

16 May 2016

Ms Brooke Stewart
Senior Analyst
Financial Advisers
Australian Securities and Investments Commission

By email: brooke.stewart@asic.gov.au

Dear Ms Stewart,

RE - Consultation Paper 254: Regulating digital financial product advice

Thank you for offering an opportunity to comment on this Consultation Paper 254: '**Regulating digital financial product advice**' ("CP254"). This submission is made on behalf of MIntegrity, a specialist regulatory consulting firm that works collaboratively with market participants, operators and regulators to raise integrity standards across the industry (www.mintegrity.com.au).

Our submission, as outlined in the table in Appendix 1, provides comments that are designed to help ASIC in developing appropriate policies as they relate to the provision of digital financial product advice to retail clients. In particular, we have attempted to include where appropriate information relevant to compliance costs, impacts on competition and also other impacts, costs and benefits.

MIntegrity would welcome an opportunity to provide ASIC with further information around the proposals that have been presented in CP254 and we look forward to further consultation with the industry where necessary.

Yours sincerely,

Andrew Tait

Co-founder | Director | MIntegrity

Appendix 1:

Table: MIntegrity - CP254 Comments

ASIC Proposal	Question	Response
<p>A1 We propose to release draft Regulatory Guide 000 Providing digital financial product advice to retail clients (RG 000) to assist digital advice providers in complying with the law.</p>	<p>A1Q1 Overall, is the proposed guidance helpful? If not, why not?</p> <p>A1Q2 Is our proposed guidance (in Section D of the draft regulatory guide) helpful in assisting digital advice providers to provide scaled advice that is in the best interests of clients? If not, why not?</p>	<p>A1Q1 Yes we believe that ASIC has provided clear and relevant guidance in the proposed Regulatory Guide. We have set out some feedback below that we believe will further help the industry to responsibly implement the provision of digital financial advice in Australia.</p> <p><i>Retail and Wholesale clients</i></p> <p>We suggest that independent reviews are necessary to validate the information provided by clients online. Given the reliance on clients' answers to a set of questions, in distinguishing retail from wholesale clients, a review by the Responsible Manager of an appropriate sample of clients' answers would help to ensure that digital financial advice is not being erroneously provided to a wholesale client. The proposed Regulatory Guide is currently silent on this issue. We suggest that disclosures are made up front in the digital advice model making it clear that digital financial advice is only permissible for retail clients.</p>

		<p><i>Digital devices used by clients</i></p> <p>We suggest that ASIC considers adding guidance on the presentation of disclaimers and disclosures given the variety of devices used by retail clients in the current market. Smartphones and ipads carry the biggest risk in terms of misleading and deceptive presentation. RG 000.89 sets out some guidance about the delivery of the advice but the format of the advice could be covered here in relation to scaled advice specifically where a small screen precludes full information on one page or splitting of information that may be perceived in a manner not intended by the licensee.</p> <p>Formatting and appropriate font size as well as ensuring that the message is not lost where the client has to scroll through multiple pages to receive the same message as one full screen of a standard PC screen. These considerations would help to satisfy the best interests duty and related obligations and ASIC may wish to provide examples to guide the industry.</p> <p>A1Q2 Yes. However we consider that for personal advice that is scaled, RG 000.94 and RG 000.95 refer to filtering out clients for which the scaled personal advice is not</p>
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		<p>appropriate. It would assist the industry if ASIC includes examples of questions and answers that may indicate that the advice is not appropriate.</p> <p><i>Decision tree records of questions and sample monitoring</i></p> <p>We believe that digital advice licensees are best advised to retain a working copy of the key questions and decision tree pathways in place to detect scenarios where scaling is inappropriate. Sample monitoring coordinated by the Responsible Manager of the licensee would help to detect and preclude non-compliance.</p> <p><i>Data</i></p> <p>We suggest that issue management and incident management processes would bolster the current RG 000.69.</p> <p>We suggest that ASIC could add encryption of personal information into RG 000.64 as best practice given the Privacy Act requirements.</p> <p><i>A1Q2 "Better Position"</i></p> <p>We request clarification of the term 'better position' in relation to the provision of scaled advice (in paragraph 90 of CP 254). We consider this paragraph should be amended so that better position is in reference to the scope of the advice only.</p>
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<p>B1 We propose to require that a digital advice licensee has at least one responsible manager who meets the minimum training and competence standards for advisers.</p> <p>To assist existing AFS licensees that may not have a responsible manager who meets these standards, we propose a transition period of six months.</p> <p>Note: See RG 000.44–RG 000.51 of</p>	<p>B1Q1 Do you agree with this proposal? Please provide supporting arguments.</p> <p>B1Q2 Do you agree that, if the changes proposed in the Corporations Amendment (Professional Standards of Financial Advisers) Bill 2015 become law, at least one responsible manager should:</p> <p>(a) meet the new higher training and competence standards (i.e. have a degree or equivalent, pass an exam, complete a professional year and undertake continuing professional development); and</p> <p>(b) comply with the</p>	<p>B1Q1 We agree with this proposal in respect of personal advice. The professional standards and educational requirements of a Responsible Manager are required in the provision of digital personal financial advice, as any other financial adviser providing personal advice. However we do not consider that this requirement should strictly apply to general advice on Tier 2 products and could be left to the discretion of the licensee. In many cases very senior financial advisers do not keep up to date with the minimum training and competence standards for advisers even though they are registered financial advisers and possess the expertise necessary.</p> <p>B1Q1 RG 000.52 sets out the general obligation for an AFS licensee to manage conflicts of interest. We suggest that ASIC could provide an example of effectively managing a conflict of interest between a Responsible Manager and a client in the recommendation of a product. Principles of avoiding, managing and disclosing a conflict may be helpful to industry.</p> <p>B1Q2 Yes. However please refer to answer to B1Q1 above in relation to digital financial general advice.</p> <p>B1Q3 No. There should be at least one Responsible Manager approving the digital advice framework and this individual should meet all the requirements that are expected of a financial adviser providing personal advice.</p> <p>B1Q4 Existing licensees would require a transition period of up to 18 months to meet the new professional standards. The extent of the training, availability of suitable training</p>
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<p>the draft regulatory guide for more details.</p>	<p>proposed ethical standards (i.e. comply with a code of ethics and be covered by an approved compliance scheme)?</p> <p>B1Q3 Are there any aspects of the proposed higher training and competence standards in the Corporations Amendment (Professional Standards of Financial Advisers) Bill 2015 that should not apply to at least one responsible manager of a digital advice licensee?</p> <p>B1Q4 Is the proposed transition period of six months long enough for existing AFS licensees to comply with the requirement to have a responsible manager who</p>	<p>programs and the fact that this training needs to be undertaken simultaneous to remunerated employment, means that a transition period of up to 18 months is a more reasonable timeframe.</p>
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	<p>meets the minimum training and competence standards? If not, why not?</p> <p>B1Q5 Please provide feedback on any costs or benefits that may apply to your business under the proposal.</p>	
<p>C1 We propose 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.</p> <p>Note: See RG</p>	<p>C1Q1 Do you think we should be more detailed in our guidance on the ways in which we think digital advice licensees should monitor and test algorithms? If so, what additional guidance should we provide?</p> <p>C1Q2 Please provide feedback on any costs or savings to</p>	<p><i>C1Q1 Frequency of monitoring of algorithms</i></p> <p>The proposed guidance notes that algorithms should be regularly reviewed and updated, the frequency of which is dependent on the nature, scale and complexity of the business and whenever there are factors that may affect their currency or to ensure they are free of defects. It would be useful if two or three specific examples can be provided in the guidance as to when this might be necessary.</p> <p><i>Sample testing ratio</i></p> <p>We also suggest that ASIC provides some examples in RG 000.70 to ensure that the sample-testing ratio is high enough and varied enough in control design to</p>

<p>000.68–RG 000.70 of the draft regulatory guide for more details.</p>	<p>your business as a result of this proposed guidance.</p> <p>C1Q3 Do you think we should introduce a self-certification requirement which would require digital advice licensees to certify that their algorithms have been adequately monitored and tested?</p> <p>C1Q4 Should we require independent third-party monitoring and testing of algorithms? If so, in what circumstances would this be warranted?</p>	<p>adequately detect flaws in the algorithm.</p> <p><i>Outsourced algorithm build or monitoring</i></p> <p>Where the financial advice algorithm is developed by an outsourced entity, the licensee is responsible for all ongoing monitoring, detection and rectification problems. RG000.103/RG 100.104 set out best practice in relation to testing and monitoring and in the event of changes to the algorithm. Where the building and designing of the algorithm is outsourced, we suggest it would be prudent for the licensee to keep a record of key contingencies of changes to questions themselves, the ordering of questions, migration of data issues, and to consult the outsourced entity in such events to avoid unintended consequences to the advice provided.</p> <p>In RG 000.63, we suggest that ASIC includes more detail around keeping records of all consultations with the outsourced provider at the initial build stage. We acknowledge that the licensee does not need to fully understand the coding of the model where the design and build is outsourced but the licensee should still have detailed consultation during the process to fully understand the workings of the algorithm that underpin the advice provided digitally.</p> <p>For example, where a question in the online process needs to be amended, changed or deleted (impacting answers which will have subsequent impacts on later questions in the decision tree), those interdependencies need to be recorded, monitored and understood by the licensee.</p>
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		<p>It would be pragmatic to include Service Level Agreements as a method by which to monitor outsourced providers particularly where the <i>monitoring</i> of the algorithm is outsourced. The Regulatory Guide is currently silent on this matter.</p> <p><i>C1Q3 Self-certification of algorithms</i></p> <p>ASIC has proposed not to require licensees to comply with Market Integrity Rules that require self-certification of algorithms. We appreciate the cost benefit analysis presented in CP 254. However we suggest that given the ‘best interests’ obligations, that the higher standard of self-certification would be better applied as an AFS license condition under s 914A of the Corporations Act, as stated in paragraph 36 of the CP 254. The nature of digital financial advice, especially in the context of personal scaled advice, is such that the drafting of the questions to clients and the algorithm design will be highly subjective.</p> <p><i>C1Q4 Independent third party monitoring</i></p> <p>Paragraph 31 of the CP 254 and RG 000.106 contains a licensee’s responsibilities in relation to defective advice. In the context of defective advice provision and reportable breaches, we suggest that ASIC would provide clarity to the industry if it sets out an example where independent third party monitoring and testing of algorithms would be warranted. A best practice approach whereby licensees monitor incidents and issues and perform root cause analysis on a weekly basis would ensure that digital financial advice is provided responsibly in Australia. It would be useful if</p>
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