too much power in the hands of pension providers. The problem is only exaggerated when pension providers are commercial financial institutions. Conflicts of interest can therefore exist between the fiduciary duty to act in the best interests of the pension fund members and beneficiaries and making profits for shareholders.¹³

In support of our general comment, we note the comments of the University of NSW¹⁴: “It is clear that express requirements for ‘financial product governance’ are more developed in Europe and to some extent in international organisations than in the US or Australia.” There are also self-regulatory examples in Australia of established product and distribution obligations. The FSI has required a product governance obligation, dealing with product design and distribution, and we interpret this as including advice. Further, the FSI recommended it be ‘principles based’. This could be done by ASIC developing a Regulatory Guide setting out expected design and distribution obligations and shaping the Product Intervention Powers. As an alternative, still principles based and which we prefer, would be to anchor the Regulatory Guide expectations of product design and distribution obligations in a new license obligation under Section 912A of the Corporations Act. We suggest the Regulatory Guide for design and distribution obligations should be closely related to the standard and evidence required for Product Intervention Powers.

16. Do you agree with the proposal that distributors must put in place reasonable controls to ensure that products are distributed in accordance with the issuer’s expectations?

AIST-ISA response

Yes we agree. We also submit that the onus should be on the issuer to undertake regular reviews to ensure the product is not being mis-sold and that there is a requirement to document findings

¹³ International Organisation of Pension Supervisors, (2010). Managing and Supervising Risks in Defined Contribution Pension Systems. Working Paper No.12. Available at: http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1809741

¹⁴ University of NSW, (2015). *Product Intervention Powers: a Legal, Comparative & Policy Analysis*. [online] Sydney: University of NSW. Available at: <https://tinyurl.com/zrnh8f3> [Accessed 13 Mar. 2017].

of such a review and to report instances of potential or actual mis-selling. Further ASIC guidance would be welcomed.

17. To what extent should consumer be able to access a product outside of the identified target market?

AIST-ISA response

We concur with the papers observation on page 25 that “allowing consumers to ‘opt-out’ of the protections by agreement has the potential to compromise the integrity of the reforms...”

18. What protections should there be for consumers who are aware they are outside the target market but choose to access a product regardless?

AIST-ISA response

We would need further information about how a ‘target market’ is to be defined before we could fully answer this question. Insofar as an informed choice has been made by a consumer

19. Do you agree with the proposal that distributors must comply with reasonable requests from the issuer related to the product review and put in place procedures to monitor the performance of products to support the review? Should an equivalent obligation also be imposed on advised distributors?

AIST-ISA response

We agree, however we cannot fully answer this question until we have further information about the definition of ‘distributor’. Please see our answer to question 6.

20. In relation to all the proposed distributor obligations, what level of detail should be prescribed in legislation versus being specified in ASIC guidance?

AIST-ISA response

We cannot answer this question until we have further information about the definition of ‘distributor’. Please see our answer to question 6. Our answer to question 15 is also relevant to this question.

21. Do you agree with the obligations applying 6 months after the reforms receive Royal Assent for products that have not previously been made available to consumers? If not, please explain why with relevant examples.

AIST-ISA response

We agree with the view expressed on page 28 of the proposals paper that “Ideally the reforms should apply as consistently as possible with minimal grandfathering of existing products to avoid any regulatory cost advantages of existing products over new products.” For the reasons provided

in the paper, including that there may be products currently under development, we agree with the obligations applying 6 months from Royal Assent for products that have not previously been offered to consumers.

22. Do you agree with the obligations applying to existing products in the market 2 years after the reforms receive Royal Assent? If not, please explain why with relevant examples and indicate what you consider to be a more appropriate transition period.

AIST-ISA response

As a general comment, we support the application of consumer protection requirements to existing products, including legacy products. We repeat our concern that legacy products in general and certain other products in particular have inexplicably been granted exemptions or carve-outs from various legislative and regulatory requirements and that such exemptions must be removed. Notwithstanding this we recognise that there should be a period following Royal Assent to enable compliance regimes to be applied to products that are already available to consumers. We do not support a 2 year period and believe a 12 month period is more than sufficient to implement any measures to comply with any new requirements.

6 Product Intervention Power (chapter 4)

6.1 Introduction

We support the power proposed to provide ASIC with product intervention powers to enable ASIC to take a more proactive approach to reduce the risk of significant consumer detriment. These powers need to be coupled with greater regulator accountability through the combination of greater transparency regarding ASIC disbursement of levies and outcomes of the Regulator Performance Framework.

6.2 Questions raised and AIST-ISA response

23. Do you agree that ASIC should be able to make interventions in relation to the product (or product feature), the types of consumers that can access a product or the circumstances in which a consumer can access the product? If not, please explain why with relevant examples.

AIST-ISA response

- We reiterate our previous comment that the many inconsistencies, gaps and exemptions which exist in the current legislation and regulatory framework must be removed as a priority. Without this, ASIC does not have a sufficiently solid consumer protection framework within which to operate properly. Annexure A contains a summary of key inconsistencies, gaps and exemptions.
- We broadly support the concept that ASIC should be able to make such interventions. This support is subject to the various issues we have raised throughout this submission being resolved. This includes the various issues we have raised in our response to questions regarding the definition of distributor, the meaning of target market and distribution channels.
- We agree that the modes of intervention should be flexible.

24. Are there any other types of interventions ASIC should be able to make (for example, remuneration)?

AIST-ISA response

We refer to our answer to question 3 where we supported Product Intervention Powers across a broad range of activities, including credit. This is extremely important, owing to the bundling of products and services, and marketing and distribution.

We also refer to Annexure A, where we outline a significant issue associated with remuneration – which request fixing as a priority through legislation:

“Conflicted remuneration is banned for most of the financial services industry, but there is an exemption for advice about retail life insurance.”

We strongly recommend that this issue, along with other inconsistencies, gaps and exemptions in the legislative and regulatory framework, needs fixing as a priority. This is an important first step to better enabling ASIC to use its Product Intervention Powers.

25. Do you agree that the extent of a consumer detriment being determined by reference to the scale of the detriment in the market, the potential scale of the detriment to individual consumers and the class of consumers impacted? Are there any other factors that should be taken into consideration?

AIST-ISA response

We support the proposed factors that ASIC should take into consideration when determining whether a detriment is significant. When looking at the class of consumers likely to be impacted by the detriment we suggest that this should, in addition to the matters identified, explicitly consider whether the class of consumer or target market was likely to substantially involve a financially sophisticated consumer or otherwise.

While we broadly support Product Intervention Powers, we need further consultations regarding the basis of ASIC interventions. The types of questions which need answering include:

- What are the factors which ASIC should take into account? Examples include:
 - timeliness of acting.
 - use of Product Intervention Powers infrequently.
 - non-alteration of existing consumer rights.
 - Impacts on competition, stability and integrity of the system.
- We note that the Proposals refer to legislation specifying the steps which ASIC would need to take before exercising this power, and we agree with that approach.
- We note and support that comments by the University of New South Wales¹⁵ that other jurisdictions such as The European Union, the United Kingdom, and the United States of America do not limit the standard for intervention by the size of the class of consumers affected. This approach differs to that put forward in the Proposals paper, which would limit ASIC's intervention powers to the potential scale of the detriment in the market.

¹⁵ University of NSW, (2015). *Product Intervention Powers: a Legal, Comparative & Policy Analysis*. [online] Sydney: University of NSW. Available at: <https://tinyurl.com/zrnh8f3> [Accessed 13 Mar. 2017].

26. Do you agree with ASIC being required to undertake consultation and consider the use of alternative powers before making an intervention? Are there any other steps that should be incorporated?

AIST-ISA response

We strongly support any proposal which includes accountability for the product intervention powers. We agree that any steps to demonstrate such accountability should be legislated. Accordingly, we support the need for consultation and the user of alternative powers.

27. Do you agree with ASIC being required to publish information on intervention, the consumer detriment and its consideration of alternative powers? Is there any other information that should be made available?

AIST-ISA response

We strongly support ASIC being required to publish this information. We also strongly recommend that there are other issues which ASIC should be publishing based on their existing activities. These include:

- ASIC's regulatory guidance on client review and remediation does not currently require licensees to report either to ASIC or publicly on the outcomes of review and remediation programs. Since 2014, banks have implemented review and remediation programs relating to systemic failures ranging from charging excessive fees due to system errors, failures to comply with responsible lending laws, charging fees for services that were not provided and breaches of the regulatory regime for financial advice.
- As at October 2016, following a review by ASIC, ANZ, NAB, CBA, Westpac and AMP had paid or agreed to pay \$23.7 million of fee refunds and compensation to over 27,000 customers who were charged fees for ongoing advice services which they never received.
- ASIC estimated that total compensation may increase to over \$178 million, plus interest.
- We recommend ASIC should provide regular updates on the number of customers who have received fee refunds and compensation for failure to deliver ongoing advice services and the total value of fee refunds and compensation paid.
- AIST in its levies submission¹⁶ advocated that ASIC should commence publicly reporting on its regulatory activities on a risk-related basis, including by sub-sector (eg. profit-to-member or for-profit). This would assist with identifying the need to collect higher levies at a sub-sector or entity level, and would better correlate levies raised with the need for ASIC activity and enforcement. Such risk-related data could include the number of

¹⁶ AIST, *ASIC Supervisory Cost Recovery Levy Bill 2017 and Related Bills* 10 March 2017. <https://tinyurl.com/z3rxbd7> (accessed 13 March 2017).

breaches, data from External Dispute Resolution sources, ASIC time spent on particular entities or sub-sectors, and the number of entity internal complaints.

28. Do you agree with interventions applying for an initial duration of up to 18 months with no ability for extensions? Would a different time frame be more appropriate? Please explain why.

AIST-ISA response

We are not convinced that the FSI's proposal that ASIC interventions apply for an initial 12 months with the ability to extend the intervention is not appropriate. Whilst we recognise the need for industry certainty, consumer interests should be paramount.

29. What arrangements should apply if an ASIC intervention is subject to administrative or judicial appeal? Should an appeal extend the duration that the Government has to make an intervention permanent?

AIST-ISA response

An appeal need not extend the period of an ASIC intervention, but it should be a process that limits or undermines the intervention. The probability of administrative or judicial reviews adds weight to the argument that intervention extensions should be allowed.

30. What mechanism should the Government use to make interventions permanent and should the mechanism differ depending on whether it is an individual or market wide intervention? What (if any) appeal mechanisms should apply to a Government decision to make an intervention permanent?

AIST-ISA response

There are a range of powers available to the Government to provide permanent intervention as there are appeal rights to aggrieved parties. We cannot answer this question until proposals have been further developed.

31. Are there any other mechanisms that could be implemented to provide certainty around the use of the product intervention power?

AIST-ISA response

We cannot answer this question until we have a greater understanding as to what the requirements might be.

32. Do you agree with the powers applying from the date of Royal Assent? If not, please explain why with relevant examples.

AIST-ISA response

It is appropriate that the powers apply from the date of Royal Assent. The paper correctly recognises that the intervention power will only have an impact on prospective investments and as such there appears to be no grounds for the implementation of transitional arrangements.

33. What enforcement arrangement should apply in relation to a breach of the design and distribution obligations or the requirements in an intervention?

AIST-ISA response

We note that there are a range of alternative enforcement options that could be applied in the event of a breach of any new obligations. Administrative, civil, criminal penalties and injunctive relief are all options which should be available depending upon the nature and severity of the breach, the level of cooperation of the issuer and or distributor and in the case of injunctive relief, the urgency of the matter.

We cannot answer this question until we have a greater understanding as to what the requirements might be and what the outcomes of the current Government review into ASIC's enforcement regime.

34. What consumer rights and redress avenues should apply in relation to a breach of the design and distributions obligations or the requirements of an intervention?

AIST-ISA response

A consumer is not in a position to seek redress if they are unaware that there has been a breach of product design or distribution obligations. It is suggested that most consumers will be unaware of any breaches. Of those few consumers that will be aware of a breach, few will be in a position to enforce any rights that may exist. We note that the proposal paper suggests no alternation to the existing rights of consumers of financial products and merely recognises that there is currently a review regarding financial external dispute resolution mechanisms. Whilst we support enhanced consumer rights, for the purposes of these submissions, we argue that the focus should be on the obligations of product issuers and distributors and the enforcement role of ASIC. We note that the proposals paper identifies as one of the principles designing the proposals is the view that 'consumers should ultimately remain responsible for the consequences of their financial decisions'. With financial literacy levels in Australia at unacceptably low levels it is imperative that appropriate obligations are imposed upon product issuers and distributors to ensure product is not mis-sold. The clear lessons from behavioural economics are that consumers don't necessarily make financial decisions in their best interests.

Annexure A: At a glance - inconsistent treatment of choice superannuation products

This is an extract from AIST’s submission¹⁷ 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 30 June 2015, choice superannuation products cover \$904,556 million of members’ pre-retirement superannuation moneys compared with \$428,300 million in MySuper. More detail regarding these may be found in AIST’s submission.

Table 1 – Overview of exemptions from regulatory framework

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	APRA deferred collecting data for choice products/investment options for	Members rely on APRA, employers, advisers, Government, researchers,

¹⁷ AIST, (2017). *Senate Inquiry into consumer protection in the banking, insurance and financial services sector.*

Different treatment	Comments	Impact on consumers
products/investment options equivalent to the comprehensive statistical collection derived from the MySuper reporting standards.	consideration during the development of the requirements for choice dashboards.	commentators and trustees to analyse the characteristics and performance of choice 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.

Different treatment	Comments	Impact on consumers
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.	<p>Rice Warner found fees and costs for legacy products are on average more than double those for contemporary products.</p> <p>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.</p>	Members who hold legacy superannuation products will not have a dashboard, making it difficult 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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