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Product Regulation
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ASIC's Consultation Paper 325 Product design and distribution obligations

The Actuaries Institute ("the Institute") is the professional actuarial association representing over 5000 members that mainly serve the Australian financial services sector. Many actuaries fulfil roles that are critical to the design of financial products including product, underwriting and pricing related roles.

We welcome the opportunity to comment on the proposals included in ASIC's Consultation Paper 325 *Product design and distribution obligations* ("CP325") released on 19 December 2019.

The Institute strongly supports the overarching intent of the proposed design and distribution obligations ("DDO"), that product issuers and distributors must take a customer-centric approach to provide consumers with financial products that meet their likely needs, objectives and financial situation.

However, this submission also raises the risk of several unintended consequences flowing from CP325 that may have detrimental consumer outcomes. The following comments are meant to reduce that risk.

1. ASIC should consider introducing a requirement that insurers assess and document a product's 'value' from a consumer's perspective as part of a robust product governance framework, to clarify ASIC's expectations of insurers.
2. The test for the treatment of behavioural bias should be moderated to recognise that use of choice architecture can benefit consumers. Furthermore, we suggest a change in emphasis from impeding consumer outcomes, to impeding outcomes for a *class of consumers*, with specific consideration to vulnerable groups of consumers.
3. The application of the proposed DDO to superannuation will be complex and may lead to confusion, for example;
 - o MySuper is exempt from DDO, yet superannuation members become subject to DDO as soon as they make an investment choice. ASIC should provide guidance to assist with this interaction;



- o There is overlap with elements of the APRA member outcomes requirements, where Choice products are the combination of the investment options and insurance offerings to those members who are not in MySuper. Under member outcomes, it is the totality of the product that is assessed whereas ASIC's guidance in CP325 appears to be focussed on each individual investment option within the product. The inclusion of insurance in the Target Market Determination adds another layer of complexity at the overall product and/or investment level. ASIC needs to provide clearer guidance to assist.
4. The Target Market Determination guidance is very broad consistent with ASIC's principles-based approach. The Institute notes that this may lead to a diverse range of documentation from insurers that could make product comparison problematic for consumers.
 5. Life insurance is generally a long-term contract and consumers' needs can change significantly over the long-term. This means the target market for the product needs to be broad to cover changing needs over time. Some guidance or examples on target market determination for these long-term products would be useful.
 6. There is an increasing consumer desire to protect privacy and a business focus to make the customer's journey easier. Collecting an increasing level of personal data runs counter to those trends. Consideration should be given to the establishment of a 'safe harbour' for insurers that do not collect data that consumers choose not to provide.
 7. Lastly, the impact of the COVID-19 virus on insurance operations and workplaces generally, will impede collaboration amongst stakeholders to implement DDO reforms. ASIC should therefore consider the practicality of the current timetable and if necessary adjust to ensure a workable transition to the new regime.

The Institute has appreciated ASIC's efforts to consult with the profession through its industry briefing sessions and we look forward to future opportunities to assist in the development of DDO. In the meantime, if you wish to clarify any aspects of this submission, please contact Elayne Grace, Chief Executive Officer of the Actuaries Institute, on (02) 9239 6100 or elayne.grace@actuaries.asn.au.

Yours faithfully

Hoa Bui
President



Item #	Feedback Question	Initial Response
B1Q1	<p>Is our guidance on a robust product governance framework useful? What additional matters, if any, do you think are important in ensuring that a product governance framework will be effective and support compliance with the design and distribution obligations?</p>	<p>Overall, we view that ASIC's guidance is useful. We make two comments in respect of a robust product governance framework that fulfils the objectives of the design and distribution regime:</p> <ol style="list-style-type: none">1. For certain general insurance products, the financial position of the customer is not included in the underwriting process e.g. car and home insurance. Customers may be reticent to divulge such information and costs of collecting such information outweigh benefits.2. Commercial considerations and consumer protection have inherent conflicts. A robust product governance framework should seek to identify the overall 'value' to the consumer by balancing the trade-offs between customer and provider. Ultimately, a class of consumers should not be put in the target market if the product is not of value to them. Guidance on the criteria for a '<i>product value assessment</i>' would clarify the expectation of providers when designing products to reduce the risk of mis-selling to consumers.



<p>B2Q1</p>	<p>Is our guidance on the consumer-centric approach issuers and distributors should take to deliver good consumer outcomes useful?</p>	<p>We agree with the general intent: a consumer-centric approach, giving due consideration to behavioural biases, is necessary to deliver good consumer outcomes. However, we believe that the draft guidance goes further than necessary and may constrain insurers and distributors from taking action which may genuinely benefit consumers. Below, we suggest a refined wording which we feel better meets the underlying intent, without this unintended consequence.</p> <p>The proposed requirement to “not take advantage of behavioural biases or factors that can [our emphasis added] impede consumer outcomes” is very strong and will restrict genuinely beneficial strategies, choice architectures, and interactions. The proposed requirement is a significantly more stringent test compared to a test of whether a consumer detriment is likely to occur and affects significant groups of consumers in a material way. Use of the word ‘can’ suggests an impediment cannot ever have a possibility of occurring to any degree to any consumer.</p> <p>In our view, a more appropriate test to meet the intent is whether behavioural biases, particularly the potential for vulnerable consumers to suffer harmful outcomes, have been appropriately considered in the design of the interaction in order that consumers are not deliberately impeded in making appropriate choices on average or in general across a class of consumers. This should be evaluated at a group or cohort level, giving suitable weight to vulnerable individuals, since as noted above a test at the individual level is perhaps too strong a test for any interaction to meet. This aligns to the concept of consumer outcomes to a class of consumers consistent with the remainder of the DDO regime. We suggest the following wording:</p> <p>“We propose to give guidance that issuers and distributors should seek to understand how behavioural biases or factors can both impede and improve the ability of consumers to make appropriate choices, and use this knowledge to select strategies which do not seek to impede a class of consumers from making an appropriate decision for them on average. Particular consideration should be made for consumers exhibiting vulnerability, for example vulnerable groups could be evaluated as separate cohorts.”</p>
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<p>C1Q1</p>	<p>Do you agree with our approach to guidance on the form and content of a target market determination? If not, why not?</p>	<p>Overall, we agree that the Target Market determination (TMD) can differ depending on the circumstances and hence the guidance should be principles based.</p> <p>The Institute believes that more specific guidance is around TMD the less scope there will be for inconsistencies with provider documentation. While these are not intended to be customer facing disclosure documents (RG000.63), the TMDs will be publicly available and inconsistencies may make it difficult for consumers and distributors to compare target markets between products and limit their usefulness. We recommend that ASIC encourage industry developed standards to foster consistency.</p>
<p>C2Q1</p>	<p>Is our guidance on the approach to identifying the target market for new products and continuing products useful?</p>	<p>The same comments as per C1 apply.</p>
<p>C3Q1</p>	<p>Do you have any comments on our approach to guidance on identifying and describing the target market?</p>	<p>No additional comments beyond C1Q1</p>
<p>C3Q3</p>	<p>What additional matters, if any, do you consider to be relevant?</p>	<p>Identifying target markets for long term life insurance can be more complicated than some of these examples and may benefit from its own example. In particular, consideration of the suitability of the product for a person who may be relatively young with many life decisions ahead could be different to the long-term considerations drawn out in the reverse mortgage example.</p> <p>A younger person taking out an income protection policy or life insurance may have very different current needs depending on if they have dependents or large financial commitments, and their needs could change significantly over time in ways that are difficult to foresee. With long term life insurance products, a new contract is not entered into each year. If these future needs are not considered the consumer may find it difficult to obtain more appropriate cover at a later date, for example if they have had a health event.</p> <p>Considering the future needs of the target market, and how suitable/flexible the product is for these, is very important for policies that the consumer may hold for 15+ years.</p>



<p>C4Q1</p>	<p>Do you have any comments on our proposed guidance for issuers considering the role of diversification as it relates to their identification of the target market?</p>	<p>We consider that it will be essential for superannuation product issuers to receive clear guidance on what constitutes reasonable steps to fulfil their obligations in this regard.</p> <p>As members may hold assets in multiple superannuation schemes and have assets outside super, it is not reasonable to expect each superannuation product issuer to have detailed information on the member's overall investment portfolio and level of diversification.</p> <p>We consider that the example of reasonable steps for product issuers provided in Example 9 (RG 000.121) would provide a good template for the guidance to be provided in this instance.</p>
<p>C5Q1</p>	<p>Do you agree that consumer understanding of a product does not necessarily equate to the product being likely to be consistent with the likely objectives, financial situation and needs of consumers in the target market? If not, why not?</p>	<p>There are several factors to consider in developing a target market. While the consumer's understanding of the product is important, the target market should not be predominately based on this.</p>
<p>C6Q1</p>	<p>Do you agree that it may also be useful for an issuer to describe the negative target market for its financial product? If not, why not?</p>	<p>Yes, we agree that describing the negative target market could be useful.</p>
<p>C6Q2</p>	<p>Is our guidance on the role of describing a negative target market adequate and useful? If not, please explain why, giving examples.</p>	<p>Yes, it is useful.</p>



<p>C7Q1</p>	<p>In relation to our guidance on how a target market determination should be approached for superannuation products, as set out in Example 7:</p> <p>(a) Do you agree with our proposed guidance that if investment options are suitable for different groups of members, then the trustee should account for this in undertaking its target market determination for the Choice superannuation product? If not, why not?</p> <p>(b) What factors do you consider relevant to the grouping of investment options in making a target market determination? Why?</p> <p>(c) Do you agree with our proposed guidance to consider insurance as part of the target market determination for a Choice product? If not, why not?</p> <p>(d) How should a trustee take into account insurance in making a target market determination for a Choice product?</p>	<p>a) We agree with the proposed guidance.</p> <p>b) In a superannuation context, there are several factors that should be considered. As a superannuation fund comprises a large number of non-homogeneous members, the general risk profiles of different member groups can be taken into account when making a target market determination e.g. accumulation members vs retirees. This would align with the APRA member outcomes requirements which focuses on membership cohorts.</p> <p>c) Clarity required in terms of the intended definition of "insurance" in this context. Could be interpreted as bundled group insurance through super (assume this is the case), structured protection strategies that are part and parcel of an investment strategy such as a structured product with a floor or otherwise related to guarantees such as those underpinning annuity products.</p> <p>We consider that very clear examples of how to allow for the inclusion of group insurance in a Choice product's target market determination would be helpful for superannuation product issuers. This is because there are significant differences between how super funds operate their products, with many of them offering a wide range of underlying investment options designed for individual members with differing needs and risk profiles. The inclusion of group insurance adds another layer of complexity at the overall product and/or investment level, which will have an impact on the target market determination. Given the very broad range of characteristics to capture at the overarching product level, there is a risk that the resulting target market determination could be generalised to the point where it is not very helpful to the end consumer.</p> <p>d) See c) above.</p>
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C7Q2	Do you agree with our guidance on the application of the target market determination obligation to IDPS?	We agree with the guidance provided.
C7Q3	Do you agree with our guidance on how a target market determination should be approached for a bundled product? If not, why not?	We agree with the guidance provided.
C7Q4	Do you agree with our proposed approach to the application of the design and distribution obligations to products that can be customised at point-of-sale? If not, why not?	We agree with the guidance provided. However, it is suggested that clear examples where products are customisable for income protection and other life insurance would be helpful.
C7Q5	Are there any options or choices, or types of options or choices, that you consider would affect the product's suitability for a consumer if selected? Please give examples.	Yes, for example: <ul style="list-style-type: none"> - Optionality related to the risk profile of the product (e.g. high growth to conservative) - Nature of the units (capital growth vs income units) - Drawdown levels for retirement products (minimum withdrawal vs higher levels) - Waiting Periods on Income Protection insurance products from short to very long (e.g. 1 month to 2 years). - Own occupation vs any occupation TPD insurance cover - Level vs stepped premiums for long term life insurance products



C8Q1	Do you have any comments on the following examples, which we have used in our guidance to illustrate key principles set out in RG 000.107–RG 000.120: (a) Example 7: Superannuation products; (b) Example 8: Investor directed portfolio services; (c) Example 9: Superannuation; (d) Example 10: Mortgage fund; and (e) Example 11: Listed investment companies?	<p>Example 7:</p> <p>Clarity and clear example required for the treatment of group insurance in a Choice product environment.</p> <p>It is unclear why there is no obligation on the issuer of a group insurance policy to make a target market determination based on the input from the superannuation product issuer (in this case the distributor of the insurance product). This is the case in other situations under the Product DDO where both the product issuer and distributor have obligations related to the target market determination.</p> <p>Example 8:</p> <p>We consider that IDPS operators should make their target market determinations for the overall platform available to product issuers looking to distribute their product via the platform. This would assist those product issuers to make informed decisions about whether the platform is appropriate and in line with the distribution of the product to the intended target market.</p> <p>In addition, it is suggested that clear examples where products are customisable for income protection and other life insurance would be helpful particularly when distributed through financial advisers.</p> <p>Example 9:</p> <p>Superannuation product providers will require some protection in instances where they are required to restrict members from selecting certain investment options based on limited information about the member's overall financial circumstances and assets outside of the super fund. It potentially also borders on providing the member with personal advice when directing them to a call centre to access the specific investment option (if the suggestion is that original disclosure and risk warnings were not deemed sufficient to deter members that fall outside the target market).</p>
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<p>C8Q2</p>	<p>Do you agree with the factors listed in Table 3 of draft RG 000 that we expect will be relevant when considering whether an issuer has met the reasonable steps obligation? If not, why not?</p>	<p>Yes, noting that the obligation on the product issuer to supervise and monitor the distributor will rely on the product issuer's ability to obtain relevant and appropriate information from the distributor in a timely manner. From a distributor perspective, it would also be helpful to distinguish between the approaches when dealing with financial advice dealer groups as opposed to individual financial advisers.</p> <p>Without direction and mandated requirements to distributor to provide such information in an industry-wide acceptable format and timeframe, the processes implemented by the product issuer will be hampered and may be unsuccessful in meeting the reasonable steps obligation.</p>
<p>C9Q1</p>	<p>Do you have any comments on our guidance on setting appropriate review triggers and maximum review periods?</p>	<p>Minimum and maximum review timeframes need to be stipulated to ensure that product issuers and distributors cooperate in a collaborative fashion.</p> <p>For example, the expectation could be set for annual reviews of the appropriateness of the target market determination, with the minimum requirement for a review to be carried out at least every 3 years. In the absence of such guidance, there will be little onus on the product issuers and distributors to do this in a structured and timely manner and may lead to great discrepancies in how this is carried out between different providers and the industry as a whole.</p>
<p>C9Q2</p>	<p>Do you have any comments on the following examples, which we have used in our guidance to illustrate key principles set out in RG 000.127–RG 000.130: (a) Example 12: Insurance; and (b) Example 13: Managed fund?</p>	<p>Example 13:</p> <p>We suggest that consideration be given to changes in the observed level of risk and volatility in a product over time relative to what was stipulated at the launch of the product. For example, the risk and volatility might be higher than what was expected at the time when the investor first invested in the product and while the risk profile and disclosure might be updated over time, the existing investor might no longer fall within the appropriate target market and might not be aware of the specific implications of the changes to him/her.</p>



<p>C10Q1</p>	<p>Do you have any comments on our guidance on the issuer's obligation to specify information it requires from its distributors?</p>	<p>The guidance given is principles based, though there are examples of the information that may be sought from distributors under RG.000.139. There is an argument for developing industry standards that specify the minimum level of information to be sought from distributors. Otherwise, there is a danger of different information requirements included in different distribution agreements, as well as a race to the bottom where issuers ask for minimal requirements for fear of asking for too much information and losing business.</p>
<p>C10Q2</p>	<p>What existing information collected by distributors would be relevant to an issuer's consideration of the ongoing appropriateness of its target market determination?</p>	<p>Information such as lapse rates by distributor (though can be sourced from a company's own records), complaints, subjective feedback on administration/claims management capability would all be useful in a target market determination.</p>
<p>C10Q3</p>	<p>In addition to the information set out at RG 000.139, are there other types of information an issuer should collect from distributors? If so, please describe the type of information you think would be relevant.</p>	<p>The information could include lapse rates for similar products sold by the distributor (not just the company's products), feedback on claims management and administration issues and capability, feedback on underwriting issues and capability etc.</p>
<p>C10Q4</p>	<p>What potential effects on competition may occur as a result of the issuer's right to set the information the distributor must provide?</p>	<p>As per C10Q1, the issue will be if an issuer asks for too much information, the distributors may push back and sell business with an issuer with less cumbersome requirements.</p>
<p>C10Q5</p>	<p>Do you have any comments on our guidance on the issuer's obligation to specify the reporting period in relation to the number of complaints?</p>	<p>It would be useful for industry standards to be developed that specify a maximum reporting period e.g. RG.000.141 states 5 years is too long as a period over which complaints are reported so an appropriate maximum reporting period should be much less.</p>



C11Q1	<p>Do you consider our guidance on the types of information issuers should have regard to (described at RG 000.143) to be useful? If not, why not?</p>	<p>Yes, RG.000.143 is necessarily principles based and it would not be possible for ASIC to specify information that would assist in a review in every circumstance.</p>
C11Q2	<p>In addition to the data sources described in draft RG 000 at RG 000.143(a)–RG 000.143(d), are there other sources of information that you think an issuer should take into account in reviewing a target market determination?</p>	<p>The other sources apart from those mentioned in the responses to C10, include surveys on adviser experience, policyholder engagement and claimant journeys. Whilst ASIC states that consumer satisfaction is not an appropriate source of data, consumer dissatisfaction can be useful in identifying issues with the target market to which the product is sold. In addition, issuers' own data on customer profiles (e.g. business mix), in addition to other consumer data described in RG.000.143 (a) and Example 12, can help with the target market review.</p>
C12Q1	<p>Are there any additional factors that issuers should consider? If yes, please provide details.</p>	<p>ASIC's proposed factors make sense. The Institute considers the following factors may also assist in assessing significant dealings outside of the target market:</p> <ul style="list-style-type: none"> - the proportion of gross income/premium from the product in respect of consumers outside of the target market. This will take account of situations where only a small proportion of consumers may be outside the target market; however, they contribute to a larger proportion of income as they hold larger accounts / policies.
D1Q1	<p>Do you agree with the factors listed in Table 5 of draft RG 000 that we will take into account when considering whether a distributor has met the reasonable steps obligation? If not, why not?</p>	<p>The Institute agrees with the proposed factors.</p>



<p>D1Q2</p>	<p>What additional factors, if any, do you consider should be included in Table 5 of draft RG 000?</p>	<p>The Institute suggests that distributors should use a combination of data collection, analytics and judgement to meet the reasonable steps obligation. These are important pieces of evidence to show the distributor has considered the intent of the target market to mitigate the risk that it does not understand the class of consumers it should sell to, and evidence the distributor has sufficient understanding of how he product offering can meet the needs and objectives of consumers.</p>
<p>D2Q1</p>	<p>Do you have any comments on our proposed guidance for distributors in Example 14 of draft RG 000?</p>	<p>The Institute agrees with the proposed risk rated approach. Please refer to our comments on question B1, that general insurers do not currently include the financial situation of a person in underwriting a policy, as this applies a new business and renewal.</p>
<p>D7Q1</p>	<p>Do you think it would be useful to provide guidance on the following arrangements between the issuer and the distributor: (a) whether there is a need for information requirements to be set out in an agreement between the issuer and the distributor; (b) the format of information exchange; and (c) the mode of delivery and communication of information? If so, what considerations are relevant to these factors?</p>	<p>a) Yes, information requirements should be set out in distribution agreements and this is appropriate to be stated in the ASIC guidance. There should be a transition period for reviewing existing arrangements. b) and c) It is not necessary for ASIC to provide guidance on the mode of delivery/communication and format of exchange, albeit it would be expected in most cases to be in the form of a periodic report.</p>