



Pepperstone Group Limited
ACN 147 055 703 AFSL 414530
Level 16, Tower 1
727 Collins Street, Melbourne Victoria 3008
Australia

T: +61 (0) 3 9020 0155
F: +61 (0) 3 8679 4408
www.pepperstone.com

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Product Regulation
Strategic Policy
Australian Securities and Investments Commission
GPO Box 9827
Brisbane QLD 4001

By email: product.regulation@asic.gov.au

Dear Product Regulation Team,

Re: ASIC Consultation Paper 325 *Product design and distribution obligations*

Pepperstone Group Limited (“**Pepperstone**”) welcomes the opportunity to comment on the ASIC’s “Product design and distribution obligations” consultation paper (“**CP 325**”).

Pepperstone is a global over-the-counter (“**OTC**”) derivatives broker that was established in 2010. Pepperstone is licensed and regulated by the Australian Securities and Investment Commission (“**ASIC**”). The Pepperstone group also holds a Financial Conduct Authority (“**FCA**”) authorisation and a Category 4 Dubai Financial Services Authority licence, via its locally incorporated subsidiaries in the United Kingdom (“**UK**”) and Dubai International Financial Centre, respectively. Group subsidiaries have also recently received in-principle approval for regulatory authorisations issued by the Cyprus Securities and Exchange Commission and the Kenyan Capital Markets Authority .

While Pepperstone is supportive of strengthening Australian requirements and providing protection to investors, we are concerned that ASIC’s interpretation of the new design and distribution obligations under *Treasury Laws Amendment (Design and Distribution Obligations and Product Intervention Powers) Act 2019* (“**Product Distribution Obligations**”) could be interpreted as going beyond product distribution requirements, in effect implementing new material obligations on certain financial services licensees. We are also concerned about the role of the consumer in the new world once the Product Distribution Obligations are in force, as well as the impact on competition in Australian financial markets.

We have set out our concerns in more detail below.

Product Distribution versus Client Suitability/Best Interest Obligations

In particular, we are concerned that some of the prescriptive detail and recommendations in ASIC's draft regulatory guide attached to CP 325 ("**Draft RG**") goes beyond the scope of Proposed Distribution Obligations, in effect turning them into individual client suitability or best interest obligations, which are not currently imposed on certain licensees (for example, general advice licensees). We note other jurisdictions such as the UK and Europe ensure that product distribution obligations and suitability/best interest obligations are considered to be distinct and separate. This is because there is an important distinction regarding whether someone is within a class of consumers that is likely to be suitable for access to a product, versus whether the product an individual can access is suitable for them given their specific needs and circumstances.

We also feel it necessary to highlight that there are multiple references to the Royal Commission Final Report in the Draft RG to justify many of the additional requirements. We believe it important to point out that those findings were in relation to the actions of large financial institutions and may not be relevant to smaller firms or those firms that do not have a personal advice relationship with a retail client.

We believe that a more specific client suitability obligation or a more granular Product Distribution Obligation will result in a regime that greatly restricts the products able to be offered by licensees that do not provide personal financial advice. This is because general or no advice licensees will simply not be able to obtain the detailed information that will protect them from a potential enforcement action taken with the benefit of hindsight.

Given the unpredictability of markets and the limited discussions that consumers want to have or the evidence that they are willing to provide to financial services businesses that are not in a long-term personal advice relationship with them, it may be that most Australian licensees will be limited to only being able to provide the most vanilla financial products to consumers.

We consider that introducing the Product Distribution Obligations as drafted will make the Australian regime far more burdensome and difficult to comply with than equivalent regulatory obligations in other jurisdictions such as the UK and Europe. We believe this would make Australia less desirable as a location for innovative businesses and would generally make it difficult for Australian companies to compete with equivalent overseas businesses given the additional restrictions, cost and burden that the Product Distribution Obligations impose.

Our suggestion would be to either move the more detailed client recommendations to a different regulatory guide that deals with guidance for licensees that have specific client suitability or best interest duty obligations. Alternatively, there could be some additional commentary in the Draft RG that recognises there will be some client relationships with manufacturers or distributors where detailed information will not be available and the "reasonable steps" requirements will adjust accordingly.

Consumer Choice and Consumer Responsibility

Another aspect we want to highlight is when revisiting the original Government comments behind the reform, the principles used in designing the proposals included the following:

- consumers should receive fair treatment from financial firms and that product issuers and distributors should design, target and distribute products that meet consumer needs;
- these measures should encourage a more consumer-centric approach to the entire product lifecycle;
- consumers should ultimately remain responsible for the consequences of their financial decisions;
- these measures should apply to a broad range of product, but be implemented in a flexible and scalable manner;
- these measures should not unnecessarily inhibit product innovation and allow for consumers to access a diversity of products; and
- the measures should be implemented in a way that avoids unnecessary regulatory costs.¹

We are concerned that CP 325 and its Draft RG is worded in such a way that it seems to have removed the aspects of consumer choice and consumer responsibility.

Consumer choice is an important consideration in Product Distribution Obligations discussions because even if a manufacturer/distributor takes steps to prevent a consumer from accessing a product, this will not necessarily prevent Australian consumers from investing in riskier products. It will only mean they will start looking offshore to be able to access the range of products they want to invest in, moving their investment decisions outside of the Australian regulatory regime and potentially exposing them to more risk. It may also be that the consumer is aware of facts not made available to a manufacturer or distributor that changes how they should be categorised. We therefore recommend that Draft RG still allows for consumer decisions to be recognised.

The Impact on Innovation

There is also the risk of limiting innovation. If a firm is looking to offer a brand new innovative product, not only can it be difficult for the firm to know exactly how the product will operate and act prior to its full release, the costs associated with pre-testing will simply be too expensive to justify creating the product without the firm knowing if it is likely to obtain market share. There is also the risk that in trying to obtain some marketing testing the firm will expose the idea to the marketplace, allowing other more established firms to take advantage and making the product less valuable on release.

We believe that this issue could be rectified by allowing for some additional commentary around availability of information, particularly for new products and recognising that ASIC will consider this in its supervision of these requirements.

The Advantage for Larger Institutions

Generally we are concerned that while some of the prescriptive guidance in the Draft RG may appear reasonable on paper when applied to larger, more established licensees like banks and large financial advisors, their impact on other firms, which may not have access to large in-house legal and compliance teams or comprehensive record keeping systems, could be severe.

¹ Treasury, Design and Distribution Obligations and Product Intervention Power, Proposals Paper, December 2016 page 8.

It is important to remember that large financial institutions already have the financial, technical, legal and human resources to be able to easily implement the type of product governance framework and assessment requirements envisaged by the guidance outlined in the Draft RG, even if they do not have the specific systems in place currently. Requiring this level of detail for smaller product manufacturers operating in Australia is likely to have a more material cost impact on those firms who may have to establish comprehensive systems and processes from scratch.

It is readily accepted that competition is one of the key levers that keep larger institutions such as banks more cost efficient and productive.² Yet we believe there is a risk that prescriptive requirements meant to improve those institutions' behaviour could remove competition from the Australian market, because only large, established firms will have the resources to implement the changes and absorb the costs.

We believe that including more suggestive wording in the Draft RG, rather than strongly worded guidance would assist firms to be able to scale the requirements or gradually implement the requirements over time.

The Definition of “Good Consumer Outcome”

Finally, we also have material concerns that ASIC's approach to what is considered a “good consumer outcome” in the Draft RG is too narrow. Consumers benefit from choice, from clarity and from competition. We are concerned that ASIC appears to be limiting a good consumer outcome to only those scenarios where a consumer is guaranteed to make secure money with no risk. We do not consider this to be a realistic view of how financial markets operate and we believe it exposes licensees to uncertain regulatory risk in scenarios they may not be able to control, such as unexpected market movements.

We believe it is best not to materially emphasise loss or gain when considering a “good consumer outcome” because some of the riskiest products can provide the greatest short terms gains and some of the more conservative products can be impacted negatively in certain circumstances. The recent stock market impacts from the Coronavirus (“**COVID-19**”) is an example of this.

We believe a better assessment of good consumer outcome would be to move it more to a consideration of whether the products distributed to consumers operated as intended.

Regulatory Decisions or Business/Market Decisions

We believe that some of the Draft RG may be inadvertently entering into areas that are more appropriately managed and decided on by businesses or driven by market forces such as:

- the removal of currently available products;
- the commentary around low or no value products; and
- the discussion around an assessment of fees charged for similar performing products.

The current environment of online reviews, comparison and commentary, as well as the ability for consumers to more easily access performance information for various products means that

² See Competition in the Australian Financial System, Productivity Commission Inquiry Report, No 89, 29 June 2018.

consumers are in a more informed position about the value of a firm's offerings compared to their competitors.

This suggests that guidance around these points may not be necessary as market forces are likely to impact whether a product is successful or not and therefore remains in existence.

Other Options

We believe a useful path for the Draft RG could be to return to the original Government Design and Distribution Obligations and Product Intervention Power Proposals Paper which mentioned the following standards as good examples of where distribution and product approval standards had been implemented:

- the UK Financial Conduct Authority (FCA) Guidance Note on *The Responsibilities of Providers and Distributors for the Fair Treatment of Customers*;
- the Markets in Financial Instruments Directive 2004/39/EC ("**MiFID II**") requirements under the European Union Standards;³ and
- the Australian Financial Markets Association (AFMA) *Product Approval Principles*.

In our view, ASIC drafting more general guidance consistent with those principles would still protect consumers and would be in line with the Product Distribution Obligations.

For example, the European Securities and Markets Authority ("**ESMA**") Guidelines on MiFID II product governance simply outlines 5 categories that manufacturers should consider when identifying their target market:

- the type of clients to whom the product is targeted;
- knowledge and experience;
- financial situation with a focus on the ability to bear losses;
- risk tolerance and compatibility of the risk/reward profile of the product with the target market; and
- clients objectives and needs.

The ESMA guidance provides some limited suggestions as to what to include in those categories but does not make any category more important than the other and leaves the detail of what to consider in those categories up to the manufacturer/distributor.

The guidance also recognises that there will be scenarios where products are sold outside of a target market as a result of non-advised sales or in scenarios in which a distributor or product manufacturer may not be able to make a thorough target market assessment by virtue of the services they provide. This could be likened to a general advice relationship which is a type of scenario does not seem to be recognised in the Draft RG.

As noted above, the ESMA guidance does acknowledge that client suitability requirements are separate and apply in addition to the product distribution obligations. On that point we note that Australia already has a number of client suitability obligations including the responsible lending obligations and the best interest duties. The option is open to ASIC to provide more specific guidance on those requirements independently to the Product Distribution Obligations guidance.

³ For example, see ESMA Guidelines on MiFID II product governance requirements.

We are happy to provide more information on any of the matters raised above but have provided additional information in our responses to the CP 325 questions below.

B1 We propose to give guidance that a robust product governance framework that fulfils the objectives of the design and distribution regime should:

- (a) focus on the identified target market across the lifecycle of the financial product;*
- (b) be designed to reduce the risk of products being sold to consumers that are not consistent with their likely objectives, financial situation and needs; and*
- (c) be documented, fully implemented, monitored and reported on and regularly reviewed to ensure that it is up to date.*

B1Q1 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?

While it may be that other provisions of the *Corporations Act 2001 (Cth)* (“**Corporations Act**”) are relevant to ensure systems and processes are appropriate and having a formal product governance framework may assist with compliance, we do not necessarily agree that these requirements arise from the Product Design Obligations.

We therefore recommend making requirements for a formal product governance framework more of a suggestion rather than a mandatory requirement and potentially removing some of the stronger wording such as that in RG 000.36:

“If issuers and distributors do not do this, we consider it will be more difficult to comply with the design and distribution obligations, and to demonstrate compliance”.

We also highlight in the case of some online platform providers, it may be that clients access the product directly themselves and not via a distribution network or via active marketing. This type of scenario does not seem to be considered by the Draft RG.

In addition, we note the requirement in RG 000.47 for a firm to consider “the ‘choice architecture’ of its financial product to ensure that it is consistent with the target market, including, for instance, the impact of complexity and frictions in choices, processes and information”. This assessment does not appear to be part of the Product Design Obligations and appears to be inconsistent with other global regulatory standards. We therefore request that ASIC give further consideration to this requirement to make sure Australian firms are not at a disadvantage to other international businesses.

B2 We propose to give guidance that issuers and distributors should not take advantage of behavioural biases or factors that can impede consumer outcomes. In addition, issuers and distributors should consider consumer vulnerabilities and how these vulnerabilities may increase the risk that products sold to consumers do not meet their needs and lead to poor consumer outcomes.

B2Q1 Is our guidance on the consumer-centric approach issuers and distributors should take to deliver good consumer outcomes useful?

We are not sure this is necessary and are concerned that some of the guidance is considering a market and business environment that is overly simplified and ideal and may be difficult to implement in practice.

The Corporations Act already contains other standards relating to misleading and deceptive conduct and vulnerability. We do not believe it is necessary to include additional requirements under the Draft RG that goes beyond those standards.

A detailed understanding of behavioural biases is also a specific field of expertise that is beyond the skill and resource capacity of many small-mid tier financial services licensees. The expense of implementing such skills and resources in a firm would be extremely costly.

Many biases can also be specific to an individual's circumstances and experience. In our view it is simply not possible for a firm, particularly one that does not have a direct personal advice relationship with a retail client, to form an opinion as to how their biases may implement their decisions. These requirements could therefore expose firms to extreme regulatory uncertainty and risk.

Again, we also highlight that the original intention of the Product Design Obligations was not to take away consumer responsibility and choice and would caution a regime that does impact that, either directly or indirectly.

B2Q2 What additional matters, if any, do you consider to be relevant?

We are of the view that the requirements outlined in RG 000.52-RG 000.56 may go beyond the requirements of the Product Design Obligations. We do not believe it is relevant to provide any detailed guidance about what is a "good consumer outcome" as we think this will depend on numerous factors.

As mentioned above, we believe that ASIC should carefully consider retaining the current narrow definition of consumer outcome, which in our view could severely impact investor choice and competition in Australia.

We believe it is better to leave the requirement as a high-level requirement, which is more consistent with the legislative requirements and international obligations.

C1 We propose to provide guidance that what amounts to an appropriate target market determination can differ, depending on the type and particular characteristics of the financial product to be issued, the intended distribution approach and the issuer's product governance framework.

C1Q1 Do you agree with our approach to guidance on the form and content of a target market determination? If not, why not?

We agree with sections RG 000.64 - RG 000.65, as those sections state that the legislation sets out a number of matters a target market determination must include and ASIC is not providing definitive guidance. It also highlights the key issue that the determination can differ depending on the type and particular characteristics of the financial product to be issued, the intended distribution approach and the issuer's product governance framework.

We do have some concerns that despite those sections, the Draft RG then goes on to be quite prescriptive in nature and is worded in a way which again could either directly or indirectly move beyond the requirements of the Product Design Obligations.

We would caution the suggestion that there is a clear aim to impact current products that are available to retail clients in Australia:

“RG 000.70 We expect product design to be driven by features that benefit the consumer. The design and distribution obligations mean that a product development process that does not consider consumer outcomes will not be feasible. For example, we expect that in complying with the obligations, some issuers will conclude that a financial product or product feature is unlikely to be consistent with the objectives, financial situation and needs of any consumers. This may be due, for example, to risk, low value, or because the product is inherently flawed.”

Market forces and consumer decisions are key to driving the success and availability of financial products in Australia. If a product does not benefit the consumer then it is not going to be successful.

We believe that the wording in the above section could be harmful to firms because it exposes them to the risk of regulatory action or consumer backlash if a consumer suffers any loss, even if other consumers do not suffer loss, or even if the potential upside reward of the product is balanced with the potential for loss and those risks are understood.

Unfortunately, we are already seeing less honest consumers using regulator statements to try to extort money from firms, even in scenarios where there is no fault from the firm. We would therefore caution ASIC from using such phrases in its formal guidance.

We also do not believe it would be ASIC’s intention to restrict products in Australia that are readily available in other regulated international jurisdictions, as this would simply move Australian consumers offshore. We are concerned the above referenced paragraph may have that impact.

C2 We propose to provide guidance that, generally speaking: (a) for new products—issuers should identify the target market and design financial products that are likely to be consistent with the likely objectives, financial situation and needs of consumers in that target market; and (b) for continuing products—issuers should still critically assess the product (and its features) and identify the target market under the design and distribution obligations by reference to the likely objectives, financial situation and needs of consumers for whom the product would likely be consistent. If issuers already have processes directed towards these purposes, they should check that the processes meet the detailed requirements of the legislation.

C2Q1 Is our guidance on the approach to identifying the target market for new products and continuing products useful?

We believe that detailed restrictions taken together (for example the sections disallowing any emphasis on consumer experience, understanding, diversification, product variation or a desire for a product), along with an overemphasis on product performance and review (including quantitative requirements) potentially to an individual consumer level, leave very little room for product manufacturers to be able to draft a target market statement with any level of regulatory certainty. It also results in the Proposed Distribution Obligations being far more burdensome and costly on manufacturers and distributors.

We believe that ASIC's current approach to identifying the target market for new and continuing products as drafted in the Draft RG may result in the Australian regime becoming far too stringent, negatively impacting innovation and competition in this country.

In our view the push for a very granular consumer class in a target market statement is also a practical problem for firms who offer general advice services and who may not be able to access the type of consumer information required for such a detailed assessment.

We believe that allowing for a less granular consumer class and less consumer intrusive ongoing reviews in these types of scenarios would provide better certainty to those firms and will respect the choice of a consumer who made the decision to enter into an arrangement with little or no input from the firm.

C2Q2 What additional matters, if any, do you consider to be relevant?

While the Draft RG mentions the complexity of the product is relevant to how detailed the target market statement needs to be, we are of the view that the type of service, and the way consumers access the product or are distributed the product should also be relevant.

We believe that there also needs to be some recognition that products offered via general or no advice services may not be able to access detailed client information prior to a product being issued.

C3 While we do not propose to give any definitive formulation of how a target market should be described in a target market determination, we propose to give guidance that explains the process and key considerations for identifying and describing the target market by reference to examples across different product sectors. See draft RG 000 at RG 000.66–RG 000.89.

C3Q1 Do you have any comments on our approach to guidance on identifying and describing the target market?

We would discourage ASIC from prescribing specific guidance in relation to any particular product sector as it may unintentionally impact innovation or evolution of products in those sectors.

We believe a better solution is to allow industries themselves to work together to discuss and consider best practices and consumer choice to impact the success or failure of various products.

C3Q2 Do you have any comments on the following examples, which we have used in our guidance to illustrate key principles set out in RG 000.66–RG 000.89:

- (a) Example 1: Credit cards;*
- (b) Example 2: Reverse mortgages;*
- (c) Example 3: Cash options in superannuation;*
- (d) Example 4: Consumer credit insurance;*
- (e) Example 5: Low-value products; and*
- (f) Example 6: Basic banking products?*

As we do not offer these products, we are not in the best place to provide much additional information beyond how we have responded to C3Q1. We do highlight that “Example 5: Low-value products” does not seem to be a necessary example. If a product has no or low value to consumers it will logically not be bought by consumers unless there is some misleading and

deceptive or unconscionable selling practices in which case, there are other Corporations Act provisions available to protect consumers.

C4 We propose to give guidance that when an issuer considers it appropriate to contemplate consumers in the target market acquiring the financial product as part of a diversified portfolio, the reasonable steps obligation will require the issuer to manage the risk of the product being sold to consumers who do not have a diversified portfolio.

C4Q1 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?

We agree that this should not be the only matter considered in a target market statement but it can be relevant for certain higher risk products.

We note that ESMA discusses diversification in its guidance on MiFiD II and specifically mentions that the identification of a target market by the distributor is without prejudice to the assessment of suitability. Therefore permissible deviations between the target market identification and the individual eligibility of the client may occur if the recommendation or sale of the product fulfils the suitability requirements conducted with a portfolio view.⁴ Distributors may not even be required to report sales to the manufacturer that are outside of the positive target market if these sales are for diversification and hedging purposes and if the sales are still suitable for the given client's total portfolio or the risk being hedged.⁵

We believe ESMA's approach may be useful when dealing with diversification issues.

C5 We propose to give guidance that we do not consider a target market for a product should be predominantly based on consumer understanding of a product.

C5Q1 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?

We agree that understanding of the product should not be the only consideration in a target market assessment, but we do not necessarily agree that it cannot be material to a decision about whether a product should be made available to a consumer.

It is true that knowledge of a product does not mean it is necessarily suitable for an individual consumer given their specific circumstances. We believe this is more a question about client suitability rather than product distribution.

C6 We propose to provide guidance that in making a target market determination, it will also be useful for the issuer to consider, in addition to the target market, those for whom the financial product is clearly unsuitable (the 'negative target market').

C6Q1 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?

⁴ See ESMA Guidelines on MiFiD II product governance requirements paragraph 53.

⁵ Ibid paragraph 54.

We agree that a negative target market can be useful. We believe it should be up to the issuer to determine whether it is necessary and how detailed that should be, particularly as this is not part of the original legislative requirements.

C6Q2 Is our guidance on the role of describing a negative target market adequate and useful? If not, please explain why, giving examples.

We do not agree with any wording that would suggest that, by not having an articulated or negative target market, an issuer is not taking reasonable steps to comply with their Product Distribution Obligations, as this requirement does go beyond those obligations.

C7 We propose to give guidance on how the target market determination applies for certain products when the application of the obligation is not straightforward, including: (a) to superannuation and investor directed portfolio services (also known as 'platforms' or 'IDPS'); (b) when products are offered and acquired as a 'package' or 'bundle'; and (c) when products are customisable by the consumer at point-of-sale, including through choices or options (e.g. selecting a waiting period for an income protection insurance product).

C7Q1 In relation to our guidance on how a target market determination should be approached for superannuation products, as set out in Example 7:

(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?

(b) What factors do you consider relevant to the grouping of investment options in making a target market determination? Why?

(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?

(d) How should a trustee take into account insurance in making a target market determination for a Choice product?

As we do not offer these types of products, we do not have any comment to make regarding this guidance beyond our concern that ASIC should avoid being too specific in its guidance in order to avoid limiting innovation and consumer choice.

C7Q2 Do you agree with our guidance on the application of the target market determination obligation to IDPS?

Please refer to our comment to C7Q1.

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 do have a concern about how this would operate from a practical perspective. Please also refer to our previous comments about suitability versus product distribution. We believe this type of detailed guidance could impact consumer choice.

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 reiterate our concerns around choice architecture requirements. We also believe that the Draft Guide should avoid prescriptive guidance regarding this type of distribution as it may impact

consumer choice or increase the complexity or administrative burden of this type of option. We believe a scenario where the consumer is the one making the choice is preferable in many cases from a conflicts of interest perspective so it should not be impacted by hurdles unless there is clear evidence of harm.

C7Q5 Are there any particular 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.

The Product Design Obligations are not a suitability obligation so we would caution having this type of guidance as part of the Draft Guide considerations. It may unintentionally limit consumer choice in scenarios where an issuer does not have detailed information about the consumer.

C8 We propose to give guidance on the reasonable steps obligation for issuers, and set out our view on the factors that may be relevant to the obligation. These factors include:

- (a) the distribution conditions that are specified in the target market determination;*
- (b) the issuer's marketing and promotional materials;*
- (c) the selection of distributors;*
- (d) the supervision and monitoring of distributors;*
- (e) the issuer's ability to eliminate or appropriately manage conflicts of interest; and*
- (f) whether issuers have provided distributors with sufficient information to help them ensure that distribution is consistent with the target market determination.*

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?*

We believe that the Draft RG may be too prescriptive and encourage ASIC to consider whether the guidance is related to product distribution or is moving (either directly or indirectly) towards more of a best interest/client suitability obligation. If that is the case, then we suggest that ASIC consider covering the requirements in other guidance that is kept separate to the Product Distribution Obligation guidance.

In the event that there are material gaps in current regulatory requirements for individual client suitability, we believe that ASIC and Government should independently consider additional law reform via standard methods.

C8Q2 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?

We have no comment to make regarding these factors.

C8Q3 What additional factors, if any, do you consider should be included in Table 3 of draft RG 000?

We do not believe there should be additional factors added to Table 3. We would encourage less prescriptive wording in the Draft RG.

C9 We do not propose to set out in guidance standard review triggers and maximum review periods for issuers to adopt. Instead, our draft guidance sets out examples to illustrate what review triggers may be appropriate for certain types of financial products. See draft RG 000 at RG 000.127–RG 000.134 and Examples 12–13.

C9Q1 Do you have any comments on our guidance on setting appropriate review triggers and maximum review periods?

We have no specific comments about this guidance.

C9Q2 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?

We believe the examples contain review triggers that are not necessarily relevant to the Product Distribution Obligations and appear go beyond the requirements of those specific obligations. We are concerned they could appear to be too stringent and move towards restricting product and consumer choice.

We are also concerned that they appear to move towards a regulatory regime that impacts choices that should be left in the hands of businesses and consumers.

C10 We propose to give guidance on the issuer's obligation to specify in the target market determination:

(a) any information that it considers is necessary to require from its distributors in order to promptly decide that a target market determination may no longer be appropriate; and

(b) the reporting period for the information the distributor must provide to the issuer about the number of complaints about the financial product.

C10Q1 Do you have any comments on our guidance on the issuer's obligation to specify information it requires from its distributors?

Given the prescriptive nature of the information in RG 000.139, we would suggest this section be worded in a less stringent manner so that if a licensee believes on a reasonable basis that a particular factor is not relevant to their product, they do not feel mandated to include it.

We are also concerned that should the Australian obligations mandate distributors to provide too much specific information that is not required to be provided under other similar international obligations, that may discourage distributors from wanting to work with Australian licensees or distribute Australian products.

C10Q2 What existing information collected by distributors would be relevant to an issuer's consideration of the ongoing appropriateness of its target market determination?

We do not believe we are in the best position to provide this information knowing it could impact all firms that are subject to these obligations, as it is going to depend on too many factors, including the type of relationship a firm may have with a consumer.

C10Q3 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.

We believe it is best to leave this requirement at a higher, less prescriptive level and that it be left to the commercial relationship between the issuer and their distributor.

C10Q4 What potential effects on competition may occur as a result of the issuer's right to set the information the distributor must provide?

As mentioned above, we believe this could have a material impact on competition, particularly in light of the fact that the requirements will only be in Australia.

In addition, we believe that requiring detailed or specific information is likely to impact smaller to mid-tier firms more than larger institutions as they may have to implement systems and processes that they do not currently have.

Finally, this may have a material impact on Australian distributors themselves as larger institutions may simply choose to move their distribution services in-house for ease, control and cost efficiency rather than rely on smaller third parties.

We therefore strongly discourage ASIC from providing guidance on specific aspects of the relationship between the product issuer and distributor.

C10Q5 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?

We have no comments to make in relation to this question.

C11 We propose to give guidance that, in reviewing a target market determination, we expect the issuer will take into account all available information on its financial product, using multiple data sources. See draft RG 000 at RG 000.143–RG 000.145.

C11Q1 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?

We believe the guidance could be too prescriptive and will likely increase the cost of implementation of the Product Distribution Obligations to small-mid tier firms who are unlikely to have the systems and policies in place to obtain the information or analyse all information as is suggested in RG 000.143.

We suggest that ASIC consider the wording of requiring firms to use “all available information on its financial product” in its assessments, as some of the information may not be relevant to product distribution.

C11Q2 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?

We would recommend that ASIC does not mandate specific data sources that issuers should take into account in reviewing a target market determination. We recommend simply having those data sources as suggestions instead.

C11Q3 Do you have any other comments on our guidance on conducting a review of a target market determination?

Please refer to our previous comments on the potential for the guidance to be too prescriptive or potentially adding additional obligations that go beyond the Product Distribution Obligations.

We again note that a detailed requirement like this is likely to be most beneficial for larger financial institutions that will already have the data, systems and human resources to be able to more easily implement, consolidate and analyse this form of detail and more easily absorb the cost. We believe this requirement will likely give those entities a clear competitive advantage.

C12 We propose to provide guidance that the factors an issuer should consider when determining whether there has been a significant dealing in a financial product that is not consistent with the product's target market determination include:

- (a) the proportion of consumers who are not in the target market acquiring the financial product;*
- (b) the actual or potential harm to consumers; and*
- (c) the nature and extent of the inconsistency of distribution with the target market determination.*

C12Q1 Are there any additional factors that issuers should consider? If yes, please provide details.

We do not believe there should be additional factors added.

UK and European requirements contemplate that there are likely to be reasons for people outside a target market choosing to purchase products and that there may be valid reasons for this.

We recommend that the guidance clarify that the proportion of consumers who are not in the target market acquiring the financial product does not need to include those that have purchased the product on a reasonable basis, for example, those purchasing the product for clear documented diversification purposes or other valid reasons such as personal advice provided by an unrelated licensee.

D1 We propose to give high-level guidance on the reasonable steps obligation for distributors of financial products by setting out our view on factors that may be relevant to this obligation, including:

- (a) the distribution method(s) used;*
- (b) compliance with distribution conditions;*
- (c) the marketing and promotional materials circulated by the distributor;*
- (d) the effectiveness of the distributor's product governance framework;*
- (e) the steps taken to eliminate or appropriately manage the risk that incentives for staff or contractors may influence behaviours that could result in distribution being inconsistent with the target market determination;*

- (f) *whether reliance on existing information about the consumer is appropriate;*
- (g) *whether the distributor has given staff involved in distribution operations sufficient training;*
and
- (h) *how the distributor forms a reasonable view that a consumer is reasonably likely to be in the target market.*

D1Q1 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?

We have some concerns that the detailed list potentially goes beyond the legal requirements outlined in the Product Distribution Obligations.

We also believe the information provided fails to take into consideration certain factors. For example, the suggestion that a complex or high-risk investment is not suitable for banner advertising does not take into consideration the ability to restrict banner advertising to only those that have previously directly searched for the specific product or only to people with certain attributes.

This is an example where technology is improving so that marketing can be more targeted, and it demonstrates why being too specific in guidance can be a problem for innovative products and solutions.

We also disagree with the assumptions that any consumer accessing a product outside of the target market constitutes an extreme event. As mentioned above, overseas regulators have the view that there can be legitimate reasons as to why a consumer outside of the target market statement gets access to a product, including because they have themselves chosen to do so. We believe this position is also recognised by s994E(4) discussions which states that it not a failure of the reasonable steps obligation simply because a consumer obtains a product outside of a target market statement.

Having said that, we do consider it relevant that where there is a negative target market specified, it should be rare that consumers within that segment gain access to the product. A firm's records regarding that scenario should be clear and detailed. Our recommendation is the guidance should be worded more to reflect that scenario which is again more consistent with overseas obligations.

Our comments from the previous sections about competition are also relevant to the response for this question.

D1Q2 What additional factors, if any, do you consider should be included in Table 5 of draft RG 000?

Please refer to the above. We do not believe a prescriptive list will assist distributors in complying with their obligations and in fact we believe it more likely to harm the financial services industry.

D2 We propose to include an example to illustrate, at the time of renewal for general insurance policies, how insurers (in their role as distributor) can approach the reasonable steps obligation to ensure that the renewal process results in outcomes that are consistent with the target market determination. Our guidance suggests that, at the time of renewal, an insurer should:

- (a) *analyse information it holds, such as:*
 - 1. information it gathered when the customer initially acquired the product; and*

- II. updated details that have been provided, or through claims that have subsequently occurred; and*
- (b) consider a number of factors, including the likelihood that a class of consumers is no longer in the target market for the policy. When an insurer assesses that it is likely that a consumer is no longer in the target market for an insurance policy, this should not result in an insurer declining to offer a renewal of the policy without contacting the consumer.*

D2Q1 Do you have any comments on our proposed guidance for distributors in Example 14 of draft RG 000?

While we are not best placed to make comment on the detail as we do not offer these types of products, we do have concerns about the prescriptive nature of the guidance in general and would discourage this level of detail as it is likely to impact innovation and competition. It also disadvantages smaller distributors who may not have the same systems and resources that larger distributors may have which enables them to more easily absorb the cost of the requirements.

D2Q2 What other steps or controls, if any, do you consider would be appropriate for a distributor to consider what reasonable steps should be taken at renewal?

Please refer to the previous comment.

D3 We propose to provide guidance:

- (a) that, in most cases, a distributor should have sufficient information about a consumer through its existing sales processes to form a reasonable view on whether the consumer is reasonably likely to be in the target market for a financial product;*
- (b) that the ways a distributor's processes could assist it to form a reasonable view that a consumer is reasonably likely to be in the target market for a financial product include:*
 - I. the inclusion of 'knockout questions' within application processes;*
 - II. analysis of data held on the consumer or a class of consumers; and*
 - III. in some cases, asking the consumer direct questions to determine whether they are reasonably likely to be in the target market (see draft RG 000 at RG 000.168(a)– RG 000.168(c)); and*
- (c) on the steps that a distributor can take to reduce the likelihood that a consumer will be left with the impression that their personal circumstances have been considered, including:*
 - I. not having a relevant provider (i.e. an individual authorised to give personal advice to consumers on relevant financial products) involved in the distribution process to ask specific questions of a consumer and communicate the view that the consumer is in the target market to the consumer; and*
 - II. only asking specific questions of a consumer (when required) in the later stages of the sales process after the consumer has already made the decision to acquire the financial product (see draft RG 000 at RG 000.169(a)–RG 000.169(b)).*

D3Q1 Do you agree that, in most cases, a distributor would have sufficient information about a consumer through its existing sales processes to form a reasonable view on whether the consumer is reasonably likely to be in the target market for a financial product?

We do not necessarily agree with this statement, especially if ASIC's expectations for a granular target market statement remains. There are some financial service relationships where a consumer may approach an issuer of a product directly without any form of active marketing. That issuer becomes the distributor merely as a consequence of the fact that they are dealing in the financial product.

Our experience has been that those types of consumers can be extremely reluctant to provide detailed information to an issuer prior to being able to trade in the products they want. It may therefore not be possible for firms to get a granular understanding of these consumers without appearing to be offering personal advice or signing off on the suitability of the product for each specific consumer, which in itself may cause harm.

We believe some consideration needs to be given to those types of relationships across the entire Draft Guide.

D3Q2 What data do you consider would help distributors reasonably conclude that a consumer is reasonably likely to be in the target market for a financial product?

This is going to depend on a number of factors so we believe it is best for ASIC not to be too prescriptive on these points.

D3Q3 Do you consider our guidance should identify (in draft RG 000 at RG 000.168) other ways that a distributor's sales processes can assist it to form a reasonable view that a consumer is reasonably likely to be in the target market for a financial product? What other approaches can be taken?

It is not advisable for ASIC to provide this form of guidance as this is likely to impact innovation and is unlikely to cover the varied aspects of financial product and services that can be offered. We believe this may also make the Australian regime anti-competitive compared to other international regimes.

We also highlight the additional material cost to small-mid tier firms who will likely have to pay to change onboarding systems or processes in order to deal with, for example, specific questions having to be asked.

D3Q4 Do you have any comments on our proposed guidance (in draft RG 000 at RG 000.169) on how a distributor could reduce the likelihood of leaving a consumer with the impression that their personal circumstances have been considered?

We are concerned that even with these standards being used, the more information required to be asked of consumers as a consequence of the target market assessment, the more likely a consumer is going to assume the product is specifically suitable to them as an individual rather than a broader consideration.

D4 We propose to provide guidance that the reasonable steps a distributor should take when selling a financial product to consumers who are outside the target market for the product depends on the circumstances of the interaction, the nature and degree of harm that might result, and the steps that can be taken to mitigate the harm.

D4Q1 Do you have any comments on our proposed guidance on the content of the reasonable steps obligation in these circumstances?

Please refer to our previous comments on this matter.

D4Q2 Are there any specific methods that you consider our guidance should identify for distributors seeking to meet the reasonable steps obligation in the context of interacting with consumers who are outside the target market for a financial product?

We believe the guidance should be altered to include scenarios where it would be reasonable for a consumer to access a product even though they are outside of a target market.

D5 We propose to provide guidance that a target market determination for a financial product should be considered by a financial adviser in providing the advice and meeting their best interests duty. See draft RG 000 at RG 000.180–RG 000.183.

D5Q1 Do you agree that a target market determination for a financial product should be considered by a financial adviser in providing the advice and meeting their best interests duty? If not, please explain

We believe questions of client suitability or best interest duties should not be included in the Draft RG as the identification of the target market is a separate responsibility to that of conducting a suitability or appropriateness test for each individual client within that target market.

D6 We propose to provide additional guidance on aspects of the interaction between the responsible lending obligations and the design and distribution obligations, including that:

(a) information gathered as part of the responsible lending obligations may help the distributor form a reasonable view on whether the consumer is reasonably likely to be in the target market for a product; and

(b) the reasonable steps obligation does not require further steps to be taken by a distributor when assessing, for responsible lending purposes, whether the consumer can comply with their financial obligations under the contract.

D6Q1 Do you have any comments on our proposed guidance on using information gathered for the purpose of meeting responsible lending obligations in order to assist a distributor to form a reasonable view on whether a consumer is reasonably likely to be in a target market for a financial product?

We believe it would be better if questions of client suitability or best interest duties are not included in the Draft RG, as the identification of the target market is a separate responsibility to that of conducting a suitability or appropriateness test for each individual client within that target market.

D6Q2 Are there any further issues you consider are raised by the interaction of the two regimes that should be dealt with in our guidance? Please explain.

Please refer to our comment above.

D7 We do not propose to provide specific guidance on the practical aspects of the relationship between the issuer and the distributor regarding information exchange.

D7Q1 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?*

We do not think it would be useful for ASIC to provide guidance on these matters in the Draft RG. We agree with the position that these are commercial matters that issuers and distributors can determine themselves.

D7Q2 Are there other considerations that need to be taken into account in the collection and exchange of information between an issuer and a distributor?

We do not believe it would be useful for ASIC to provide guidance on this aspect in the Draft RG.

E1 We propose to give guidance on the factors that we will take into account when considering whether to provide an exemption from, or modification to, the design and distribution obligations. These factors include:

- (a) (a) whether the objects of Ch 7 are being promoted, including the provision of suitable financial products to consumers (see s760A(aa));*
- (b) (b) the policy intention underlying the design and distribution obligations to:
 - I. improve consumer outcomes; and*
 - II. require financial services providers to have a consumer centric approach to making initial offerings of products to consumers; and**
- (c) Parliament's intent (as reflected in the law) for these obligations to apply to a broad range of financial products. See draft RG 000 at RG 000.232.*

E1Q1 Do you agree with the factors that we will take into account when considering whether to provide an exemption from, or modification to, the design and distribution obligations? If not, why not?

We have no comment to make about this section.

E1Q2 Are there any additional factors that you consider we should take into account?

We have no comment to make about this section.

E2 We propose to give guidance that, if we grant disclosure relief for a financial product, relief from the design and distribution obligations will not automatically follow. If requested, we will consider whether to grant relief from the design and distribution obligations as a separate matter to our consideration of the disclosure relief. See draft RG 000 at RG 000.233.

E2Q1 Do you agree with our proposed approach to providing relief from the design and distribution obligations when disclosure relief has been granted in relation to a financial product? If not, why not?

We agree with this approach and have no additional comments to make.

Regulatory and financial impact

We are concerned that the level of detail in the Draft RG seemingly goes beyond the obligations outlined the Product Distribution Obligations. This means there will likely be a material additional cost to small-mid tier firms, beyond the implementation of the original regulatory requirements as written.

The cost will not only relate to changes to systems, procedures and resourcing but will also arise from:

- the loss of business opportunities as a consequence of the requirements resulting in far more detail that needs to be asked from consumers than is required in other regulatory jurisdictions;
- the loss of access to certain distributors as a consequence of more detailed requirements that is required in other regulatory jurisdictions; and
- the inability of many firms to offer certain currently established products in this jurisdiction to certain consumers merely due to the fact that issuers without a personal advice relationship will not have access to the information required under the Draft Guide.

As pointed out previously, we are also concerned that the Draft RG implements regulatory obligations that are far more costly and burdensome than equivalent overseas jurisdictions which will make it more difficult to compete with overseas entities offering the same financial products.

Conclusion

We ask that ASIC reconsider the original intention of Design and Distribution obligations in Australia and potentially recast the Draft RG to represent those ideals, in light of the fact that these obligations were not designed to limit investor choice or responsibility or prevent consumers from accessing higher risk products.

We suggest that ASIC also consider ensuring other investor protections such as best interest and client suitability are kept as separate obligations so as not to inadvertently implement additional requirements on firms that are currently not obligated to consider those individual consumer attributes.

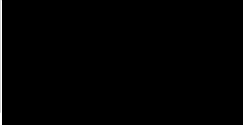
We believe that the Draft RG may generally benefit from some consideration of general or no advice scenarios where consumers access the product directly from issuers and detailed consumer information may be difficult to obtain.

In our view, ASIC should avoid being overly prescriptive in its Draft RG as that will limit innovation in Australia. This is especially the case where prescriptive wording provides an unfair advantage to larger institutions that will already have the internal systems, process and resources to be able to more easily absorb the cost of the changes.

We also believe that the Draft RG would also benefit from a reconsideration of what is a “good consumer outcome” so as to not just limit it to scenarios where a consumer is guaranteed to make money or is certain of exactly how much money they will make prior to a product being distributed to them. In our view, this in itself will greatly reduce the access to financial products in Australia and may simply encourage consumers to access those products offshore outside of the Australian regulatory environment.

Please let us know if you require any additional information.

Yours Sincerely,



Tamas Szabo
Group CEO
Pepperstone