

Ms Brooke Stewart
Senior Analyst
Financial Advisers
Australian Securities and Investments Commission
Email: brooke.stewart@asic.gov.au

17 May 2016

Subject: Regulating Digital Financial Product Advice

Dear Ms Stewart

Mercer welcomes ASIC's invitation to lodge a submission responding to its consultation paper entitled *Regulating digital financial product advice* (and the associated draft regulatory guide entitled *Providing digital financial product advice to retail clients*).

As ASIC acknowledges, the provision of digital advice (or 'robo-advice') has grown rapidly in Australia in recent years and, in that context, it is important for ASIC to confirm and explain its regulatory settings. This regulatory guidance is timely and we welcome the responsiveness that ASIC has shown to industry feedback seeking more information. Mercer considers that digital financial product advice offers investors new and exciting opportunities. Our submission is based on some important overarching themes:

- Digital advice plays an important part in providing low cost, limited scope advice to a large number of customers who would not pay for face to face advice and so would otherwise miss out on the benefits of advice. To encourage continued innovation of digital advice tools, regulatory guidance must have an impact that is practical and cost effective.
- The nature of a digital advice tool is constrained by the technology and algorithms that underpin it. Every digital advice tool will be limited in its scope and application to some extent. We ask that ASIC's guidance on meeting the advice requirements for digital advice tools acknowledge how those requirements are met given the limited nature of any digital tool.
- Regulatory guidance must be sufficiently flexible to accommodate developments in technology – both the customer interface options, tool sophistication and the devices that customers use to access digital advice. The guidance must also be practical and cost effective for all types of devices (including mobile phones with small screens).

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- Regulatory guidance must respect the valuable intellectual property rights of algorithm developers and not expressly or implicitly require disclosure of the full algorithm by the developer to licensees.
- Regulatory guidance must recognise that filtering out clients can happen outside the digital advice tool.

Our submission elaborates these themes and responds to consultation paper questions and the draft regulatory guidance. Comments are in the separate attachment to this letter.

Who is Mercer?

Mercer is a global consulting leader in talent, health, retirement and investments. Mercer helps clients around the world advance the health, wealth and performance of their most vital asset – their people.

Mercer Australia provides customised administration, technology and total benefits outsourcing solutions to a large number of employer clients and superannuation funds (including industry funds, master trusts and employer sponsored superannuation funds). We have over \$50 billion in funds under administration locally and provide services to over 1.3 million super members and 15,000 private clients. Our own master trust in Australia, the Mercer Super Trust, has around 230 participating employers, 213,000 members and more than \$20 billion in assets under management.

We would be delighted to discuss the contents of our submission in more detail. At a meeting with ASIC, we could provide practical insights on the provision of digital advice and financial product advice more generally and explain information on costs and savings. If ASIC would like to arrange a meeting, please contact me on 03 9623 5168 or by email.

Yours sincerely,



Guy Thorburn
Partner

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Attachment: Consultation paper *Regulating digital financial product advice*

1. Introduction

Mercer endorses a regulatory approach that commits to technology neutrality and, so far as possible, makes the obligations applying to the provision of traditional (non-digital) financial product advice and digital financial product advice the same.

That said, there are some unique features of digital advice that stem from the nature of the digital tool and the fact it is constrained by the underpinning technology and algorithm. The rapid advance of technology also affects the devices that customers choose to access digital advice and the capability of the tools themselves. ASIC guidance and the clarification of ASIC's expectations would be very helpful when applying the general financial product advice obligations to digital advice given these unique features. In many cases, we submit that principles based guidance may be the most appropriate approach to ensure that regulatory guidance is flexible enough to cater for future technological developments.

2. Proposed guidance to assist digital advice providers

A1Q1: Overall, is the proposed [regulatory] guidance helpful? If not, why not?

A1Q2: Is our proposed regulatory guidance (in section D of the regulatory guide) helpful in assisting digital advice providers to provide scaled advice that is in the best interests of clients? If not, why not?

In general, Mercer considers that the draft regulatory guide is helpful. However, some aspects require greater elaboration and there are also some statements that we do not accept. Our feedback, capturing sentences and paragraphs of particular interest to Mercer, is in Table 1 overleaf.

Table 1

RG 000	Mercer comment
000.14	<p>Mercer applauds the acknowledgement in this paragraph of the impermanency of the digital advice environment. It is quite foreseeable, given the rate of technological change, that investors could be accessing digital advice through new or completely altered devices and mediums. Rather than face the uncertainty of new or revised regulatory guidance with each technological change, Mercer requests that ASIC pursue a principles-based approach with its guidance and regulatory strategy, permitting sufficient flexibility to accommodate technology change. We reiterate this sentiment elsewhere in our submission.</p>
000.49 – 000.51	<p>Mercer supports a requirement that digital advice licensees must have at least one responsible manager who meets the minimum training and competence standards as per RG 105. However, we do not support the further requirement that the responsible manager meet the Corporations Amendment (Professional Standards of Financial Advisers) Bill 2015 as this reflects the requirements of practitioners and responsible managers are not covered by this proposed new legislation. This is to ensure consistency with requirements for physical advice. For completeness, Mercer supports that a licensee should have at least one person involved in providing the robo advice tool who does meet the proposed requirements the Corporations Amendment (Professional Standards of Financial Advisers) Bill 2015. We therefore ask that ASIC’s guidance clarify that responsible managers are not required to also meet the standards of practitioners.</p> <p>Mercer already satisfies all of the AFS licensee requirements to provide digital financial product advice and considers the six month transition period to comply for other AFS licensees adequate.</p>
000.57 - 000.63	<p>Paragraph 000.57 refers to an obligation for people in the digital advice business to have an “<i>understanding</i> of the technology and algorithms used to provide digital advice”. It is unclear what level of “understanding” ASIC expects.</p> <p>Many licensees will licence their digital and physical advice tools from a tool developer. In that situation, it is unlikely that the licensee will have a detailed understanding of the <i>technology</i> and <i>algorithms</i> used. Instead, the licensee will have a detailed understanding of the output that the tool can produce and the <i>benefits</i> and <i>limitations</i> of that tool in the context of the licensee’s client base.</p>

	<p>This is in the same way that the licensee giving face to face advice would use advice tools from a tool developer (eg XPlan and Decimal) to produce the output for the adviser. The licensee will clearly have a deep understanding of the output of the advice but would not usually understand the intricacies of the software that powers the output. In the same way we would expect licensees offering robo advice to have a deep understanding of the output, scope and limitations of the tool, but would not have a deep understanding of the algorithm embedded within the tool.</p> <p>We ask that ASIC clarify that the understanding of the <i>technology</i> and the <i>algorithm</i> need only be general. Of course, we would expect licensees to have a detailed understanding of the benefits and limitations of the tool in terms of the proposed output to that licensee’s client base.</p>
000.69 – 000.70	<p>Mercer acknowledges the imperative for the <i>output</i> from algorithms that underpin digital financial product advice to be tested, legally compliant and current. In that respect, we support the tenor of ASIC instructions to test and monitor algorithms. However, we request that ASIC’s guidance be less prescriptive and more principles based to better allow for innovation and development of digital tools.</p> <p>For example, ASIC states in paragraph 000.69 that “Decision trees or decision rules should form part of [the documentation that licensees retain on algorithms]”. We submit that this is too narrowly focused. For any particular tool, the most appropriate way to document its purpose, scope and design may or may not include decision trees - it will depend on the tool. It would be more helpful if this was expressed as an example rather than an ASIC expectation. Mercer would not support a mandatory requirement that decision trees form part of the documentation retained in respect of algorithms.</p> <p>We specifically request the following:</p> <p>Outsource providers We ask that ASIC guidance recognise that some of the detailed testing, change management, review etc. may be done by appropriately skilled outsourced providers to the licensee.</p> <p>Reconstructing the algorithm We ask ASIC to clarify that it is not expecting licensees to be able to “reconstruct” a former version of an algorithm by replicating the output it produced before the change. We consider that the obligation to keep records that describe any change made to the algorithm is adequate. As currently drafted, paragraph 000.69 creates confusion by stating that ASIC expects licensees to “be able to control, monitor and <u>reconstruct</u> any changes to algorithms over a seven-year timeframe.”</p>

	<p>Disclosing the algorithm For the avoidance of doubt, we ask that ASIC make its guidance clear that it does not expect developers of digital advice tools to disclose the full algorithm underpinning the tool to each licensee that uses it. The commercial value of the relevant tool is almost entirely in its unique algorithm and that algorithm represents highly valuable intellectual property of its developer that would be compromised by full disclosure.</p> <p>Defects As will be explained in more detail later, we ask that ASIC guidance recognise that finding a defect should only result in the tool being suspended for those customers detrimentally affected by the defect. For example, if a defect is discovered in the way the tool calculates optional health benefits, it could be suspended for any member that has opted to hold those benefits (but remain active for those customers who have not).</p> <p>Similarly, where only part of a tool is defective (and could be suspended without adversely detracting from the advice given to customers), only that part could be suspended leaving the remainder active. For example, a tool may offer customers advice about 3 topics – whether to make additional contributions, what investment option to choose and whether they need additional insurance. Customers can choose which of these topics they’d like advice about. If the licensee becomes aware of a problem getting a correct data feed from the insurer’s system (about premiums for individual customers) then the licensee should be able to “turn off” the part of the tool offering advice about insurance but leave active those parts of the tool offering advice about contributions and investment choice.</p>
000.76 – 000.81	<p>Mercer understands and endorses the necessity for licensees to have adequate compensation arrangements for their financial services businesses overall. In that respect, we endorse the statement in paragraph 000.80 that licensees should apply their responsibilities in accordance with RG 126. Mercer is concerned, having regard to paragraph 000.81 expectations, that ASIC is advocating compensation arrangements for digital financial product advice that differ from compensation arrangements for other forms of advice.</p> <p>We request that ASIC guidance recognise that a digital advice tool is one of a number of different tools, systems or software that a licensee may use and that it is likely that, for most licensees, bigger risks emerge from some of those other systems (such as unit pricing or administration). We ask that the guidance be clear that the assessment of the adequacy of the compensation arrangements is in the context of the licensee’s business overall.</p>

Part D	<p>The application of section 961B of the <i>Corporations Act 2001</i> (Cth) to digital advice is the central issue on which ASIC guidance would be most helpful.</p> <p>In this regard, we have had the opportunity to review the Financial Services Council (FSC) submission and its comments in response to A1Q1 and A1Q2, including the specific application to digital advice. We fully endorse the FSC position.</p>
000.90 – 000.94	<p>Mercer considers that paragraph 000.94 requires significant amendment. As mentioned, we have reviewed the FSC submission and fully endorse its comments on this paragraph. We ask that ASIC revise the paragraph to reflect the FSC approach.</p> <p>Reframing paragraph 000.94 should remove the current requirement for separate disclosure of dispute resolution processes that ASIC suggests. Mercer considers that this disclosure is duplicative given that information on dispute resolution processes would be captured in other documents namely the FSG. This highlights a broader point that an issuer, when deciding which information is most important for the customer to receive within the digital advice tool, should have the flexibility to consider that particular information may have already been provided, or will be required to be provided, in other regulated documents (e.g. FSG or SoA).</p> <p>Further, we submit that clients may accept the scope of the advice in any number of ways – including by continuing to use the tool after the limited scope has been clearly explained. Implicit in the way these tools are used, every click is the customer’s positive interaction with the tool. Inherent in each of these interactions is acceptance of the steps that preceded that specific interaction. Therefore, we do not support a requirement for additional positive acknowledgement.</p> <p>Additionally, we note that at paragraph 000.91, and in the ‘Key points’ for Part D of the current regulatory guide, ASIC states “Most advisers offering traditional financial product advice limit the scope of their advice, and communicate the limited nature of this advice through conversations with their clients. In a digital advice context, however, such conversations are not possible”</p> <p>We disagree. There is nothing that precludes a digital advice provider outlining the limitations of their advice as they are appropriate to the situation throughout the digital conversation, in a manner sensible to that conversation, just as would occur in a conversation in a physical world. We submit that paragraph 000.94 should be revised to ensure, as far as possible, equivalence of requirements for digital and traditional (non-digital) advice. This accords with RG 244 which states that “in general, the same rules apply to all advice, regardless of how it is delivered” [paragraph 244.95].</p>

000.95 – 000.100	<p>Mercer agrees that a robust filtering process is important to delivering sound and appropriate digital financial product advice. However, we ask that the draft guidance recognise that filtering out clients can happen outside the digital advice tool. Again, we refer to the arguments put by the FSC in response to A1Q1. We fully support that position.</p> <p>Paragraph 000.97 is an example of where we ask ASIC guidance to change to reflect the FSC position. We submit that whether any particular question is or isn't appropriate depends on the scope of the advice being given. ASIC is asked to not specify particular questions, processes and outcomes.</p> <p>Similarly, in paragraph 000.100, ASIC states: "A digital advice model that results in all clients receiving advice would raise serious concerns and would prompt close scrutiny from ASIC." We submit that words are missing. Specifically, the words 'the same' are missing from before "advice". Alternatively, if that was not what ASIC meant, we ask that this statement be changed to reflect that significant filtering is possible and is often done outside of the digital advice tool itself. (Please see our earlier comment). Hence, with appropriate filtering outside the tool, in fact it may be quite appropriate for a digital advice tool to be able to give advice to almost all customers that it is offered to.</p>
000.101 – .103	<p>The 'Reviewing digital advice' section of the draft regulatory guide provides further guidance on licensees' monitoring and reviewing obligations, this time in respect of the final digital advice rather than the underpinning algorithm. Mercer supports the principle that licensees should monitor and review financial advice they provide through any medium.</p>
000.105	<p>Mercer is concerned at the suggestion that advice must cease while an algorithm defect is being rectified. We ask that ASIC's guidance recognise that finding a defect should only result in the tool being suspended for those customers detrimentally affected by the defect.</p> <p>For example, if a defect is discovered in the way the tool calculates defined benefits, it could be suspended for any member with a defined benefit (but remain active for those customers who only have accumulation benefits). Similarly, a tool should remain operational if a defect affects only one particular aspect or offering from the tool but not others – please see the example in our comments about paragraphs 000.69 – 000.70].</p>

Key terms	Mercer notes that there is no 'responsible manager' definition in the 'Key terms' to assist users.
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3. Proposed requirements for responsible managers of digital advice licensees

We [ASIC] propose to require that a digital advice licensee has at least one responsible manager who meets the minimum training and competence standards for advisers. To assist existing AFS licensees that may not have a responsible manager who meets these standards, we propose a transition period of six months

B1Q1: Do you agree with this proposal?

B1Q2: Do you agree that, if the changes proposed in the Corporations Amendment (Professional Standards of Financial Advisers) Bill 2015 became law, at least one responsible manager should:

- (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*
- (b) comply with 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?*

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?

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 meets the minimum training and competence standards? If not, why not?

B1Q5: Please provide feedback on any costs or benefits that may apply to your business under the proposal

As Table 1 notes, Mercer supports a requirement that digital advice licensees have at least one responsible manager who meets the minimum training and competence standards as per **RG 105**. However, for the purpose of equivalency, we do not support a further requirement that the responsible manager meet the Corporations Amendment (Professional Standards of Financial Advisers) Bill 2015 standards as they reflect requirements for practitioners and responsible managers are not covered by that legislation.

The role of responsible manager for licensing purposes is different to the role of a qualified financial adviser. This is consistent with the proposed Corporations Amendment (Professional Standards of Financial Adviser) Bill 2015 (which applies to advisers but not responsible managers). While in a start up organisation, those distinct roles may well be discharged by the same individual, this would not always be the case. We ask that ASIC's guidance clarify that the role of and qualifications of responsible managers remain unchanged.

We consider a transition period of six months adequate for existing AFS licensees to meet minimum training and competence standards. In terms of costs or benefits, we submit that the proposal, which we do not support, would add additional and unreasonable costs for digital advice providers compared to providers of other forms of advice.

4. Proposed requirements for monitoring and testing of algorithms by digital advice licensees

We proposed to issue guidance on the ways in which we think digital advice should monitor and test the algorithms underpinning the digital advice being provided.

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?

C1Q2: Please provide feedback on any costs or savings to your business as a result of this proposed guidance.

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?

C1Q4: Should we require independent third-party monitoring and testing of algorithms? If so, in what circumstances would this be warranted?

Mercer does not consider that more detailed guidance is required. However, if more guidance is given, we request that the additional guidance be principles based and not prescriptive.

Appropriate testing and monitoring will depend on the circumstances of the particular digital advice tool - such as its complexity; the type of advice being given; the type of customers using the tool; the potential for malfunction to cause loss to those customers; whether there have been changes to the algorithm, the data feeds, the digital platform, the user interface, the law etc. and the complexity of those changes; and the history of the tool (e.g. whether there have been problems in the past). What testing must occur, and how often, should be determined by the licensee in discharge of its fiduciary and statutory obligations and the particular circumstances of the relevant digital advice tool.

Many parts of a digital advice tool interact to produce the output to customers – the algorithm, the data feeds to the tool, the digital platform that the tool sits on, the user interface of the tool etc.

We ask that ASIC reframe the focus of its guidance from the algorithm to the output of the tool to capture the full impact on the customer. This would more closely align with how ASIC monitors face to face advice – by looking at the output rather than by focusing on the various software tools that an adviser uses to produce that output.

In response to C1Q3 and C1Q4, we do not support self-certification or independent third party monitoring of algorithms in the sense of testing on a regular timing cycle. As ASIC highlights in its

consultation, licensees should satisfy themselves that a robo advice tool has been adequately tested by suitably qualified professionals. The frequency of the testing will depend on the frequency of changes to the tool and the environment in which it operates, rather than be tied to a particular calendar based cycle.

In terms of cost impact, we do not expect the costs associated with the proposed guidance to be significant if the guidance is predominantly principles based and the points made in our submission are largely accepted. This is because:

- the general law and the existing licensing regime already impose robust obligations on licensees (that are consistent with principles based guidance); and
- principles based guidance more directly aligns the costs with the circumstances of the particular tool.