WALSH & COMPANY
ASSET MANAGEMENT

9 February 2018

Manager
Financial Services Unit
Financial System Division
The Treasury
Langton Crescent
PARKES ACT 2600

By email: ProductRegulation@treasury.gov.au

Dear Ms O'Rourke,

Walsh & Company welcomes the opportunity to comment on the exposure draft legislation (Exposure Draft) and explanatory memorandum (EM) released on 21 December 2017 in relation to the proposed design and distribution obligations (DDO); and product intervention power (PIP).

These important reforms will have a significant impact on the evolution and depth of the investment market within Australia. Australian households have very diverse financial situations and goals, yet given our ageing population, more and more people will fully or partially self fund their own retirement. The Association of Super Funds of Australia has estimated that in 2025, around 40 per cent of those aged 67 will be partially or fully self-funded retirees (or at least not eligible for the Age Pension). They predict that by 2055, the number of retirees relying on the full age pension could be down to 25 per cent or less. [1]

To help accumulate capital for retirement, as well as to provide stable and ongoing income for those people in retirement, consumers must be able to choose from a range of risk weighted products to suit their individual situation. Limiting barriers to innovation is critical to ensuring that choice is available across all market cycles, at all wealth levels and in an appropriate time frame to benefit consumers.

By way of background, Walsh & Company, a Sydney-based specialist global fund manager co-founded by Max Walsh in 2007, is part of the Evans Dixon Group. Our experience as investors and in helping our clients has shown that the best investment opportunities are not always readily accessible to Australian investors. We provide investors with access to market segments that are often beyond reach - including New York residential and Australian commercial property, US small-mid market private equity, fixed income, and sustainable investments - helping them build high quality diversified portfolios. We are dedicated to protecting and growing our clients' wealth over time. Every decision we make is with the goal of advancing our clients' best interests.

[1] The Association of Superannuation Funds of Australia Limited (November 2017) "Mythbusters" superannuation.asn.au

We thank you for allowing the opportunity to provide comments on this important issue. If you have any questions regarding this submission, please do not hesitate to contact me on [redacted]

Best regards,

Mr Alex MacLachlan

Managing Director, Chief Executive Officer

Walsh & Company Asset Management
Level 15
100 Pacific Highway
North Sydney NSW 2060

T 1300 454 801
F 1300 883 159
E info@walshandco.com.au
walshandco.com.au

ABN 89 159 902 708
AFSL 450 257

Long term impact on consumer choice and investment sector

We see significant implications to the long term shape of the industry as a result of certain aspects of the proposed draft legislation. The increased obligations product issuers will face if these proposals are progressed without some adjustment, will significantly increase the cost and complexity of dealing with third party arm's length distributors, such as small businesses and independent financial advisors. This is because:

1. Each small firm is likely to have their own proprietary systems and processes which are unlikely to align with the product issuers systems. This will make obtaining detailed client records and information, and monitoring compliance with the target market determination as currently proposed, difficult and time consuming.
    a. As this will increase the costs of dealing with these smaller non-aligned businesses, they may end up excluded from distribution arrangements and have difficulty accessing an appropriate range of financial products. This would impact on their ability to remain competitive in the market place and to construct appropriately diversified and risk weighted portfolios.
    b. In some situations, larger product issuers may buy out smaller businesses resulting in an increased concentration between product issuers and distributors.
    c. This is likely to lead to increased risks in the economy as the concentration of advice and investments is held with only a few companies.
    d. Product issuers may also find it more cost effective to go directly to consumers via a digital advice channel, potentially freezing out the remaining smaller non-aligned businesses and creating a significant issue for the long term sustainability of the Financial Advice sector.
    e. The above factors may result in a large proportion of consumers only being offered, or able to afford, digital advice (due also to a much narrower pool of advisors). In turn consumers may have a lower understanding of financial issues and concepts and be less able to interpret investment risks themselves because of the lack of personal dialogue and explanations that are not provided in a digital advice model.
    f. Smaller businesses or independent financial advisors may prefer to restrict as much information as possible about their client base from reaching the hands of potential competitors (which could include product issuers). This could leave smaller businesses at risk of anti-competitive behaviour, predatory pricing or at the other end of the scale – poor servicing.

The application of the product intervention powers as it is proposed, will have significant implications for innovation. This is because:

2. Products are likely to be structured more towards 'middle of the road' with investors having less opportunity to target particular asset classes or investment approaches.
    a. Narrowing of the range of investments that are available will have significant implications for the accumulation of long term capital for retirement and importantly, also for the management of portfolios in the critical pension stage. This conflicts with the extensive work in progress to develop the

MyRetirement framework which is aimed at helping the growing number of people reaching the pension stage of retirement to have sufficient product choice.

b. A good illustration of our concern is the example of infrastructure, which as an investment option has served super fund members across all types of funds (including industry and SMSFs) well as an alternative investment. Would these options have been set up and offered if the intervention powers were in place at the time, noting the risks to the product designer?

Legislative references to review:

Distribution Information

3. As it is currently drafted, it is not clear which party (issuer versus distributor) holds the obligation to collect and keep records of distribution information. This creates a situation of duplicating obligations, which will impose an unnecessary cost burden that eventually increases the costs to investors.
4. We suggest that the s993DF (2) is amended to make it clear that the distributor holds the responsibility to keep records of distribution information. This is necessary because issuers are less likely to have the systems to be able to keep records and this may also create difficulties when dealing with international investors.

Reasonable steps

5. We suggest that under s993DE (3) products recommended by a distributor under Personal Advice are deemed to have met the reasonable steps test.
6. We suggest that inquiries made by issuers purely to comply with s993DE (1) are specifically exempted from meeting the personal advice provisions (similar to AML exception).
7. Reasonable steps should be more clearly defined, we suggest 993DE(3) is amended to read:

   In subsections (1) and (2), ***reasonable steps*** *means steps that are, in the circumstances, reasonably able to be taken to reduce the likelihood that any dealing in, and financial product advice in relation to, the financial product is not in accordance with the target market determination, taking into account all relevant matters including:*
8. We would be supportive of broader industry consultation or an industry working group coming up with a definition.

Significant detriment

9. The current list of factors that would be taken into account in determining if a detriment is significant does not make any reference to how movement in asset values or outlook that may be part of, or caused by, the market and economic cycle or investment risks as disclosed as specific to the particular investment product, would be treated.
10. We suggest specific exclusions are made under s1022CD to make it clear that changes in value, losses, volatility or other events occurring as part of the market and economic cycle, or as a result of a risk disclosed in the disclosure documents is not considered to be significant detriment.
11. Without this specific exclusion, investors may feel their investments are underwritten by ASIC who will step in to protect them. This will also create long term issues for consumers in terms of appreciation of investment risk and reward trade off and will significantly impair innovation.

Consultation

12. The acceptable level of consultation that has to be undertaken in s1022CE(2) is extremely worrying. As it is currently drafted, publicly publishing an intervention order for comment on the ASIC website is deemed to meet the consultation requirement.
13. If this were to occur, even if it was subsequently determined after the publication of such a notice that the investment product was not likely to create significant detriment and the intervention order was without basis, the investment product and the product issuer would be irreparably damaged due to the public concern.
14. This proposed process would put consumers at risk as they are likely to be extremely concerned by such a notice being published and may act to sell or exit the investment immediately, regardless of the appropriateness of doing so. Realising the investment at an inopportune time may create a loss for the consumer.
15. Apart from putting consumers at risk, this process is likely to create a self-fulfilling prophecy by putting enormous pressure on the investment product managers to manage investor concerns, redemption requests and liquidity requirements.
16. We suggest that the definition at s1022CE needs to be amended. Specifically the following additional section should be inserted in front of s1022CE (1)(a)

> *"Provided as the draft product intervention order as a confidential document to the Responsible Manager of the investment product and the Responsible Manager must be provided an audience with the relevant ASIC representatives within 24 hours of the proposed order being provided. The Responsible Manager, will have 72 hours to resolve the issues raised and ASIC may only decide to proceed with opening the proposed order for public consultation after a further 24 hours has elapsed (total of 5 business days)"*

Other Comments

17. Target market determination - we recommend that it is made clearer throughout s993DB that the target market determination applies to a theoretical investor.
    a. With regards to "*class of persons*" referred to in s993DB (9) we understand further guidance on this area will be provided in the regulations. It is vital that broad and open consultation is allowed to ensure that the range of indicators are practical and not overly detailed.
18. Timing – given the regulations will have such a significant impact on the meaning and interpretation of these rules, we suggest that at least 24 months needs to be given from when the regulations are finalised, before these new obligations are applied.
19. Review Panel - we recommend a panel is set up to review and provide feedback on ASIC's Product Intervention Power determinations. This could be similar to the engagement and consultation process that occurs with the ASX National Listing Committee.

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