Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry

Financial Products Available to Retail Investors

Background Paper 6 (Part C)

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1. Purpose of the Paper

This background paper outlines the main categories of financial products available to retail investors, the size of retail investment in the main categories of financial products held by Australian retail investors and the ways in which retail investors are protected, including prohibitions and restrictions on retail investment in particular financial products. This paper has been prepared using publicly available information.

2. Introduction

Individuals and households — understood for the purposes of this paper as being classified as 'retail clients' under the *Corporations Act 2001* (Cth)[1] — seek to use a range of financial products to meet their personal, domestic and household needs. As the 2014 Financial System Inquiry recognised, the Australian financial system, including the financial products it produces and distributes, 'plays a vital role in meeting the financial needs of Australians, allowing people to make payments, access credit, manage risk and save for retirement'.[2]

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1 See section 5.1 below.

2 Financial System Inquiry, *Fact Sheet: Consumer Outcomes*, 1 <http://fsi.gov.au/files/2014/12/Final_Report_Fact_Sheet_Consumer_outcomes.pdf>.

3. The Range of Financial Products

3.1 Definition of 'Financial Product'

This section briefly outlines what is covered by the term 'financial product' for the purposes of the *Corporations Act 2001* (Cth).[3] The outline may assist a better understanding of the range of financial products discussed later in this paper.

The definition of 'financial product' is central to the operation of Chapter 7 of the *Corporations Act 2001* (Cth) — the statutory chapter regulating the financial services industry in Australia.[4] There is a three part approach to defining a 'financial product' for the purposes of the *Corporations Act 2001* (Cth).

First, there is a general definition which focuses on the key functions performed by financial products.[5] Broadly summarised, this general definition provides that a financial product is a facility which involves:

- Making a financial investment (an investor giving money to another person and that other person uses it to generate a financial return or other benefit for the investor);[6]
- Managing a financial risk (managing, avoiding or limiting the financial consequences of particular circumstances happening);[7] and/or
- Making non-cash payments (making payments by means other than notes or coins, such as by direct debit, cheque, purchased payment facility or travellers cheque).[8]

Second, a specified list of facilities is defined to be *included* as financial products.[9] A regulation making power allows specific inclusion of further financial products.[10]

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3 Note there is also a similar (but more expansive) definition of 'financial product' under s 12BAA of the *Australian Securities and Investments Commission Act 2001* (Cth) ('ASIC Act') for the purposes of that Act. In particular, Part 2, Division 2 of the ASIC Act sets out the general consumer protection provisions for financial products and services, for example, dealing with matters such as misleading or deceptive conduct, unconscionable conduct and unfair contract terms. These provisions are equivalent to the Australian Consumer Law provisions of the *Competition and Consumer Act 2010* (Cth) as administered by the Australian Competition and Consumer Commission. This paper only discusses matters relating to the *Corporations Act 2001* (Cth) as it is an example of 'industry-specific consumer regulation' for financial products: see further Financial System Inquiry, *Interim Report* (July 2014), 3-50–3-52, <http://fsi.gov.au/files/2014/07/FSI_Report_Final_Reduced20140715.pdf>.

4 See Australian Securities and Investments Commission, *Regulatory Guide 121: Doing Financial Services Business in Australia* (July 2013), <http://download.asic.gov.au/media/1259634/rg121-published-30-july-2013.pdf>.

5 *Corporations Act 2001* (Cth), s 763A(1).

6 Ibid s 763B.

7 Ibid s 763C.

8 Ibid s 763D.

9 Ibid s 764A(1)(a)–(l).

10 Ibid s 764A(1)(m). See also *Corporations Regulations 2001* (Cth), reg 7.1.04N.

Third, a specific list of facilities is defined to be *excluded* as financial products.[11] Again, a regulation making power allows specific exclusion of further financial products,[12] and the Australian Securities and Investments Commission ('ASIC') is given power to declare that specified things are not financial products.[13] If a specific exclusion applies, then a facility will not be a financial product, even if it would otherwise be captured within the general definition or the list of specific inclusions.[14]

3.2 Categories of Financial Products

ASIC has developed a classification system of 'financial products', as defined under the *Corporations Act 2001* (Cth), for their Australian financial services licence application processes.[15] Under that classification system, there are 12 broad categories of financial products, as set out in Table 1.

Table 1: ASIC Financial Products Categories

	ASIC's Financial Products Category	High Level General Description of the Financial Product Category
1.	Deposit and payment products, including basic deposit, non-basic deposit and non-cash payment products[16]	Any deposit taking facility made available by an authorised deposit taking institution ('ADI') in the course of its banking business, excluding retirement savings accounts. Examples include transaction accounts, savings accounts and term deposits offered by ADIs.
2.	Derivatives[17]	A financial instrument whose value is derived from an underlying asset, such as a share, commodity or index.[18] Examples include options and futures contracts.[19]
3.	Foreign exchange contracts[20]	A contract to buy or sell currency (whether Australian or not) or exchange one currency for another (whether Australian or not)[21] that is not a derivative or a foreign exchange contract that is to be settled immediately.[22]

11 *Corporations Act 2001* (Cth), s 765A(1)(a)–(x).

12 Ibid s 765A(1)(y). See also *Corporations Regulations 2001* (Cth), regs 7.1.05–7.1.07J.

13 *Corporations Act 2001* (Cth), s 765A(1)(z).

14 Ibid s 765A(1).

15 ASIC, *Regulatory Guide 2: AFS Licensing Kit: Part 2 — Preparing your AFS Licence or Variation Application* (September 2017), <http://download.asic.gov.au/media/4501225/rg2-published-29-september-2017.pdf>.

16 See ibid s 764A(1)(i).

17 See ibid ss 761D, 764A(1)(c).

18 ASIC, *MoneySmart Glossary — derivative* (23 August 2011), <https://www.moneysmart.gov.au/glossary/d/derivative>.

19 Ibid.

20 See *Corporations Act 2001* (Cth), s 764A(1)(k).

21 See ibid s 761A (definition of 'foreign exchange contract').

22 Ibid s 764A(1)(k).

	ASIC's Financial Products Category	High Level General Description of the Financial Product Category
4.	General insurance[23]	Insurance policies that provide cover for events that cause financial losses, property damage or personal injury, excluding life or health insurance.[24] General insurance products include home and contents insurance, motor vehicle insurance, business insurance, lender's mortgage insurance, workers compensation and travel insurance.[25]
5.	Government debentures, stocks or bonds[26]	These are debentures, stocks or bonds issued or proposed to be issued by a government.
6.	Life products, including any products issued by a registered life insurance company that are backed by one or more of its statutory funds[27]	Life insurance products that pay a set amount of money to an insured person's beneficiaries when the insured person dies.[28]
7.	Managed investment schemes, including simple managed investment schemes and interests in both registered and unregistered schemes[29]	A managed investment scheme has the following essential features: • people are brought together to contribute money to get an interest in the scheme; • money is pooled together with other investors or used in a common enterprise; and • a responsible entity operates the scheme (i.e. investors do not have day-to-day control over the operation of the scheme).[30] Managed investment schemes cover a wide range of investments, with popular managed investment schemes including cash management trusts, property trusts, Australian equity (shares) trusts, international equity trusts.[31] They are also known as 'managed funds', 'pooled investments' or 'collective investments'.[32]

23 See ibid s 764A(1)(d).

24 Senate Economics References Committee, *Australia's General Insurance Industry: Sapping Consumers of the Will to Compare* (August 2017), 3, <https://www.aph.gov.au/Parliamentary_Business/Committees/Senate/Economics/Generalinsurance/~/media/Committees/economics_ctte/Generalinsurance/report.pdf>.

25 Insurance Council of Australia, *Types of Insurance*, <http://www.insurancecouncil.com.au/for-consumers/types-of-insurance>.

26 See *Corporations Act 2001* (Cth), s 764A(1)(j).

27 See ibid ss 764A(1)(e) and (f).

28 ASIC, *Glossary — Life Cover* (2 February 2016), <https://www.moneysmart.gov.au/glossary/l/life-cover>. See also ASIC, *Life Insurance*, MoneySmart (15 March 2018), <https://www.moneysmart.gov.au/insurance/life-insurance>.

29 See *Corporations Act 2001* (Cth), s 764A(1)(ba).

30 ASIC, *Funds Management — Managed Investment Schemes* (12 March 2018), <http://asic.gov.au/regulatory-resources/funds-management/#mis>.

31 Ibid.

32 Ibid.

	ASIC's Financial Products Category	High Level General Description of the Financial Product Category
8.	Retirement savings accounts[33]	An account offered by financial institutions that is used to save money for retirement.[34] These accounts are simple, low cost, low return accounts.[35]
9.	Securities[36]	This refers to an investment such as shares or bonds which can be traded in financial markets.[37] Shares, also known as equities or stocks, are ownership interests in a company.[38] Bonds are a form of fixed interest investment instrument, which pays a regular, fixed interest amount for the term of the investment. The invested funds (the principal) are paid back at the end of the term (maturity).[39]
10.	Superannuation, including self-managed superannuation funds and a client's existing superannuation holding[40]	Money that an individual and their employers put into a special fund during the individual's working life to provide money for retirement.[41]
11.	Margin lending facilities, including standard margin lending facilities and non-standard margin lending facilities[42]	A loan (or facility) that is taken out to invest in share or managed funds. The investment is used as security for the loan (or facility). Margin calls are possible if the value of the investment falls below a set amount.[43]
12.	Miscellaneous financial facilities	This is an ASIC administrative category for their Australian financial services licence application processes only. It is designed to cover financial products which do not fall clearly within the financial product categories 1 to 11 above.[44] It is not relevant for present purposes as it does not outline any financial products in its own right.

Source: *ASIC*[45]

33 See *Corporations Act 2001* (Cth), s 764A(1)(h).

34 ASIC, *MoneySmart Glossary — retirement savings account* (21 March 2018), <https://www.moneysmart.gov.au/glossary/r/retirement-savings-account>.

35 Ibid.

36 See *Corporations Act 2001* (Cth), s 764A(1)(a).

37 ASIC, *Glossary — Security* (29 July 2015), <https://www.moneysmart.gov.au/glossary/s/security>.

38 ASIC, *Glossary — Share* (29 July 2015), <https://www.moneysmart.gov.au/glossary/s/share>.

39 ASIC, *Glossary — Bond* (9 September 2015), <https://www.moneysmart.gov.au/glossary/b/bond>.

40 See *Corporations Act 2001* (Cth), s 764A(1)(g).

41 ASIC, *Glossary — Superannuation (Super)* (18 November 2015), <https://www.moneysmart.gov.au/glossary/s/superannuation-super>.

42 See *Corporations Act 2001* (Cth), ss 761EA, 764A(1)(l).

43 ASIC, *Glossary — Margin Loan* (12 May 2016), <https://www.moneysmart.gov.au/glossary/m/margin-loan>.

44 See ASIC, *Regulatory Guide 2*, above n 15, 23.

45 Ibid 22.

4. Size of Retail Investment in Financial Products

This section outlines some information on the size of investment for the main categories of financial products held by Australian retail investors, being:

a) Currency and deposits;
b) Superannuation;
c) Shares and other equity;
d) Insurance; and
e) Securities (other than shares), loans and placements.

The value of retail investment in these categories of financial products can be determined using data from the Australian Bureau of Statistics ('ABS') on 'household' financial assets, which for the purposes of this paper, will be taken as a proxy for retail investment in financial products.[46]

In the December quarter 2017, $5 trillion in financial assets were attributable to households in Australia,[47] which was equivalent to around 49 per cent of the net worth of the household sector in Australia. Table 2 shows the value of financial assets attributable to households at the December quarter 2017, by the categories of financial asset as measured by the ABS.

Table 2: Financial Assets of the Household Sector, December quarter 2017

Currency and deposits	Super-annuation	Shares and other equity	Insurance	Securities (other than shares), loans and placements	Other	Total
Value ($ billion)						
1,094.4	2,735.6	937.0	180.9	10.1	83.7	5,041.5
Percentage of net worth of households						
10.7%	26.8%	9.2%	1.8%	0.1%	0.8%	49.5%

Source: *ABS*[48]

46 The ABS definition of 'household' is 'a group of persons who share the same living accommodation, who pool some, or all, of their income and wealth and who consume certain types of goods and services collectively, mainly housing and food': see ABS, *5232.0 - Australian National Accounts: Finance and Wealth, Dec 2017*, Explanatory Notes, (29 March 2018) <http://www.abs.gov.au/AUSSTATS/abs@.nsf/Latestproducts/5232.0Glossary1Dec%202017?opendocument&tabname=Notes&prodno=5232.0&issue=Dec%202017&num=&view=> (definition for 'household'). The other three institutional sectors in the ABS data are non-financial corporations, financial corporations and the general government sector: ibid (definition for 'institutional sectors').

47 ABS, *Cat. No. 5232.0 Australian National Accounts: Finance and Wealth, Dec 2017* (29 March 2018), Table 34: Household Balance Sheet, Current prices, <http://www.abs.gov.au/AUSSTATS/abs@.nsf/DetailsPage/5232.0Dec%202017?OpenDocument>.

48 Ibid; *ABS Cat. No. 5216.0 - Australian System of National Accounts: Concepts, Sources and Methods, 2015* (22 March 2016),

Table 2 shows that Australian households hold a significant portion of their net worth in currency and deposits. Currency and deposits are useful for concluding transactions. Some deposits, such as term deposits, may have some characteristics of an investment such as the earning of interest, but deposits are generally considered to be both low risk and low return.[49]

In the December quarter 2017, financial assets associated with superannuation represented around 27% of the net worth of Australian households, or around $2.7 trillion. According to the Australian Prudential Regulation Authority ('APRA'), in the December quarter 2017, there were 125 retail superannuation funds, 40 industry superannuation funds, 37 public sector superannuation funds (including exempt schemes) and 24 corporate superannuation funds.[50]

The data in Table 2 relating to shares includes direct ownership of shares, whether they are listed on a public exchange or not, and other direct equity investments held by households.[51] It also includes indirect equity investments, such as equity investments made through other vehicles such as mutual funds and unit trusts.[52] Information on the proportion of Australian households that hold equity investments, whether as exchange traded shares or as other equity interests, is not readily available. The *ASX Australian Investor Study 2017*, however, found that, in 2017, 31 per cent of Australians held shares that were traded on an exchange.[53]

No information on the proportion of households that hold insurance products or debt securities and loans has been identified.

<http://www.abs.gov.au/AUSSTATS/abs@.nsf/ProductsbyCatalogue/8AC0D9921051E17BCA2570B300807D36>; United Nations et al., *System of National Accounts 2008,* 219–235 (Chapter 11), <https://unstats.un.org/unsd/nationalaccount/docs/SNA2008.pdf>.

49 In March 2018, Reserve Bank of Australia ('RBA') data indicated the average interest rate on bank deposits in transaction accounts ($5,000) was 0 per cent per annum, and the average interest rate on banks' 3 month term deposits ($10,000) was 1.9 per cent per annum: RBA, Table F4, *Retail Deposit and Investment Rates* (March 2018), <http://www.rba.gov.au/statistics/tables/csv/f4-data.csv>.

50 APRA, *Statistics: Quarterly Superannuation Performance* (December 2017), 7 <http://www.apra.gov.au/Super/Publications/Documents/1802-QSP-1712.pdf>.

51 See United Nations et al., *System of National Accounts 2008,* above n 48, 219–235 (Chapter 11), 593.

52 Ibid 231.

53 Deloitte Access Economics, *ASX Australian Investor Study 2017*, 1, <https://www.asx.com.au/documents/resources/2017-asx-investor-study.pdf>.

5. The Availability of Financial Products to Retail Clients

5.1 The 'Retail' and 'Wholesale' Clients Distinction

The distinction between 'retail' and 'wholesale' clients was first introduced into the *Corporations Act 2001* (Cth) by the *Financial Services Reform Act 2001* (Cth). The main policy objective behind the introduction of this distinction was to identify the investors that would have the benefit of the consumer protection provisions, i.e. retail clients.[54]

For the purposes of Chapter 7 of the *Corporations Act 2001* (Cth), a person to whom a financial product is provided is treated as a 'retail client' unless specifically provided otherwise under the following three rules.[55] Consequently, a wholesale client is a person that is not a retail client.[56]

First, for certain general insurance products, there is a product based approach to the retail and wholesale clients distinction. Where the below listed general insurance products are acquired by an individual, or acquired for use in connection with a small business,[57] then the person acquiring that general insurance product will be treated as a 'retail client'.[58] This is similar to the approach taken under the *National Consumer Credit Protection Act 2009* (Cth) for consumer credit products and services.[59] The specified general insurance products are:

- motor vehicle insurance;
- home building insurance;
- home contents insurance;
- sickness and accident insurance;
- consumer credit insurance;
- travel insurance;
- personal and domestic property insurance; and
- other general insurance products prescribed by regulations (i.e. medical indemnity insurance).[60]

54 Revised Explanatory Memorandum, Financial Services Reform Bill 2001 (Cth), [2.25]. Cf the definition of 'consumer' under s 12BC of the *Australian Securities and Investments Commission Act 2001* (Cth). See also n 3 and accompanying text.

55 *Corporations Act 2001* (Cth), s 761G(1). The provisions discussed in this section 5.1 also apply to the provision of financial services, but will not be discussed here, given the focus of this paper on financial products.

56 Ibid s 761G(4).

57 'Small business' is defined for this purpose under ibid s 761G(12).

58 Ibid s 761G(5). Conversely, a person will be treated as a 'wholesale client' when acquiring a general insurance product not included in the above list or not as an individual or for use in connection with a small business.

59 See the definition of 'consumer' under s 5(1) of the *National Consumer Credit Protection Act 2009* (Cth), where 'consumer' is defined as 'a natural person or strata corporation'.

60 *Corporations Act 2001* (Cth), s 761G(5)(b). See also *Corporations Regulations 2001* (Cth), regs 7.1.11–7.1.17A.

Second, there is another product based approach to the retail and wholesale clients distinction for superannuation and retirement savings account ('RSA') products. Subject to two exceptions, a person acquiring a superannuation or RSA product will always be treated as a retail client.[61] The two exceptions are if the person acquiring the superannuation or RSA product is an RSA provider or a trustee of a superannuation entity with net assets of at least $10 million.[62] The policy rationale for this product based approach was to ensure that disclosure is given to all persons (except those covered by the exceptions) in relation to these products.[63]

Third, for all financial products (except for general insurance, superannuation and RSAs), there are five tests which may result in a person not being classified as a retail client (and therefore being a wholesale client) under the:

a) 'Product value' test,[64] where a person acquires a financial product above the prescribed amount set by the regulations[65];
b) 'Small business test', where the financial product is provided for use in connection with a business that is not a 'small business';[66]
c) 'Individual wealth' test, where a person has net assets or gross income for the last two years above certain thresholds specified in the regulations;[67]
d) 'Professional investor' test, where 'professional investors' are considered wholesale clients;[68] or
e) 'Sophisticated investor' test, where 'sophisticated investors' are considered wholesale clients.[69]

At a general level, the policy rationale for these tests is to use the specified indicia to identify those investors that are 'better informed and better able to assess the risks involved in financial transactions' and therefore do not need the same level of protection as retail clients.[70]

5.2 Main Uses of the 'Retail' and 'Wholesale' Clients Distinction for Retail Investor Protection

As mentioned above in section 5.1, the importance of the retail and wholesale clients distinction is to determine when the retail investor protection provisions under Chapter 7 of the *Corporations Act 2001* (Cth) are available.

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61 *Corporations Act 2001* (Cth), s 761G(6).
62 Ibid s 761G(6)(c).
63 Revised Explanatory Memorandum, Financial Services Reform Bill 2001 (Cth), [2.27].
64 *Corporations Act 2001* (Cth), s 761G(7)(a).
65 *Corporations Regulations 2001* (Cth), regs 7.1.18–7.1.24.
66 *Corporations Act 2001* (Cth), s 761G(7)(b) and s 761G(12) (definition of 'small business').
67 Ibid s 761G(7)(c).
68 Ibid s 761G(7)(d).
69 Ibid s 761GA.
70 Revised Explanatory Memorandum, Financial Services Reform Bill 2001 (Cth), [2.25].

Specifically, investors who are classified as retail clients will have the benefit of the following main protections under Chapter 7 of the *Corporations Act 2001* (Cth):

- When an Australian financial services licensee or its authorised representatives provides a financial service to a retail client, a Financial Services Guide must be provided;[71]
- When an Australian financial services licensee or its authorised representatives gives personal financial product advice to a retail client, a written Statement of Advice must be provided;[72]
- When certain financial service providers recommend or offer a financial product to a retail client, a Product Disclosure Statement must be provided;[73]
- Periodic statements for certain financial products that have an investment component must be given to retail clients;[74]
- If an Australian financial services licensee provides a financial service to a retail client, it must have a dispute resolution system that complies with the relevant requirements[75] and compensation arrangements;[76]
- Financial advisers giving financial product advice to retail clients are subject to certain education and training requirements[77] and must comply with the requirements introduced by the Future of Financial Advice reforms on matters such as an obligation to act in the best interests of their clients and restrictions on certain forms of remuneration arrangements;[78]

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71 See generally *Corporations Act 2001* (Cth), ss 941A and 941B. A Financial Services Guide provides information about the entity providing the financial service(s), including an explanation of the financial service(s) offered, the fees charged and how complaints will be dealt with: see further ASIC, *Glossary — Financial Services Guide* (29 July 2015), <https://www.moneysmart.gov.au/glossary/f/financial-services-guide-fsg>.

72 See generally *Corporations Act 2001* (Cth), ss 946A–947E. A Statement of Advice will set out the advice given and must include the basis on which the advice is given, details of the person or entity providing the advice and information on any payments or benefits received by the adviser: see further ASIC, *Glossary — Statement of Advice (SOA)* (6 March 2018), <https://www.moneysmart.gov.au/glossary/s/statement-of-advice-soa>.

73 See generally *Corporations Act 2001* (Cth), Chapter 7, Part 7.9, Division 2. A Product Disclosure Statement provides information about the financial product's key features, fees, commissions, benefits, risks and the relevant complaints handling procedure: see further ASIC, *Glossary — PDS* (28 September 2017), <https://www.moneysmart.gov.au/glossary/p/pds>.

74 *Corporations Act 2001* (Cth), s 1017D.

75 See generally ibid ss 912A(1)(g) and 912A(2).

76 Ibid s 912B.

77 Ibid s 912A(1)(e) and (f). See also ASIC, *Regulatory Guide 146: Licensing: Training of Financial Product Advisers* (July 2012), <http://download.asic.gov.au/media/1240766/rg146-published-26-september-2012.pdf>. See generally Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry, *Background Paper 6 (Part B): Education and Training Requirements for Financial Advisers* (April 2018), available at <https://financialservices.royalcommission.gov.au/publications/Pages/default.aspx>.

78 See generally *Corporations Act 2001* (Cth), Chapter 7, Part 7.7A. See also Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry, *Background Paper 6 (Part A): Some Features of the Australian Financial Planning Industry* (April 2018), available at <https://financialservices.royalcommission.gov.au/publications/Pages/default.aspx>.

- A retail client must not be offered financial products for issue or sale in the course of, or because of, an unsolicited meeting or telephone call (the hawking prohibitions);[79] and
- A retail client may have the benefit of a cooling off period to return financial products.[80]

5.3 Prohibition on Retail Investment in Particular Types of Financial Products

As the discussion in section 5.2 indicates, the traditional approach to retail investor protection in Australia has been predominantly through disclosure regulation, for example, through the *Corporations Act* requirements to provide a Financial Services Guide, Statement of Advice and a Product Disclosure Statement.

Historically, this policy setting was informed by the recommendations and final report of the 1996–97 Financial System Inquiry (Wallis), which took the perspective that '[d]isclosure regulation is at the core of any scheme to protect consumers as it allows them to exercise informed choice'.[81] By seeking to ensure retail investors have access to adequate information on financial products, it was thought that retail investors would then be able to fully understand the consequences of their investment decisions, and 'make informed choices about financial products and their providers'.[82]

Following the experiences of the global financial crisis in 2008–09, the limitation of a predominantly disclosure based approach to retail investor protection became evident[83] when it became apparent that significant numbers of Australian consumers held financial products that did not suit their needs and circumstances and in some cases, resulted in severe financial loss.[84]

In response, there has been a shift in the focus of retail investor protection in Australia to address issues concerning the distribution of financial products and services to retail investors.[85] This includes heightened conduct rules such as the Future of Financial Advice

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79 *Corporations Act 2001* (Cth), ss 736, 992AA, 992A. See also ASIC, *Regulatory Guide 38: The Hawking Provisions* (May 2005), <http://download.asic.gov.au/files/Hawking_Guide.pdf>.

80 See *Corporations Act 2001* (Cth), Chapter 7, Part 7.9, Division 5.

81 Financial System Inquiry, *Final Report* (March 1997), <http://fsi.treasury.gov.au/content/FinalReport.asp>, 235, 261.

82 Ibid 237. See also Senate Economic References Committee, *Performance of the Australian Securities and Investments Commission* (June 2014), 40, <https://www.aph.gov.au/Parliamentary_Business/Committees/Senate/Economics/ASIC/Final_Report/~/media/Committees/Senate/committee/economics_ctte/ASIC/Final_Report/report.pdf>.

83 See, e.g. Financial System Inquiry, *Final Report*, above n 2, 193; Senate Economic References Committee, *Performance of the Australian Securities and Investments Commission*, above n 82, 42–43.

84 Financial System Inquiry, *Final Report*, above n 2, 27, 199.

85 Ibid 199–200. See also Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry, *Background Paper 6 (Part A): Some Features of the Australian*

('FOFA') reforms on the best interests duty and related obligations,[86] structural interventions such as the prohibition of forms of conflicted remuneration (also under the FOFA reforms)[87] and reforms to improve the standard of financial advice provided to retail clients by reforming the education and training requirements for financial advisers providing personal advice to retail clients.[88]

The strongest form of retail investor protection — the outright prohibition of certain specified financial products for retail investors — has not to date featured prominently in Australia. Instead, there are some restrictions imposed on retail investment for certain financial products. For example, there is a cap for retail investments in crowd-sourced funding investments.[89] There are also responsible lending obligations for the issuing of margin lending facilities to retail investors.[90] Such a policy setting may have reflected a concern that it is not the role of Parliament, the Government or regulators to determine whether particular financial products are appropriate for retail investors.[91]

However, following the global financial crisis in 2008–09, various jurisdictions around the world have implemented some form of product intervention powers,[92] which are designed to allow regulators to intervene in the design and/or distribution of financial products for retail investors.[93] The use of such a power may extend to prohibiting specific financial products for retail investors. For example, the UK Financial Conduct Authority has used its

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Financial Planning Industry (April 2018), available at <https://financialservices.royalcommission.gov.au/publications/Pages/default.aspx>.

86 ASIC, *Senate Inquiry into the Performance of the Australian Securities and Investments Commission: Main Submission by ASIC* (October 2013), 55, <https://www.aph.gov.au/DocumentStore.ashx?id=9c608b6c-b53c-4b93-967a-14e337a43607&subId=20096>.

87 Ibid.

88 Financial System Inquiry, *Final Report*, above n 2, 27–28. See also Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry, *Background Paper 6 (Part B): Education and Training Requirements for Financial Advisers* (April 2018), available at <https://financialservices.royalcommission.gov.au/publications/Pages/default.aspx>.

89 Being a cap of $10,000 per annum per company for retail investors via the same crowd-sourced funding intermediary: *Corporations Act 2001* (Cth), s 738ZC. See generally ASIC, *Crowd-Sourced Funding* (12 March 2018), <http://asic.gov.au/regulatory-resources/financial-services/crowd-sourced-funding/>; ASIC, *Crowd-Sourced Funding*, MoneySmart (10 November 2017), <https://www.moneysmart.gov.au/investing/crowd-sourced-funding>.

90 Margin lenders must assess whether a margin loan is unsuitable for a retail investor: *Corporations Act 2001* (Cth), s 985E. See generally ASIC, *Margin Lending* (20 October 2014), <http://asic.gov.au/for-finance-professionals/afs-licensees/applying-for-and-managing-an-afs-licence/licensing-certain-service-providers/margin-lending/>; ASIC, *Margin Loans*, MoneySmart (4 October 2017), <https://www.moneysmart.gov.au/investing/borrowing-to-invest/margin-loans>.

91 See, e.g., Parliamentary Joint Committee on Corporations and Financial Services, *Report: Inquiry into Financial Products and Services in Australia* (November 2009), 143, <http://www.aph.gov.au/binaries/senate/committee/corporations_ctte/fps/report/report.pdf>.

92 See Australian Government, *Design and Distribution Obligations and Product Intervention Power: Proposals Paper* (December 2016), 59–61 (Appendix E), <https://static.treasury.gov.au/uploads/sites/1/2017/06/C2016-054_Design-and-distribution-obligations.pdf>.

93 See generally Financial System Inquiry, *Final Report*, above n 2, 206–12.

product intervention powers to prohibit retail investors from investing in contingent convertible securities since 1 October 2014.[94] The European Securities and Markets Authority has recently agreed on measures to prohibit binary options and restrict contracts for differences to retail investors in the European Union.[95]

In Australia, in response to the recommendations of the 2014 Financial System Inquiry,[96] there are currently reforms underway to implement a form of product intervention power for ASIC in relation to financial products and credit products.[97]

Under the *Treasury Laws Amendment (Design and Distribution Obligations and Product Intervention Powers) Bill 2017* (Cth) (the Bill),[98] if enacted, ASIC would have a new product intervention power.

Broadly summarised, under the proposed product intervention power, ASIC could make an order that a person must not engage in specified conduct in relation to the product.[99] It would have to consult before making a product intervention order.[100] A product intervention order may operate for a period up to 18 months, unless the Minister made a declaration that the order was to operate until revoked.[101]

ASIC could use the product intervention power only if it was satisfied that a financial or credit product 'has resulted in or will, or is likely to, result in significant detriment to retail clients' (for financial products) or consumers (for credit products).[102] Although 'significant detriment' is not defined under the Bill, there are specified factors which would have to be taken into account by ASIC in determining whether there is significant detriment, including

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94 UK FCA, *FCA restricts distribution of CoCos to retail investors* (5 August 2014), <https://www.fca.org.uk/news/press-releases/fca-restricts-distribution-cocos-retail-investors>.

95 See generally European Securities and Markets Authority, 'ESMA Agrees to Prohibit Binary Options and Restrict CFDs to Protect Retail Investors' (Press Release, 27 March 2018) <https://www.esma.europa.eu/press-news/esma-news/esma-agrees-prohibit-binary-options-and-restrict-cfds-protect-retail-investors>.

96 Financial System Inquiry, *Final Report*, above n 2, xxv, 206–12 (Recommendation 22).

97 Australian Government (The Treasury), *Design and Distribution Obligations and Product Intervention Power – Draft Legislation* (2018), <https://treasury.gov.au/consultation/c2017-t247556/>.

98 Note that the Bill, if enacted, will also introduce new design and distribution obligations that will apply in relation to financial products that are offered to retail clients: see further Treasury Laws Amendment (Design and Distribution Obligations and Product Intervention Powers) Bill 2017 (Cth), Schedule 1; Exposure Draft Explanatory Memorandum, Treasury Laws Amendment (Design and Distribution Obligations and Product Intervention Powers) Bill 2018 (Cth), 5–31.

99 Ibid (proposed s 1022CC of the *Corporations Act 2001* (Cth) and proposed s 301C of the *National Consumer Credit Protection Act 2009* (Cth)).

100 Ibid (proposed s 1022CE of the *Corporations Act 2001* (Cth) and proposed s 301E of the *National Consumer Credit Protection Act 2009* (Cth)).

101 Ibid (proposed ss 1022CF and 1022CG of the *Corporations Act 2001* (Cth) and proposed ss 301F and 301G of the *National Consumer Credit Protection Act 2009* (Cth)).

102 See Treasury Laws Amendment (Design and Distribution Obligations and Product Intervention Powers) Bill 2017 (Cth), Schedule 2, items 2 and 8.

the nature and extent of the detriment and the impact of the detriment on retail investors (including actual or potential financial loss).[103]

The main policy objective of the proposed reforms is to provide ASIC with proactive powers to 'reduce the risk of consumers suffering significant detriment from financial and credit products'.[104]

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[103] Ibid (proposed s 1022CD of the *Corporations Act 2001* (Cth) and proposed s 301D of the *National Consumer Credit Protection Act 2009* (Cth)).

[104] See Exposure Draft Explanatory Memorandum, Treasury Laws Amendment (Design and Distribution Obligations and Product Intervention Powers) Bill 2018 (Cth), [2.8], [2.13].