



**ASIC**

Australian Securities & Investments Commission

**REPORT 490**

# **Response to submissions on CP 254 Regulating digital financial product advice**

August 2016

## **About this report**

This report highlights the key issues that arose out of the submissions received on Consultation Paper 254 *Regulating digital financial product advice* (CP 254) and details our responses to those issues.

### About ASIC regulatory documents

In administering legislation ASIC issues the following types of regulatory documents.

**Consultation papers:** seek feedback from stakeholders on matters ASIC is considering, such as proposed relief or proposed regulatory guidance.

**Regulatory guides:** give guidance to regulated entities by:

- explaining when and how ASIC will exercise specific powers under legislation (primarily the Corporations Act)
- explaining how ASIC interprets the law
- describing the principles underlying ASIC's approach
- giving practical guidance (e.g. describing the steps of a process such as applying for a licence or giving practical examples of how regulated entities may decide to meet their obligations).

**Information sheets:** provide concise guidance on a specific process or compliance issue or an overview of detailed guidance.

**Reports:** describe ASIC compliance or relief activity or the results of a research project.

### Disclaimer

This report does not constitute legal advice. We encourage you to seek your own professional advice to find out how the Corporations Act and other applicable laws apply to you, as it is your responsibility to determine your obligations.

This report does not contain ASIC policy. Please see Regulatory Guide 255 *Providing digital financial product advice to retail clients* (RG 255).

# Contents

<b>A</b>	<b>Overview .....</b>	<b>4</b>
	Responses to consultation.....	4
<b>B</b>	<b>Proposed guidance to assist digital advice providers .....</b>	<b>6</b>
	Regulatory guidance.....	6
	Disclosure obligations.....	8
<b>C</b>	<b>Complying with the organisational competence obligation .....</b>	<b>10</b>
	Minimum requirements for responsible managers .....	10
<b>D</b>	<b>Monitoring and testing digital advice algorithms.....</b>	<b>13</b>
	Requirements for monitoring and testing of algorithms by digital advice licensees .....	13
	Self-certification of algorithm monitoring and testing.....	14
	Third-party monitoring and testing.....	15
	<b>Appendix: List of non-confidential respondents .....</b>	<b>16</b>

## A Overview

- 1 The provision of digital financial product advice (digital advice) has grown rapidly in Australia since 2014, with a number of start-up Australian financial services (AFS) licensees and existing AFS licensees developing digital advice models. We expect this growth to continue because a number of start-up businesses have approached ASIC asking for assistance in establishing digital advice models.
- 2 In an environment where only around 20% of adult Australians seek personal financial product advice (personal advice), ASIC sees digital advice as having the potential to be an attractive, convenient and low-cost option for consumers who may not otherwise seek advice.
- 3 We have spoken with a number of AFS licensees and their authorised representatives that provide digital advice to retail clients. We have also spoken with start-up financial technology (fintech) businesses that are considering whether to become an AFS licensee or an authorised representative of an AFS licensee. From these discussions, it has become clear that industry would benefit from additional guidance that deals specifically with digital advice.
- 4 In March 2016, ASIC initiated a consultation to examine the regulatory framework for persons providing digital advice to retail clients in Australia—from the licensing stage (i.e. obtaining an AFS licence) through to the actual provision of advice.
- 5 This report highlights the key issues that arose out of the submissions received on [Consultation Paper 254 Regulating digital financial product advice](#) (CP 254) and our responses to those issues.
- 6 This report is not meant to be a comprehensive summary of all responses received. It is also not meant to be a detailed report on every question from CP 254. We have limited this report to the key issues.
- 7 For a list of the non-confidential respondents to CP 254, see the appendix. Copies of these submissions are currently on the ASIC website at [www.asic.gov.au/cp](http://www.asic.gov.au/cp) under CP 254.

## Responses to consultation

- 8 In CP 254, we consulted on a number of issues that are unique to providing digital advice compared with traditional (i.e. non-digital) financial product advice.
- 9 Specifically, we invited feedback on the proposals in CP 254 to:

- (a) release guidance—as set out in draft Regulatory Guide 000 *Providing digital financial product advice to retail clients*, attached to the consultation paper—to assist digital advice providers (i.e. persons offering personal advice to retail clients through a computer program and to whom the obligations in Div 2 of Pt 7.7A apply) in complying with the law;
- (b) require that a digital advice licensee (i.e. AFS licensee offering digital advice to retail clients) has at least one responsible manager who meets the minimum training and competence standards for advisers. To assist AFS licensees that may not have a responsible manager who meets these standards, we proposed a transition period of six months; and
- (c) issue guidance on the ways in which we think digital advice licensees should monitor and test the algorithms underpinning the digital advice being provided.

- 10 We received 38 responses to CP 254 from AFS licensees, authorised representatives, industry and professional bodies, superannuation funds, technology businesses and individuals. We are grateful to respondents for taking the time to send us their comments.
- 11 We also engaged with industry both during and after the formal consultation period to obtain more detailed feedback on some of our proposals.
- 12 In finalising our regulatory guidance, we have sought to achieve an appropriate balance between protecting consumers and facilitating business in a digital environment.
- 13 Sections B–D of this report set out the key issues raised during our consultation, and our responses to the feedback we received.
- 14 Our final policy is set out in Regulatory Guide 255 *Providing digital financial product advice to retail clients* (RG 255).

## B Proposed guidance to assist digital advice providers

### Key points

This section outlines the key issues raised in submissions on Section A of CP 254 and our responses to those issues.

It covers our proposal to release regulatory guidance—as set out in our draft regulatory guide, attached to the consultation paper—to assist digital advice providers in complying with the law.

### Regulatory guidance

- 15 In CP 254, we proposed to release a regulatory guide to assist digital advice providers in complying with the law. We sought feedback on the usefulness of our proposed guidance.

#### Our approach

- 16 While all 38 submissions received agreed that our proposed guidance was helpful, there were mixed views on whether we should be more prescriptive in our approach.

#### *ASIC's response*

Australia's financial services regulatory regime is principles based. It does not prescribe each and every step that an AFS licensee must take to comply with the law.

We consider that our regulatory guide strikes an appropriate balance between helping digital advice licensees understand and meet their regulatory obligations while providing enough flexibility to facilitate the development and growth of unique businesses.

#### Combined financial product advice model

- 17 Some respondents specifically asked us to clarify how the regulatory guide would apply to a combined financial product advice model (also known as a hybrid or bionic advice model).
- 18 A combined advice model incorporates elements of both digital advice and non-digital advice. For example, a client may start by using a digital advice tool and later be contacted by a human adviser to complete the advice process.

- 19 Respondents requested that we include an example in the guidance to illustrate how digital advice providers can comply with the best interests duty when a combined financial product advice model is used.

*ASIC's response*

We have updated RG 255 to include Example 6, which details how digital advice providers can comply with the best interests duty under a combined financial product advice model.

### **Strategic advice and scaled advice**

- 20 A number of respondents requested that we include additional examples in our guidance, including examples on how digital advice providers can provide scaled advice (i.e. personal advice that is limited in scope) and strategic advice, and examples showing the difference between personal and general advice in a digital advice context.

*ASIC's response*

We have updated RG 255 to include:

- Example 4, which shows how digital advice providers can provide strategic advice; and
- Example 5, which shows how digital advice providers can provide scaled advice digitally that is in the client's best interests.

Examples 2 and 3 in RG 255 show how general advice and personal advice can be provided digitally.

We have not included further examples showing the difference between personal and general advice in a digital advice context because we consider that our current guidance in [Regulatory Guide 244 Giving information, general advice and scaled advice](#) (RG 244) and Section B of [Regulatory Guide 175 Licensing: Financial product advisers—Conduct and disclosure](#) (RG 175) is sufficient.

### **Associated services**

- 21 Some respondents asked us to clarify whether the proposed guidance applied to businesses that provide or develop associated services—for example, third-party technology developers who outsource services to licensees, compliance specialists or actuaries.

*ASIC's response*

We have updated RG 255 to make it clear that our guidance focuses on the obligations of those providing, or wanting to provide, digital advice.

While not directly affected by our guidance, businesses that provide associated services (e.g. technology or compliance services) may also find our guidance useful.

**Filtering out clients**

- 22 In relation to digital advice providers offering scaled advice, some submissions commented that a 'triage' or filtering process may take place before clients are provided with access to a digital advice tool so that only clients for whom advice would be appropriate were given access to the tool.

*ASIC's response*

We have confirmed in RG 255 that the filtering process may take place in different ways.

For example, a digital advice tool may be offered only to clients sharing certain characteristics, or it may be offered to clients in general—with the filtering process testing, at key points in the digital advice process, whether the advice being offered is appropriate and in the best interests of the client.

**Disclosure obligations**

- 23 A small number of respondents asked us to confirm when the digital advice licensee's obligation to provide a Statement of Advice (SOA) would be triggered in situations where a client was 'playing around' and changing the variables of the digital advice tool.
- 24 The concern was that it may be difficult for digital advice providers to determine when clients had finished inputting their data into the digital advice tool. This may cause uncertainty about the point in time at which an SOA would need to be provided.

*ASIC's response*

The law is technology neutral, and the obligations applying to the provision of traditional financial product advice and digital advice are the same.

The obligation for digital advice licensees to provide an SOA is therefore the same as for AFS licensees providing traditional financial product advice. The SOA is an important document that helps a retail client understand, and decide whether to rely on, personal advice.



We will continue to engage with industry on this issue as technologies continue to evolve. In the meantime, we have provided some useful guidance in RG 255, including Example 7, which deals with one way of managing the point in time at which an SOA needs to be provided.

We also refer in RG 255 to the relevant guidance in [Regulatory Guide 168](#) *Disclosure: Product Disclosure Statements (and other disclosure obligations)* (RG 168) and [Regulatory Guide 221](#) *Facilitating digital financial services disclosures* (RG 221) on good disclosure principles. The requirement for disclosure to be clear, concise and effective applies equally to digital disclosure, and our good practice guidance is aimed at helping to ensure that retail clients receive clear, concise and effective information when disclosure is delivered digitally.

## C Complying with the organisational competence obligation

### Key points

This section outlines the key issues raised in submissions on Section B of CP 254 and our responses to those issues.

It covers our proposals:

- to require that a digital advice licensee has at least one responsible manager who meets the minimum training and competence standards for advisers; and
- to allow a transition period of six months to assist existing AFS licensees that may not have a responsible manager who meets these standards.

### Minimum requirements for responsible managers

- 25 For digital advice licensees to meet the organisational competence obligation in [Regulatory Guide 105 Licensing: Organisational competence \(RG 105\)](#), we proposed in CP 254 that a digital advice licensee has at least one responsible manager who meets the training and competence standards for advisers. This will ensure that at least one responsible person within a digital advice licensee holds this level of competence.

#### Training and competence standards for advisers

- 26 The submissions received were largely supportive of the proposal to require that a digital advice licensee has at least one responsible manager who meets the training and competence standards.
- 27 However, a few respondents highlighted that this proposal was inconsistent with the guidance in RG 105. Respondents that disagreed with our proposal stated that the obligations in RG 105 should apply equally to digital advice licensees.
- 28 In contrast, several submissions supporting the proposal suggested that more than one responsible manager of a digital advice licensee should meet the minimum training and competence standards.

*ASIC's response*

It is important that the provision of digital advice does not result in a lessening of standards. If we do not require a digital advice licensee to have at least one responsible manager that meets the training and competence standards, it is possible that no one in a digital advice licensee will have practical, day-to-day knowledge of the advice process.

We have therefore retained the guidance in RG 255 that at least one responsible manager of a digital advice licensee must meet the minimum training and competence standards for advisers.

**Six-month transition period**

- 29 In CP 254 we proposed a transition period of six months to assist existing AFS licensees that may not have a responsible manager who meets the minimum training and competence standards.
- 30 Respondents were generally supportive of our proposal to allow for a transition period, although some respondents suggested that the proposed six-month transition period would be too short in an environment where the training and competence standards are likely to be raised. A number of respondents suggested that a transition period of 12 to 18 months would be a more reasonable timeframe.

*ASIC's response*

In most cases, existing AFS licensees will already meet the organisational competence obligation by having at least one responsible manager who meets the training and competence standards for advisers.

In a small number of instances, however, a licensee may not have a responsible manager who meets these standards because the responsible manager was previously able to demonstrate their competence under RG 105 by showing they had the relevant experience over the previous 10 years.

At the time of drafting CP 254, the Corporations Amendment (Professional Standards of Financial Advisers) Bill 2015 was due to be passed by Parliament. These reforms have since been delayed as a result of the federal election. The concerns about having insufficient time to comply with the new training and competence standards have therefore been reduced.

We think that there is a need to assist digital advice licensees that may not have a responsible manager who meets the current training and competence standards, and we consider that a transition period of six months is appropriate.

[Consultation Paper 260](#) *Further measures to facilitate innovation in financial services* (CP 260) currently contemplates an alternative method for small-scale businesses to comply with their organisational competence obligation, where these businesses only provide specified financial services to no more than 1,000 clients. We encourage digital advice providers who fall into this category to contact us through ASIC's [Innovation Hub for fintech businesses](#).

Following the six-month transition period, we will require all digital advice licensees to have at least one responsible manager who meets the minimum training and competence standards.

## Technological expertise

- 31 A few respondents suggested that we should clarify the level of technological competence required for responsible managers of digital advice licensees. Some respondents suggested that we should require digital advice licensees to appoint at least one responsible manager with appropriate expertise in technology.

### *ASIC's response*

We have not prescribed the level of technological training and competence required for responsible managers of digital advice licensees.

Many AFS licensees use technology as part of their process of providing financial services. Similar to other AFS licensees, we consider that digital advice licensees should have adequate human resources in place.

Digital advice licensees should ensure that there are people within the business who have a general understanding of the technology and algorithms used to provide digital advice, and who are able to review the digital advice generated by algorithms.

We have therefore maintained the proposed approach in our guidance.

## D Monitoring and testing digital advice algorithms

### Key points

This section outlines the key issues raised in submissions on Section C of CP 254 and our responses to those issues.

It covers our proposal to issue guidance on the ways in which we think digital advice licensees should monitor and test the algorithms underpinning the digital advice being provided.

### Requirements for monitoring and testing of algorithms by digital advice licensees

- 32 In CP 254 we sought feedback on the level of detail required in our guidance on the ways in which we think digital advice licensees should monitor and test the algorithms underpinning the digital advice being provided.
- 33 Overall, the feedback received was mixed. Some respondents submitted that there should be no further detail in the guidance on the ways in which digital advice licensees should monitor and test their algorithms. However, several respondents supported the view that we should be more prescriptive in our requirements for monitoring and testing of algorithms by digital advice licensees.

#### *ASIC's response*

We consider that we have struck an appropriate balance between protecting consumers and facilitating business in the context of an increasingly digital environment.

### Record keeping

- 34 Some respondents asked us to clarify the obligation for digital advice licensees to control, monitor and reconstruct any changes to algorithms over a seven-year timeframe. Some respondents suggested that it would be costly and unnecessary to require digital advice licensees to reconstruct former versions of algorithms.

#### *ASIC's response*

In response to this feedback, we have clarified in RG 255 that digital advice licensees are required to keep records describing any changes made to algorithms over the past seven years, but not to reconstruct a former version of the algorithm.

## Reviewing digital advice

- 35 A few respondents suggested that we clarify our statement that digital advice should be reviewed by a human adviser for compliance with the law. Some submissions suggested that we amend the word ‘adviser’ or provide examples of other qualified people who can conduct advice reviews.

### *ASIC’s response*

We have removed the word ‘adviser’ from the relevant guidance in RG 255 to clarify that we do not expect digital advice to be reviewed only by financial advisers.

We recognise that other suitably qualified professionals can also review the digital advice provided.

## Self-certification of algorithm monitoring and testing

- 36 In CP 254 we sought feedback on whether ASIC should introduce a self-certification requirement that would require digital advice licensees to certify that their algorithms had been adequately monitored and tested.
- 37 We stated that self-certification may provide ASIC and the market with an additional level of assurance that a digital advice licensee’s algorithms have been properly monitored and tested, and that the licensee has the adequate organisational and technological resources to manage the algorithms. Self-certification would, however, increase the administrative burden on digital advice licensees.
- 38 The feedback from submissions received indicated that views on imposing a self-certification requirement are mixed.
- 39 Some submissions stated that a self-certification requirement would add no value in assessing the quality of digital advice provided. In addition, some submissions noted that, if a self-certification requirement were to be imposed, it should apply to all AFS licensees equally and not just to digital advice licensees. A few respondents commented on the additional costs that would be imposed on digital advice licensees where a self-certification requirement was imposed.
- 40 In contrast, some respondents submitted that a self-certification requirement would be appropriate in a digital advice context, and that the requirement could be imposed as an AFS licence condition or as part of an AFS licensee’s annual audit reviews.

### *ASIC’s response*

We think that self-certification is likely to result in an additional burden on industry without necessarily providing a corresponding regulatory benefit.

## Third-party monitoring and testing

- 41 In CP 254 we sought feedback on whether we should require digital advice licensees to engage an independent third party to monitor and test their algorithms. We also consulted on the circumstances in which independent third-party monitoring and testing would be warranted.
- 42 Many submissions did not agree that digital advice licensees should be required to engage an independent third party to monitor and test their algorithms.
- 43 Many respondents stated that imposing such a requirement would be costly and that the decision to engage an independent third party should be left to the digital advice licensee. Respondents also suggested that requiring digital advice licensees to engage an independent third party would impose additional costs on start-up businesses which may hinder their ability to compete with larger, more established digital advice businesses.
- 44 A few respondents, including actuaries and technology companies, supported the view that digital advice licensees should be required to engage an independent third party to monitor and test their algorithms, especially if the algorithms have been developed in-house. These respondents suggested that digital advice licensees should seek the assistance of an independent third party where they do not have the necessary skills in-house or where the algorithm and ultimate advice are more complex in nature.

### *ASIC's response*

We agree with the majority of submissions received that requiring digital advice licensees to engage an independent third party to monitor and test their algorithms would be overly burdensome and may be prohibitively costly.

## Intellectual property rights

- 45 A number of submissions, including industry bodies, commented further on the commercial sensitivities relating to intellectual property rights that third-party technology developers may have in communicating their underlying algorithms to digital advice licensees.

### *ASIC's response*

Digital advice licensees should have appropriate commercial arrangements in place with third-party technology providers to enable licensees to have a working understanding of the underlying algorithms. We do not propose to otherwise comment on these arrangements as these are commercial decisions for each licensee.

## Appendix: List of non-confidential respondents

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- Actuaries Institute of Australia
  - Adviser Network Pty Ltd
  - Association of Financial Advisers Ltd (AFA)
  - Association of Securities & Derivatives Advisers of Australia Ltd (ASDAA)
  - Association of Superannuation Funds of Australia (ASFA)
  - Australian Bankers' Association Inc. (ABA)
  - AustralianSuper Pty Ltd
  - Decimal Pty Ltd
  - Doug Clark Consulting (Douglas Clark)
  - Financial Ombudsman Service Australia (FOS)
  - Financial Planning Association of Australia (FPA)
  - Financial Services Council (FSC)
  - FinTech Australia
  - IG Markets Limited
  - Ignition Wealth Pty Ltd
  - Industry Super Australia Pty Ltd (ISA)
  - Insurance Australia Group Limited (IAG)
  - Investfit
  - Johnson Winter & Slattery
  - KPMG
  - Map My Plan Pty Ltd
  - Mercer Consulting (Australia) Pty Ltd
  - MIntegrity
  - National Insurance Brokers Association of Australia (NIBA)
  - QSuper
  - Retail Employees Superannuation Trust (REST)
  - Rubik Group Services Pty Ltd
  - Setchell, Mark
  - SuperEd Pty Ltd
  - Towers Watson Australia Pty Ltd
  - Westpac Banking Corporation
  - Wright, Jeremy

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Note: ASIC received six confidential submissions.