ASIC
Australian Securities & Investments Commission

REPORT 351

Response to submissions on CP 176 Review of ASIC policy on platforms: Update to RG 148

June 2013

About this report

This report highlights the key issues that arose out of the submissions ASIC received on Consultation Paper 176 *Review of ASIC policy on platforms: Update to RG 148* (CP 176) and further targeted consultation, and outlines 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 148 *Platforms that are managed investment schemes* (RG 148).

Contents

A Overview/Consultation process

1 In Consultation Paper 176 *Review of ASIC policy on platforms: Update to RG 148* (CP 176) we consulted on proposals to update and revise our guidance in Regulatory Guide 148 *Investor directed portfolio services* (RG 148).

2 We chose to review our policy on platforms due to the significant growth and change in the sector since the original release of RG 148, and our recognition of the corresponding need to update our guidance.

3 This report is not intended to be a comprehensive summary of all responses received. It is also not meant to be a detailed report on every question from CP 176. We have limited this report to the key issues.

Responses to consultation

4 We received nine responses to CP 176 from platform operators and industry associations (including one consumer representative group). We are grateful to respondents for taking the time to send us their comments.

5 This report highlights the key issues that arose out of the submissions received on CP 176, and our responses to those issues. Feedback received on CP 176 and further consultation with industry was used to finalise our revised policy, which is published in the updated RG 148. Where relevant, this report explains where we have modified key aspects of the policy proposed in CP 176 and undertaken further targeted consultation in producing our final guidance.

> Note: RG 148 has been renamed *Platforms that are managed investment schemes*; it was previously called *Investor directed portfolio services*.

6 Generally, respondents were supportive of the need to revisit our guidance on platforms and strengthen the capacity of platform operators. However, some respondents had concerns with some aspects of the proposed guidance, particularly those aspects addressing rights of investors when they invest through a platform. We have revised our guidance taking into account some of these concerns. These matters are included in Sections B, C and D of this report.

7 For a list of the non-confidential respondents to CP 176, see the appendix of this report. Copies of the submissions are on our website at www.asic.gov.au/cp under CP 176.

B Requirements for operating a platform

Key points

This section outlines the key issues covered in submissions received on CP 176 about operating platforms, and our responses to those issues.

It covers:

- RG 148 and class orders;
- managing conflicts of interest;
- portability obstacles;
- proposed continuing guidance and class orders, and proposed changes to our regulatory approach;
- financial requirements for investor directed portfolio service (IDPS) operators;
- corporate structure requirements for IDPS operators;
- voting rights for platform investors; and
- implications for platform investors who do not opt in to continuing to receive financial product advice.

RG 148 and class orders

8 The stakeholder engagement that we undertook before the release of CP 176 indicated a sound awareness, understanding and application of our current regulatory approach to platforms. Given the absence of any significant failures of platform operators, we proposed to continue to regulate platforms through RG 148 and accompanying class orders. We recognised the need to review our approach and adopt different or improved regulatory approaches to address existing and emerging issues in the sector, and proposed to update our approach accordingly.

9 Our review has included reviewing our regulatory approach to platforms, strengthening requirements for operating platforms, promoting informed investor decision making about using platforms, enhancing investor rights in platforms, and considering an implementation and transition period for new and existing platform operators.

10 Generally, respondents agreed with the approach of continuing to regulate platforms under RG 148 and class orders, and welcomed the intention to continue regulating the platforms sector in this way and reviewing RG 148 and the class orders.

11 Some respondents noted that, in the medium to longer term, class orders should be replaced by legislation that recognises the unique characteristics of

platforms. This would be particularly beneficial from a consistency perspective as reforms reach beyond financial services into other areas such as taxation. In addition, some respondents indicated that some proposals in CP 176 cannot be adopted without legislative change.

ASIC's response

We will continue to regulate the platforms sector through a revised RG 148 and accompanying class orders, which take into account existing and emerging issues in this developing and expanding sector.

Managing conflicts of interest

12 In CP 176 we did not propose to provide specific guidance to platform operators and licensed dealer groups and their associated advisers on how to meet their obligation to have adequate arrangements in place to manage conflicts of interest.

13 We noted that we would review this position in light of the Future of Financial Advice (FOFA) reforms.

14 Generally, respondents were supportive of this approach and considered existing obligations supplemented by legislative reforms as an adequate means of addressing the management of conflicts of interest.

15 In light of the FOFA reforms being passed in legislation and subsequent targeted consultation with industry, we have proposed providing specific guidance to platform operators about meeting their obligation to manage conflicts of interest as it relates to relationships between entities in the product distribution chain. Our targeted consultation indicated that the nature of relationships between entities is currently disclosed in disclosure material and any additional specific disclosure may result in an unlevel playing field.

ASIC's response

In light of the FOFA reforms being passed in legislation, we will give specific guidance on the Australian financial services (AFS) licensee obligation to manage conflicts of interest as it applies to platform operators.

This guidance will complement our more general guidance in Regulatory Guide 181 *Licensing: Managing conflicts of interest* (RG 181) and set out our expectations about disclosure of relationships between entities in the product distribution chain and benefit flows between these entities.

Portability obstacles

16 In CP 176 we did not propose to address portability obstacles in platforms as they affect platform operators, partly because of the ongoing consideration the Australian Government is giving to product rationalisation in the managed investments and life insurance markets.

17 Most respondents stressed the importance of addressing this issue. They submitted that it has the potential to disadvantage existing and future investors, and subject the sector to unnecessary inefficiencies due to the difficulty for platform operators to facilitate investor access to improved technology and the costs incurred by investors in the maintenance of legacy platforms.

18 Respondents also noted that addressing the issue would assist financial advisers in their analysis and reporting to investors, resulting in more affordable advice.

ASIC's response

We appreciate the strong views from respondents urging reform in this area.

However, given the ongoing consideration the Australian Government is giving to product rationalisation, we do not propose to address this issue. We will write to Treasury emphasising the concerns raised and suggesting that law reform be pursued.

Proposed continuing guidance and class orders, and changes to our regulatory approach

19 As a result of the sound awareness, understanding and application of our regulatory guidance within the industry, we proposed to retain key aspects of our current regulatory approach to platforms, including:

(a) continuing relief from the requirement for IDPSs to be registered managed investment schemes;

(b) continuing to require Product Disclosure Statements (PDSs) for IDPS-like schemes;

(c) continuing to require that platform investors have access to the same standards of information about products available through platforms that they would have had if they were acquiring those products directly; and

(d) requiring that recommendations to use a platform will be treated as financial product advice.

Note: For further details of the elements we proposed to retain, see Table 1 in CP 176.

20 Respondents generally agreed with the retention of key elements of our regulatory approach.

21 One respondent suggested the removal of the requirement that IDPS investors can only be given accessible securities available for issue if:

(a) the issuer has authorised the IDPS operator to use the prospectus as the disclosure document given to IDPS investors;

(b) it is a rights issue; or

(c) a prospectus would not be required for a direct acquisition.

The respondent suggested that platform operators should instead be able to notify the product issuer that the securities are being acquired by a platform, which would then trigger the product issuer's existing obligation to notify the operator if the prospectus is supplemented, replaced, withdrawn or defective.

22 In CP 176 we also proposed certain changes to our regulatory approach, primarily concerning disclosure and operating requirements. Some of these proposed changes included:

(a) replacing specific content requirements for IDPS Guides with a general obligation to disclose and present content in a clear, concise and effective manner;

(b) allowing IDPS Guides to incorporate information by reference;

(c) allowing platform operators to give investors documents electronically; and

(d) the removal of automatic loss of relief in the event of contravention of a condition of relief in certain circumstances.

Note: For further details of our proposed changes, see Table 2 in CP 176.

23 Respondents were broadly supportive of the proposed changes to our regulatory approach in CP 176.

24 One respondent noted that the disclosure of fees and costs of platforms should also extend to include arrangements between product issuers and platform operators (e.g. preferred partnership plans). The respondent noted that these arrangements have the potential to distort the product offer menu due to the commercial benefits attributable to the platform operator.

25 Respondents also noted that further clarity was needed around whether an investor must be given a document, or whether electronic access to a document was sufficient. They affirmed that any such measures should be applicable to superannuation platforms.

ASIC's response

We have reaffirmed our guidance and accompanying class order requirements on a number of key elements of our regulatory approach. We do not intend to alter the primary foundations on which that regulatory approach has been established.

We have revised our guidance on various issues to account for existing and emerging issues in the platforms sector, including aligning our regulatory approach with current requirements in the *Corporations Act 2001* (Corporations Act)—for example, allowing incorporation by reference in IDPS Guides, allowing platform operators to give documents electronically on an opt-in basis, and applying significant breach reporting obligations on IDPS operators.

Financial requirements

26 In CP 176 we proposed to align the financial requirements for IDPS operators with those that apply to responsible entities from 1 November 2012. Among other things, this would require the IDPS operator to:

(a) prepare 12-month cash flow projections approved by directors at least quarterly;

(b) meet new net tangible asset (NTA) requirements (including where custodial functions are performed); and

(c) comply with new liquidity requirements.

27 Our rationale for this proposal was to ensure that IDPS operators have adequate resources and financial capacity to conduct their financial services businesses.

28 Respondents were generally supportive of the principle of requiring IDPS operators to maintain sufficient capital.

29 One respondent noted concern that dealer groups would seek product revenue as a result of the ban on conflicted remuneration. The respondent therefore submitted that the barriers to entry should be raised.

30 Another respondent was concerned that imposing the NTA requirement of 0.5% of the average value of property held or acquired by the IDPS operator would lead to additional costs on wholesale platforms, which would ultimately be passed on to investors.

31 In further tailored consultation, industry did not raise objections to amending the definition of 'revenue', nor to imposing a tailored audit requirement to account for any change in the financial requirements.

ASIC's response

We will impose the same financial requirements on IDPS operators as those that apply to responsible entities. In imposing new financial requirements, we will apply a definition of 'revenue' where the revenue of the AFS licensee includes the revenue of any person involved in performing functions forming part of the IDPS for which that operator is responsible to clients for providing those services.

In addition, to account for the change in financial requirements, we will impose a tailored audit requirement.

IDPS operators that were licensed to operate an IDPS before 1 July 2013 have until 1 July 2014 to meet the new financial requirements. IDPS operators that are licensed to operate an IDPS on or after 1 July 2013 will be required to meet the new financial requirements.

Corporate structure requirements

32 In CP 176 we proposed that an IDPS operator must be a public company. This was to promote greater transparency, stronger governance and financial accountability, and enhanced confidence within the platforms sector.

33 Respondents were supportive of the proposal, stating that it would lead to a level playing field with increased transparency and accountability.

ASIC's response

We will require IDPS operators to be public companies as responsible entities of IDPS-like schemes are required to be.

Voting rights

34 In CP 176 we proposed that IDPS operators who are responsible for transactional functions must have in place a voting policy for company and scheme resolutions and other corporate actions. Under this policy, IDPS operators would have to take reasonable steps to obtain investor instructions about the exercise of voting rights for company or scheme resolutions in relation to assets held through the IDPS, and act on those instructions.

35 There was strong opposition to this proposal from most respondents. Respondents stated that there is no practical or scalable way to disaggregate pooled holdings and enable investors to make individual elections for resolutions. They submitted that changes to the law would be required because, typically, product issuers do not facilitate voting by custodians

where custodians may split their vote. Extensive technology costs would also be required.

36 One respondent considered that investors would have better transparency over the shares in which they have beneficial ownership where these shares are held under a custodial account.

37 In subsequent tailored consultation, where we proposed a more flexible approach—requiring a voting policy to be in place and disclosed without mandating the provision of voting rights to platform investors—greater comfort was expressed.

ASIC's response

Although we will not be pursuing our proposal for IDPS operators to take reasonable steps to give investors the opportunity to exercise voting rights, we will require platform operators to have a voting policy in place and to disclose that policy to investors in the IDPS Guide or PDS (as relevant).

For IDPSs, if investors have the right to vote under the voting policy, we will require IDPS operators to take all reasonable steps to ensure votes attaching to financial products held for the investor are cast in accordance with any directions received from the investor and not otherwise.

We will require that IDPS operators disclose in the IDPS Guide that voting rights are not available through a consumer warning, and seek an acknowledgement from the investor in the application form that they are aware they do not have voting rights in respect of investments held within the platform where that is the case.

Implications for investors who do not opt in to continuing to receive advice

38 In CP 176, we did not seek feedback on areas of our regulatory approach to platforms that are directly related to the FOFA reforms.

39 We noted that we would consider how these reforms may affect our final regulatory approach to platforms after legislation is passed and further consultation with industry.

40 Generally, respondents acknowledged that the FOFA reforms will have a significant impact on the platforms sector. One submission noted that the matters that related to FOFA reforms in CP 176 ought to be deferred for consideration when the FOFA legislative package is enacted.

41 In subsequent tailored consultation with industry and in light of the FOFA reforms being passed in legislation, we proposed allowing platform investors

direct access to their investments when the investor discontinues the use of an adviser. Industry noted that such a proposal would have significant challenges, given not all platforms have this functionality or could build it and, if they could build it, significant IT and other costs would be involved. Costs may be prohibitive for some parts of the industry, or in the vicinity of $8–$12 million for other parts of the industry, to implement such a proposal.

ASIC's response

ASIC's primary regulatory guidance on the FOFA reforms has been developed separately.

However, in light of the FOFA reforms being passed in legislation, we will require platform operators to have in place a policy on how to deal with investors who do not opt in to continue to receive financial product advice, including how investor access to their investment is addressed. We will require that the IDPS Guide or PDS (as relevant) should disclose the implications of not choosing to use an adviser and whether this will affect the investor's ability to continue to use the platform and invest through the platform, as well as how their investment will be affected as a result.

We will also provide good practice guidance that platform investors be allowed to use any adviser (not only permitted advisers) and, where they do not opt in to continue to receive financial product advice, be allowed to have direct access to manage their investments, with key messages that we will review the industry landscape, in three to five years, to assess industry's adoption of this practice.

C Disclosure obligations

Key points

This section outlines the key issues covered in submissions received on CP 176 about the disclosure obligations of platform operators, and our responses to those issues.

It covers:

- disclosure about selection of investments;
- cooling-off rights of investors;
- withdrawal rights of investors; and
- dispute resolution and compensation available to investors.

Disclosure about selection of investments

42 In CP 176 we proposed that:

(a) platform operators disclose in their IDPS Guide or PDS (as relevant) how they select financial products for inclusion on investment menus or in model portfolios; and

(b) licensed dealer groups and their adviser representatives consider investment selection processes of platform operators when providing personal financial product advice to investors about the use of a platform.

43 The majority of respondents were supportive of the proposal, stating that it would lead to increased transparency and certainty for consumers.

44 One respondent submitted that the proposal should extend to partnership plans and other rebates. The respondent was concerned that investors may not be aware of the commercial relationships between platform operators and product issuers, and would therefore lack visibility of the resulting influence this may have on product selection. The process for choosing affiliated products over other products should therefore be clearly disclosed.

45 Some respondents submitted that the onus should remain on dealer groups and advisers to conduct due diligence on platforms and their underlying investments. They submitted that it is not the role of platform operators to make recommendations regarding the quality of financial products available through investment menus.

ASIC's response

We will require platform operators to disclose in their IDPS Guide or PDS (as relevant) how they select financial products for inclusion on investment menus or in model portfolios.

We will also provide guidance on the disclosure of the process involved in choosing products that are issued by or associated with the platform operator or its related bodies corporate, and whether a review of the investment policy is a material change and would require a supplementary IDPS Guide or PDS to be issued.

In addition, we expect licensed dealer groups and their adviser representatives to consider investment selection processes when recommending the use of one platform over another platform, or the use of any platform at all.

Cooling-off rights

46 In CP 176 we proposed that platform operators provide cooling-off rights as if the investor were acquiring the financial product directly.

47 Some respondents raised concerns about the ability of platforms to offer cooling-off rights for practical and legal reasons. For example, the platform operator would need to have a corresponding legislative right against the underlying product issuer, which would require legislative change. In addition, cooling-off rights can generally only be exercised for an entire holding and the law would not currently facilitate a wholesale investor custodian exercising cooling-off rights for part of their holding.

48 Respondents also indicated that, if the proposal were implemented, the corresponding benefit would be marginal, with little meaningful exercising of these rights by platform investors.

49 However, there was some expression of support for the principle that a consumer should have the means to withdraw from an investment if they believed it was unsuitable for them.

50 In subsequent tailored consultation, we sought feedback on whether these rights could be provided contractually, and were advised that this would be impractical and cost prohibitive to implement, with implementation and ongoing operational cost implications for both platform operators and product issuers.

ASIC's response

We will not require that platform investors be given access to statutory cooling-off rights.

However, platform operators will be required to disclose expressly to investors that cooling-off rights are not available when they invest through a platform rather than acquiring the financial product directly.

In addition, the IDPS Guide or PDS (as relevant) must contain disclosures setting out the key differences between investing through a platform and direct investment in financial products through a consumer warning, including a statement that statutory cooling-off rights are not available.

We will also require that the application form for investment through a platform include an acknowledgement by the investor that they have been informed, and understand, that they do not have statutory cooling-off rights for financial products acquired through the platform.

Withdrawal rights

51 In CP 176 we proposed that platform investors should have withdrawal rights for investments acquired through platforms where disclosure becomes defective before issue and where a product issuer provides notification of an option to withdraw under the Corporations Act.

52 Respondents were generally supportive of this proposal, provided that the obligation is also imposed on the relevant product issuer.

53 In subsequent tailored consultation with industry, we sought feedback on whether these rights could be provided contractually, and were advised that this would be impractical and cost prohibitive to implement, with implementation and ongoing operational cost implications for both platform operators and product issuers.

ASIC's response

We will not require investors in platforms to be given access to withdrawal rights because imposing the obligation on the underlying product issuer may effectively prevent netting of transactions by the custodian and alter the operating business model of most custodians.

Instead, we will require platform operators—through a consumer warning—to make clear and prominent disclosure that withdrawal rights for financial products acquired through platforms may not be available when disclosure for those investments (in a PDS or disclosure document) becomes defective before issue. We will also require that the application form for investment through a platform include an acknowledgement by the investor that they have been informed, and understand, that they do not have withdrawal rights for financial products acquired through the platform.

> In addition, we will set out our expectation that platform operators performing transactional functions and responsible entities of IDPS-like schemes should, where practicable, ensure that notification of any option to withdraw is communicated to investors no later than five days from when received, give investors access to any supplementary or replacement disclosure and inform them of how it may be accessed, and act on investors' instructions as to how to exercise the option (if desired) and allocate any withdrawal pro rata if necessary.

Dispute resolution and compensation

54 In CP 176 we proposed that platform investors should have access to a product issuer's internal and external dispute resolution system, and that platform operators must include a statement in their disclosure documents about who investors can contact about different types of complaints.

55 We also sought feedback on whether the requirement on licensed product issuers (providing financial services to retail clients) to have adequate compensation arrangements for liabilities be extended to the liabilities of platform operators (or their appointed custodians) as if they were retail clients.

56 Respondents were generally supportive of the proposed approach to dispute resolution, although noted the limitations of product issuers that have determined their commercial offering in dealing with platforms as wholesale clients.

57 There was a suggestion that ASIC provide more clarity around whether the expectation is that only a product issuer's contact details need to be provided or whether the platform operator must establish a system linking the product issuer customer service units and systems.

58 Another respondent was supportive, provided legislation imposes a suitable corresponding obligation on the issuer of the financial product.

59 Two submissions provided feedback on the extension of compensation arrangements. One provided support and the other did not consider such requirements warranted.

60 In subsequent tailored consultation with industry, we were advised that costs may be incurred by product issuers with wholesale client authorisations that need to obtain professional indemnity insurance cover to meet any revised policy.

ASIC's response

We will allow platform investors to have access to a product issuer's internal dispute resolution processes as if they were a direct investor in the product where the product issuer consents to doing so.

We will also require platform operators to make clear and prominent disclosure about who investors may complain to about different types of complaints, and to take reasonable steps to facilitate dispute resolution between platform investors and product issuers.

At this stage, and pending further consideration, we will not require product issuers to provide access to external dispute resolution schemes, nor extend adequate compensation arrangements (including professional indemnity insurance) to platform investors as if they were a direct investor in the product.

D Implementation and transition period

Key points

This section outlines the key issues covered in submissions received on CP 176 about implementation and a transition period, and our response to that issue.

61 In CP 176 we proposed that new platform operators comply with any revised guidance and accompanying class orders from the date on which that guidance is released.

62 For established operators, we proposed staged transition periods. Specifically, established IDPS operators providing transactional functions would need to comply with any revised financial requirements from 1 November 2012 and any other revised operating requirements by 1 January 2013, and other established operators would need to comply by 1 July 2013.

63 Respondents were generally supportive of this approach, although some were of the view that compliance for all operators should be aligned and that at least 12 months should be allowed for transition.

ASIC's response

Our position on implementation and the transition period is that the effective date for compliance with our revised guidance and class orders will be the same for all platform operators that were licensed to operate a platform before 1 July 2013. These platform operators will have until 1 July 2014 to comply with the revised requirements, to allow sufficient time for implementation of the revised requirements.

New platform operators (i.e. those that are licensed to operate a platform on or after 1 July 2013) will be required to comply with our revised guidance and class orders from 1 July 2013.

Appendix: List of non-confidential respondents

- AMP Financial Services
- Australian Custodial Services Association
- BT Financial Group (a part of The Westpac Group)
- Financial Planning Association of Australia
- Financial Services Council Ltd
- National Information Centre on Retirement Investments Inc
- TAL Limited
- Vanguard Investments Australia Limited
- Wealthcare Custodians Ltd