LISTED INVESTMENT COMPANIES ASSOCIATION OF AUSTRALIA LTD

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By Email: ProductRegulation@treasury.gov.au

Manager
Consumer & Corporations Policy Division
The Treasury
Langton Crescent
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Dear Sir/Madam,

Submission re Design & Distribution Obligations Draft Legislation

We are pleased to respond to your request for comment on the *revised exposure draft* for the Design & Distribution Obligations Legislation.

1. Class of Client – In practice it is not possible to be specific for many common investment products

While we recognise that there may be some investment products that cater to a very specific client type, the majority of investment products (Eg Australian Shares, International Shares, Listed Property, Bond Funds, Cash Funds) **have an extremely wide range of legitimate potential users**.

For example, exposure to a diversified portfolio of Australian shares could be of legitimate use to short, medium and long term investors, speculators, market timers, those wishing to take on large amounts of exposure to Australian shares, and those only wishing to take a small exposure to Australian shares, high rate taxpayers, low rate taxpayers, high income earners, low income earners, conservative investors, cavalier investors. There are an infinite number of situations and client characteristic combinations in which such an investment could be validly used, and accordingly there can be no specific definition of Client Class.

Most importantly it must be understood that the suitability of an investment can not be judged from that one investment on a stand-alone basis. It can only be appropriately judged after consideration is given to the client's financial position and objectives, and after considering their other investments and how all their investments as a whole combine.

The consequence is that the Class of Client for such a wide-usage product may need to be properly described along the generic lines of:

> "Those seeking exposure to [eg Australian Shares] through a product with the Key Features (of risk, return, cost etc) shown in the PDS."

Issue 1A: *We wish to highlight the important practical issue that for (probably) many mainstream investment products there will be no viable way to define the Client Class more specifically than via reference to the Key Features.*

If it is intended that the Class of Client be more descriptive than this, then it is likely that the description will restate what is already in the PDS. See point 2 below.

Issue 1B: *We also wish to highlight that the fundamental principles of financial advisory legislation, policy and best practice require* ***an Investment Product's suitability to be determined after giving consideration to a Client's entire financial position (which includes all other investments they hold, the characteristics of all those other investments, the mix and diversity of those investments, the way those investments combine as well as other relevant factors)****. Once this is recognised, it can be appreciated that the suitability of the vast majority of investment products cannot simply be defined by a specific narrow Client Class.*

2. Class of Client – If a more specific description is required, the Class of Client will restate what is already in the PDS

A PDS clearly and fully outlines all relevant Key Features of an investment product. These key features will include the attributes of income, capital value change, risk, cost and taxation. Within the PDS these will be shown (as required) at an appropriate level of detail that seeks to provide necessary details without being overly complex.

If it is intended that the Class of Client utilise a more descriptive approach to define the Client in terms of risk, return, cost and tax attributes, such classifications will in full or part restate what is already set out in the PDS.

For example:

Class of Client	Those seeking exposure to: • Australian Shares • Franked Income • Potential for growth in income and capital value over time • A diversified portfolio structure • The XYZ investment management strategy And who can accept: • Operating expenses of % • Performance fees of % • The risks of investment in Australian shares through a diversified managed portfolio which include: a) Risk that income and capital values may fall b) X risk c) Y risk Etc …….

Issue: *If the Class of Client description must necessarily restate the Key Features already in the PDS, this merely increases the verbage issued to clients and advisers for no added benefit to the client. Alternately if the Class of Client is to be described/categorised by only some of the key features then this categorisation will potentially be misleading or incomplete as it will not show "all relevant items".*

3. Conditions – In practice it is extremely unclear what conditions would apply for products with a generic Client Class description

For the many investment products with a wide range of users and a necessarily generic Client Class (as in the examples above) it is extremely unclear what "Conditions" could possibly be specified.

For example, for a product whose client class can only be described as "Those seeking exposure to [eg Australian Shares] through a product with the Key Features shown in the PDS" it is difficult to see that there can be any condition other than the generic condition "The investor considers that they fall within the stated class of client."

Issue: *As with points 1 and 2 above, if the "Condition" only states that potential investors should be comfortable with the product's key features, then this increases verbage for an investor but says nothing more than what is already in and required by the PDS and Application Form. (Application Forms carry a certification along the lines that "I have read and understood the PDS and Key Features of the Product").*

4. The legislation should more clearly state that TMDs are not required for dealing or advising on the buying and selling of investment entity shares and units in the secondary market

Advisers will appreciate that listed investment entities **do need to produce a TMD** for *new issues of shares/units* [under s994B(4)(b)] and under s994D that they as distributors may only distribute such new shares/units if a TMD is in place.

However it *is likely to be unclear to advisers* as to **whether the s994D prohibition continues to apply to them** in dealing/advising on *secondary market sales/acquisitions* of listed investment entity securities.

Under the draft legislation s994A "Retail Product Distribution Conduct" in part **continues to include secondary sales/purchases** of securities. "Retail Product Distribution Conduct" includes "dealing" and "advising". "Dealing" in turn **includes secondary market purchases** under s766C(1)(a) and "Advising" would include **advising on secondary market purchases and sales** of listed investment entity shares/units. [The exclusion of 766C(1)(d) and (e) only addresses "varying" and "disposing", it does not exclude purchases, nor exclude advising on purchases or sales.]

It is currently only by logical deduction that secondary market sales could be considered excluded from the regime.

Issue: We would prefer to see a clear statement that highlights that the requirement for a TMD *only applies while the offer for new shares/units is open, only applies to the issue of new shares, and that secondary market sales/acquisitions are explicitly excluded.*

5. There will be many situations where there are few or no Reasonable Steps that can or should be taken by the Issuer to Ensure Distribution is Consistent with TMD

Under s994E an issuer is required to "take reasonable steps" to ensure that retail product distribution conduct is consistent with the TMD.

We ***do*** recognise that for some specific purpose, or high risk, investment products there may be specific steps that should be reasonably taken by distributors.

However for the vast majority of mainstream investment products with a wide variety of possible uses for a wide variety of clients we contend that there are likely to be few or no additional steps that an Issuer can perform other than requiring the Distributor to correctly perform the role for which they are licensed and regulated. In these situations it is not practical to think that the Issuer should conduct detailed reviews on the routine operations and compliance activities of hundreds of separate distributors, nor practical that Distributors can or should be reviewed by hundreds of Issuers. The satisfactory compliance of Distributors on their basic operational and compliance functions is surely most efficiently done through the centralised processes of regulation, licensing, monitoring and audit.

Issue: *We wish to highlight that in the case of many mainstream investment products with a wide range of potential users the Issuer can do no more than expect/require the Distributor to perform their role in accordance with their license (ie do not sell the product to someone whose combination of circumstances are such that the product does not suit). Accordingly there will be many situations where the only "reasonable step" that could be taken by that Issuer is to require the distributor to certify that they and/or the client are aware of the Key Features and are satisfied that this meets their needs. This is essentially the same certification that is already currently required through PDS's and on Application Forms.*

Conclusion

On behalf of our members we fully support the continued enhancement of protections for retail investors, and the need to satisfactorily match investment products to investor needs.

We recognise that **there may be some** investment products with very specific investor uses for which specific conditions and checks may be feasible.

However we highlight that **there will be a very large number of other mainstream investment products** for which a clearly documented Key Features Summary and investor suitability certification will constitute the only viable and reasonable level of investor protection sought.

If this is the case, we would encourage policymakers to consider whether this legislation should be harmonised with the Product Disclosure legislation **to prevent the un-necessary duplication of regulation** for the majority of mainstream investment products.

We would respectfully suggest that a sensible level of harmonisation could be achieved by:

(a) Establishing a **universal Base-Level Standard for all investments** (along the lines that Issuers would ensure that Key Features are clearly and concisely disclosed within a PDS, and Investors/Advisers would certify their awareness of the Key Features and PDS)

(b) Acknowledging within the Design & Distribution **legislation that compliance with the Base-Level Standard satisfies the D&D legislation** for all investments other than "Limited Suitability Investments"

(c) **Defining "Limited Suitability Investments"** to be those whose risk, return or other characteristics require more specific or additional controls to prevent the investments being issued to those for whom

the product is unsuitable. The additional controls specified in the D&D legislation would apply to such products.

Yours Faithfully,

A.J.Gluskie, Director

Listed Investment Companies Association of Aust Ltd