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Product Regulation
Strategic Policy
Australian Securities and Investments Commission
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CP 325 Product Design and Distribution Obligations Consultation

Morgans Financial Limited (Morgans) welcomes the opportunity to provide feedback on Consultation Paper 325 - Product Design and Distribution Obligations (PDDO) released on 19 December 2019. Our comments are in relation to investment products only.

Morgans is Australia's largest national full-service stockbroking and wealth management network with more than 240,000 client accounts, over $45billion of client funds under advice, 565 authorised representatives and over 1000 employees operating from offices in all states and territories. We have been helping Australian investors with personalised investment advice and services for over 35 years

Morgans strongly believes Government policy and regulation should support a broad-based investment advice industry to ensure all retail investors can access affordable investment advice and products that are appropriate to their needs; it is in this context that we provide feedback to relevant but not all Proposals.

Proposal B

As a full-service stockbroking and advice business, Morgans supports measures that seek to ensure that investor objectives and circumstances are appropriately matched to an investment product's design; this is the role of advice.
We agree that the disciplines introduced within PPDO are important in so far as investors who do not seek professional advice can often make decisions based on misconceived biases as well as limited or indeed deficient information, leading to sub-optimal outcomes. Solving for good investor outcomes is the core of the advice industry.

Proposal C

1. All products are different, cater for different needs and objectives, therefore necessitating different Target Market Determination (TMD) frameworks.

2. PDDO seeks to close the gap identified above by ensuring that product issuers clearly define and articulate the appropriate investor segment via the TMD.
   The challenge for new products will be ensuring that the TMD developed by issuers is able to be practically applied and monitored in real time. This will require significant investment in and development of systems by distributors so they can systemise and monitor compliance of PDDO obligations. To this end, it will be important for those issuers defining a TMD to ensure the constituent inputs to the TMD are identifiable and trackable.

Monitoring in real time on a continuous basis would be extremely difficult if not impossible for exchange traded investments. Once listed, securities can be traded by any investor and so in the absence of advice they may invest in an unsuitable product.

3. Importantly, the principles-based guidance released by ASIC in December 2019, does provide scope for the industry to design appropriate frameworks specific to each product segment covered by PDDO. Deloitte Touche Tohmatsu Limited ("Deloitte") in its 2019 publication *Target market determination: renewing the focus on customer outcomes,* refers to guidance provided by the European Securities and Markets Authority (ESMA) on the Markets in Financial Instruments Directive (MiFID II) regime as a good starting point.
   This should assist the local industry in its endeavours to build a framework that achieves ASIC's aims and provides some direction for defining a TMD.

4. A TMD could include the condition that investor portfolios are diversified and we support this concept, though we note this is a subjective term and in the absence of professional advice it will be difficult to monitor. How do you define 'diversified'? Investors may have a limited number of tradeable investments but multiple properties. In this instance a single listed investment product would actually introduce diversification to a portfolio as a whole, but not if considered in isolation. The advice process will assist in making these determinations.

5. Investor education is of paramount importance and is an ongoing focus of full-service advice businesses. By way of example, Morgans produces a range of materials that are designed to educate investors about the markets in which they invest as well as specific products. Consumer understanding is an important element in determining a product's appropriateness. The advice process is equally important.

6 The concept of including a *negative target market* is useful and would hopefully prompt investors to consider carefully their own circumstances and appropriateness of a product given their circumstances. It would also assist in ensuring investors take some level of responsibility for the decisions they make. Further, it would likely guide advice practices in a positive way.

8 Issuers should be selective in terms of the appropriateness of distribution channels used for investment products. For example, issuers of listed investment products should seek to understand the advice and marketing practices of distributors as well as the resources devoted to the product segment in support of investors. Full advice firms can clearly articulate how products are selected and then how appropriateness is established before investment recommendations are made.

We contend that many of the areas addressed by the ESMA guidelines such as customer type, knowledge and experience, ability to bear losses, risk tolerance, objectives and needs are all addressed in the advice process undertaken by distributors for retail investors. Advice is a holistic process that takes into account the nature of the product and specific client circumstances, as well as necessarily filtering out those potential investors that would be incompatible with the product type. Distributors can outline their determination of such factors to issuers. Issuers can then look to those channels that they see as having practices that can identify and monitor investor type and needs as being appropriate channels to use; they are more likely to minimise potential harm to investors.

9 Reviews of a TMD could be linked to a change in the product's risk profile, market conditions, regulatory changes or a myriad of extraneous factors. Ongoing review beyond the offer period might assist investors understand changes in a product's risk profile and suitability through time. It may also assist in their consideration of suitability as their own needs and circumstances change. This would potentially narrow the information gap between those clients who have sought advice and those who have not.

10 We are very concerned that without appropriate thought and guidance, there is a risk that the TMD process could result in a different TMD for the same product type offered by two different product providers. This would make both the advice and compliance processes completely unworkable. Industry participants should be encouraged to collaborate to develop sensible and workable solutions without fear of such collaboration being deemed to be anti-competitive or collusive behaviour.
Privacy considerations and obligations require that distributors are not compelled to provide specific personal or commercially sensitive information about an individual investor. High level summary data should suffice to meet TMD obligations.

11 In reviewing a TMD, issuers should be required to take reasonable steps to monitor circumstances that may require a TMD to be updated. We would expect that current market disclosure obligations and conventions would govern such TMD releases. An issue that would have to be considered is the requirement to include information that is not publicly available or is otherwise commercially sensitive. While such information, if considered, may have a significant impact on a TMD, such disclosure could have wider implications for the company, its traded securities and markets.
Monitoring and reporting of the matters noted would seem reasonable in the context of the TMD process.

12 If the TMD is unambiguous, easily interpreted and simple to administer, then there should be no reason to expect that allocations will be made outside of the TMD. Where advice is given then the *best interests* obligations will direct distributor behaviour as appropriate.
In this context of potential harm, it would be reasonable for an issuer to consider a distributor's processes along with mitigants to potential risks that might otherwise impact a TMD.

<u>Proposal D</u>

1 Full-service stockbroking and advice firms will direct communications regarding a product to targeted and appropriate client segments; this cannot be done by execution-only businesses.
Product selection governance practices are an important element in protecting investors. Distributors should be able demonstrate the basis and process of product selection.
Advisers have an enforceable "best interests" obligation to retail clients they provide personal advice to, further, they have a commercial incentive to build and maintain long term client relationships. There is no evidence that what the paper describes as *incentives* has any impact on the quality of advice.
Staff training is an important element for all advice businesses and is incorporated into employment practices and industry compliance.
We would note that where, for example, a banner advertisement is used to alert potential investors of an investment product, a mitigating consideration should be that the banner directs investors to their adviser to seek further information along with confirmation (or otherwise) as to the product's appropriateness, based on their specific circumstances. Generic promotional material should not be used to directly facilitate an investment application.
As previously noted, full-advice businesses have sufficient knowledge about their clients to form a view as to whether a client will qualify for inclusion in a target market.

3 Full advice stockbroking and advice firms will have different levels of information for clients depending on the nature of advice given.
Personal advice clients receive advice and recommendations tailored to their specific circumstances and governed by the legislated "best interests duty". It is therefore logical that they are excluded from the PDDO regime as they are being provided with appropriate and tailored advice. The same can be said of investors who have enough experience or sufficiently large portfolios where they can diversify away various risks through deliberate investment choices. The latter categories can be defined as those investors covered under sections 708 and 761GA of the Corporations Act (qualified investors). It will be important to ensure that a TMD cannot unilaterally exclude investors receiving personal advice or covered by the Corporations Act as noted above.

For other investors, it is imperative that the TMD framework, which is the functional instrument of the PDDO process, exhibits the following characteristics:

- inputs are identifiable and measurable
- determinations from different issuers are consistent within a product segment
- framed such that they do effectively screen out inappropriate non-advised clients
- cannot unilaterally exclude personal advice investors or qualified investors

This will ensure that those investors and the distributors with which they deal, can clearly understand the nature of the product, i.e. its features and risks.
The nature of advice provided is clearly spelt out to investors and the advice process will identify and exclude inappropriate client segments.

4 Clear messaging about the circumstances where a loss of capital or income is possible should be an integral part of the advice/provision of information process. For example, the provision to investors of an abridged document (product summary) that highlights the key features and risks contained within a prospectus should be mandatory. Morgans prepares such a document for all ASX listed debt and hybrid securities to assist investors.

5 The TMD, along with other relevant factors, should be considered by an adviser in their recommendation. Every investor's circumstances are different and therefore the adviser must be able to use their professional judgement and experience in this process.

6 It will be important that the matters required to be reported are trackable as well as able to be captured and reported digitally. For investment products it is very likely that reporting will need to be on an ex-post basis due the complexities of the bidding and allocation processes for listed products, at least in the early stages of the operation of TMD. There will need to be tolerance from the regulator and issuers as systems are developed by distributors. This is because at this time distributors do not know what they will be required to monitor and report, therefore it will take time for the industry to work through these issues and overcome system shortcomings.

We would welcome the opportunity to answer any questions you may have in relation to our attached submission.

Yours sincerely

[redacted]

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