5 August 2019

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Brisbane Office

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

Dear Mr Brown

CP 313 Product Intervention Power

The Australian Financial Markets Association (AFMA) is making comment on Consultation Paper 313 Product Intervention Power (CP 313) which sets out proposals for regulatory guidance on the product intervention provisions in the *Corporations Act* flowing from the *Treasury Laws Amendment (Design and Distribution Obligations and Product Intervention Act 2019* amendments.

We agree with the proposition that it is likely the accompanying product design and distribution obligations will largely obviate the need in practice for the exercise of the product intervention power. The principle concern raised in these comments is with the selection of inappropriate case-studies and the need to provide clear examples of what would occur in relation to a determination that a product is detrimental.

1. Inappropriate case studies selection

The whole purpose of the product intervention power is to stop the distribution of product where there would be consumer detriment. The new provision in the law is about the financial or credit product. This means it is the intrinsic qualities of the product which are being examined for characteristics which would make it detrimental for certain retail clients and then stopping its distribution. The regulatory guide focuses on mis-selling activities, as highlighted by the two case studies. In neither case are the products themselves intrinsically detrimental. Rather the focus is, in the first instance, on dual pricing with regard to bank deposit rollovers, and the second relates to flex commissions on car financing. With regard to the products in question, bank deposits are not intrinsically detrimental for consumers nor is car financing a detrimental credit product.

The two case-studies provided both relate to problematic distribution practices rather than products that are inherently harmful. This is concerning both because it undermines

the usefulness of the guidance in respect of the core subject matter (i.e. product intervention) and because it raises the risk that an issuer may be caught up in regulatory action that is directly related to a distributor. As the Financial System Report recommending the power stated on p 206 "*This power is not intended to address problems with pricing of retail financial products, where consumers might be paying more than expected for a particular product or where a large number of consumers have incurred a small detriment.*"

When we say that examples should relate to illustrating the intrinsic characteristics of a product that would justify intervention, the analytical thinking of the UK Financial Conduct Authority in its March 2019 Policy Statement *PS19/11 Product intervention measures for retail binary options*, is commended to you. The FCA say *"Securitised binary options have a pre-determined, binary pay-out structure, are priced similarly to fixed-odds betting products and are unlikely to be profitable to investors over time. They also fail to serve as a useful risk-management tool (eg as a hedging instrument) as the value of the hedge is limited to the fixed pay-out of the binary option."* [p 7]. From this statement it is clear to the reader why the regulator thinks that the product has detrimental characteristics that justify the prohibition from sale.

While it is appreciated that ASIC would not want to pre-empt future regulatory action with regard to products currently in the market, it does have available to it a number of Australian examples of financial products from the past around which there is consensus for demonstrating a policy need for the introduction of the product intervention power. These being:

1. Unlisted debenture investments
2. Agribusiness schemes

It is suggested that such historical examples be the basis for your case studies.

2. Reference to individual needs

We highlight in the section above the need not to confuse issues of financial advice and distribution with a product itself. In subparagraph 26(b) of CP 313 there is reference in relation to prevention of detriment for consumers where *"the terms, features and risks of a product are inappropriate for their objectives, financial situation and needs;".* This is not a correct statement of the benefit the power brings. The banning of a product relates to the causing of "significant detriment" to retail clients in the general sense and does not relate to whether it is appropriate for a single investor in terms of the personal advice rules. It is commonly the case that a financial product is not recommended under the personal advice rules because it would not be appropriate to an individual's circumstances while the financial product is otherwise beneficial to other retail clients.

3. Regard to benefit

While the determination of a 'significant detriment' is a statutory obligation to be met by ASIC in its consultation process the benefit of a product should not be ignored. The regulatory guide should indicate that consideration of the potential benefits of the product should also be taken into account and views invited on this in consultations. Doing

this is exampled in the FCA's PS19/11 cited above. This is of particular concern in respect of investment products where the investor's capital is at-risk. Without a proper balancing of risk versus reward ASIC could form the view that some financial products have the potential to cause significant detriment, and intervene accordingly, even though such products are acquired by retail clients who are fully aware of the risk and deliberately seek higher returns on the basis of a risk/reward benefit calculation.

4. Public consultation process

In regard to consultation prior to intervention with persons likely to be affected by the order, it is indicated in the CP 313 that consultation may be achieved by means of a notice on the ASIC website seeking public comment including commentary on the significant detriment identified and the terms of the proposed intervention order. This follows section 1023F(2) which eases the targeted consultation obligation in section 1023F(1).

This raises a significant practical problem with respect to fairness of process. A public consultation will signal to all the world that a product is considered to be problematic. If this is done prematurely it is likely to cause reputational damage to the issuer prior to the completion of any targeted consultation process with persons affected, and more broadly could adversely affect existing retail clients by impacting the value of products already issued. For example, in relation to structured products, an ASIC notice relating to potential intervention in such products may have the consequence of triggering a mass sell-off of such products with the effect of pushing down the value of the remaining products held by retail clients. It is of course likely that consultation with affected parties will result in the product being voluntarily withdrawn or detrimental characteristics being removed.

Except in the most extreme circumstances of non-engagement by the issuer or urgency ASIC should engage with the affected parties prior to opening the matter up to public consultation. This process expectation should be included in the Regulatory Guide.

Please contact David Love either on 02 9776 7995 or by email dlove@afma.com.au if further clarification or elaboration is desired.

Yours sincerely

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