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Dear Colleagues

Design and Distribution Obligations and Product Intervention Power (DDO and PIP respectively): Exposure draft December 2017

The Financial Services Council (**FSC**) has over 100 members representing Australia's retail and wholesale funds management businesses, superannuation funds, life insurers, financial advisory networks and licensed trustee companies. The industry is responsible for investing more than \$2.7 trillion on behalf of 13 million Australians. The pool of funds under management is larger than Australia's GDP and the capitalisation of the Australian Securities Exchange and is the third largest pool of managed funds in the world. The FSC promotes best practice for the financial services industry by setting mandatory Standards for its members and providing Guidance Notes to assist in operational efficiency.

We refer to the exposure draft legislation (**Exposure Draft**) and explanatory memorandum (**EM**) released on 21 December 2017 for consultation in relation to the proposed:

- design and distribution obligations (**DDO**); and
- product intervention power (**PIP**).

This letter sets out the FSC's submissions in relation to the Exposure Draft and EM for the DDO and PIP. All references to sections and parts in this submission are to sections and parts of the *Corporations Act 2001 (Cth)* (**Act**) as amended by the Exposure Draft unless otherwise stated.

Our comments are directed to relevant amendments to the Act, as it is the Act amendments which will most impact the FSC's members. However, we do note that the principles that we raise may be of general application, where appropriate, to the proposed amendments to the *National Consumer Credit Protection Act 2009*.

1 Executive summary

1.1 DDO executive summary

By way of summary, we make the following submissions as matters of prime importance in the adoption and implementation of the DDO regime:

- (a) the timeframe for movement to full application of the regime needs to be extended - refer to part 2.1 below;
- (b) the exception in the definition of "personal advice" which excludes enquiries to prospective investors for AML compliance should be extended to cover compliance with the DDO regime - refer to comments at part 2.4 below;
- (c) clarification is needed that the DDO regime does not apply to any on-market trading of quoted products - refer to comments at part (b) of the Appendix;
- (d) there should be some recognition that the DDO cannot apply where there is really no distribution, such as where there is acquisition of investor-chosen products through a facility - refer to comments at parts 2.2(a) and 2.2(c) below and part (c) of the Appendix;
- (e) civil liability provisions should not be included in the legislation, because, if not appropriately constrained, class actions based on the DDO could result in issuers effectively underwriting the performance of investments. There is no equivalent private avenue for claims under UK or US laws. At a minimum, it should be clear in the alternative that available compensation does not extend to losses incurred through general market movements - refer to comments in 2.15 below; and
- (f) as a matter of general observation, we note that the DDO regime does not sit well with certain classes of financial product.
 - (1) First, certain products are already subject to a high level of "obligation" under both general law and various statutory regimes.
 - (2) Second, other products are directly chosen and acquired by investors through a facility without any "distribution" that is practical to regulate.

We have detailed some of these products in the Appendix to this submission. In our view, the broad range of products to which the DDO applies should be reconsidered and some products should be removed from scope (or alternatively confirmation is needed of the limited application of the regime in those circumstances).

1.2 PIP executive summary

In relation to the PIP, our submissions may be summarised as follows:

- (a) in the case of a single product intervention, the consultation should be conducted in private rather than a public consultation – refer to part 3.6;
- (b) our preference would be for there to be express recognition that the PIP is indeed a power of last resort – refer to part 3.11;
- (c) confirmation is requested in relation to how the exercise of the power would be subject to the usual administrative and judicial review processes applying in respect of other ASIC powers – see part 3.11 below;
- (d) as an adjunct to the previous point, we note that there is merit in consideration of an appropriate panel of industry professionals, such as the Financial Services and Credit Panel, having the power to review ASIC's PIP determinations – see part 3.10 below; and
- (e) clarification is required around the meaning of "significant detriment". We suggest that appropriate inclusionary examples are included in the Exposure Draft or EM and supplemented by ASIC guidance – see part 3.3 below.

2 Design and distribution obligations (**DDO**)

2.1 Commencement

- (a) The commencement day for the DDO amendments is 12 months after Royal Assent and the transitional provisions in Part 10 provide that the DDO amendments take effect:
 - (1) 12 months after Royal Assent for first issues of products; and
 - (2) 24 months after Royal Assent for products first issued before the commencement day.
- (b) The FSC is deeply concerned that a longer transition period is needed to allow industry to prepare properly for the DDO and to implement the necessary significant systems changes and distribution channel changes, all of which have significant lead times. When considering the time that was needed to prepare for and implement the FOFA and A-MIT reforms, we consider that an extension of at least 12 months to each transition period or alternatively, a commencement date 12 months after the beginning of the financial year following the year in which the legislation and regulations are made (assuming no significant changes to the current Exposure Draft) is essential for the DDO reforms to be workable.

- (c) Given that the European (MiFID II) equivalent of the DDO had an implementation period of over 3½ years¹, the FSC considers that an extension to the implementation period for Australia is reasonable and sensible.
- (d) As the DDO is based on principles which need to be supplemented by regulations and ASIC regulatory guidance, it is critical that industry has sufficient time between their finalisation and the DDO commencement to absorb and implement them. This means that the DDO commencement also needs to take account of the timing of the finalisation of the supporting regulations and ASIC regulatory guidance.
- (e) Further, recognising that the implementation burden for the DDO is significant, we request that Treasury adopts a phased implementation, similar to the FOFA implementation, where for a 12 months period persons may 'opt in' for early adoption of the new law, and where compliance would become mandatory at the end of the 12 months period.
- (f) We request a period of 12 months facilitative compliance, similar to the facilitative compliance period that applied following the introduction of FOFA. This is consistent with the 12 months of regulatory forbearance currently being applied in Europe in relation to the MiFID II reforms.
- (g) The FSC considers that it is important for the proper operation of this regime that industry participants should use consistent terminology and categorise similar products in a similar way for the purposes of their target market determinations (**TMDs**). The FSC would like the time to work with ASIC, after the legislation is passed, to develop guidelines such as a matrix of products and the types of investors for whom they may generally be regarded as suitable. An adequate transition period would allow this to be achieved, making implementation more efficient and effective for both industry and ASIC.
- (h) Finally, we note the discussion in recent years of a possible change to the definition of "retail client" in the Act.
 - (1) If Treasury is, in fact, contemplating such a change, this should be made known now in the context of the Exposure Draft, as a significant change in the definition would significantly alter the scope of the DDO and the lens through which almost all assessments of suitability are made. Industry would need time to work through the implications of any such proposal and thorough consultation in relation to any change would be needed.
 - (2) It is essential that the parameters of the target market and the extent of the DDO are known and certain before the substantial investment is made by

¹ Articles 16(3) and 24(2) of Directive 2014/65/EU took effect on 3 January 2018. The second consultation paper providing the detail of the new laws was released on 22 May 2014.

industry participants in design and implementation of systems for the DDO.

2.2 Financial products in the scope of the DDO

(a) Scope generally

- (1) By way of context for the comments on particular products below, the FSC would like to suggest that the policy basis for any adjustments in the scope of the DDO regime set out in the Exposure Draft should be focused on:
 - (A) clarifying that the DDO does not apply in circumstances where there is really no "distribution" because the investor alone selects the product, such as platforms, mFund, on-line subscriptions and, most importantly, trading between anonymous counterparties on regulated markets; and
 - (B) applying the regime in a way that seeks to meet its overall objective – to constrain the selling of unsuitable products to retail clients – by focusing the regime on the more risky products rather than over-regulating basic products that are suitable for most retail clients.
- (2) It is not, the FSC submits, an appropriate policy objective to steer Australians' retirement savings away from managed funds and into direct trading in ordinary shares which can be accessed without the additional paperwork and risk that will be required of issuers and intermediaries for other investment products. It is important to have a level regulatory playing field among investment products of comparable risk.
- (3) In Europe, it is important to note that under the MiID II requirements, sufficient comfort has been provided to the industry that non-complex products can be distributed through "execution-only" services without the issuer, dealer or intermediary making an "appropriateness" assessment about the client's fit within the intended target market. We consider that this is a sensible approach, as it recognises that retail consumers should be empowered to make their own investment decisions, unless of course a product is so complex that it requires financial advice or an above average level of investment acumen to understand.
- (4) The measures and controls required in order to meet the appropriateness requirement should be proportionate to the complexity and nature of the products. While it appears that it is within the intent of the draft legislation that the obligations be "scaled" to the level of risk and complexity of the product, we

think it is important that the Government signal a clear policy intention about how the obligations should be scaled down for non-complex products and investor directed products.

(b) Specific products

We have set out in the Appendix comments and observations concerning specific products, which we would ask that you consider for exclusion from the DDO.

We understand the policy intent of the regime and do not disagree with that, as a matter of broad principle.

However, for the reasons mentioned in the Appendix the practical application of the regime to a number of these products may well not be necessary – because they are already governed by robust general law or statutory rules – or because there would be significant practical difficulties in applying the regime and lead to stifling of competition and product arbitrage. There is also a need for clarification in some cases, for certainty.

(c) General comments in relation to platform products

- (1) In relation to platforms, we understand that Treasury's policy position is to have the DDO obligations apply to all forms of platforms such that the IDPS operators and super wrap trustees (**operators**) are treated as offerors (responsible persons) as well as distributors (regulated persons).
- (2) However, it is submitted that for platforms, which include an investor directed portfolio service (**IDPS**) and IDPS-like schemes and also superannuation master trusts and super wraps, this will result in ineffective or duplicative obligations and impose unworkable obligations, unless their specific circumstances are taken into account in the development of the DDO obligations.
- (3) Much of the discussion below applies to IDPS, IDPS-like schemes, superannuation master trusts and super wraps.
- (4) An overarching concept we believe fits in with Treasury's policy position in relation to giving effect to a TMD is the "pharmaceutical model".
 - (A) The analogy being that a pharmaceutical company which manufactures a drug indicates on its packaging who the drug will and will not suit and a doctor then prescribes a particular drug to individual patients.
 - (B) The pharmaceutical company has a product liability duty and the doctor has a duty to ensure that the drug meets an individual patient's needs.

- (C) Under this analogy, the “reasonable steps” required to be taken by a platform operator to ensure that a client meets the relevant TMD can be satisfied if the operator ensures that client has been given the opportunity to receive financial product advice from a licensed financial adviser or, where no such adviser is involved, the operator needs to take its own steps to ensure the client satisfies the TMD.
 - (D) It would then be up to the licensed adviser to ensure that the client is within the TMD for the underlying investment (and it does this as a “regulated person”).
- (5) If the client does not have a financial adviser the “reasonable steps” then need to be satisfied a different way. We submit that one way this could be satisfied is where an operator receives a client certification that they have been provided with the relevant PDS and that they meet that TMD (client certification).

(6) **Making of a Target Market Determination**

- (A) In the platform sector, the operator receives an instruction from its client and invests in the product on the client’s behalf and thereby provides its client with an indirect investment. The platform operator is generally not the offeror of the underlying product and under the relevant ASIC class order is required to provide the client with a copy of the PDS for the underlying investment.
- (B) The underlying product offeror is best placed to make a TMD, as it understands the product as the product offeror. It would be both duplicative and, we submit, less effective for platform operators to assess target markets for the products held on their platforms.
- (C) However, an operator could make a TMD in relation to its actual product (and not the underlying investments) such as “retail clients who are advised by a financial adviser who is appropriately licensed”.

(7) **Separately Managed Accounts**

- (A) Particular issues can arise for responsible entities of separately managed accounts (**SMAs**) that are structured as registered managed investment schemes.
- (B) In these offerings, the responsible entity generally allows investment access to a range of underlying model portfolios within the one managed investment scheme. Each portfolio

is constructed from other products (usually managed funds and listed securities).

- (C) In this context to ensure that the TMD has value, we suggest that the responsible entity be able to issue a TMD for each model portfolio or groups of model portfolios that is disclosed in the PDS, rather than a single TMD at the scheme level. With some SMAs offering up to 100 model portfolios in one PDS, it raises a concern as to the value of requiring a TMD for the SMA itself, particularly one that specifically related to the underlying investment options available via the SMA.

(8) **Giving effect to a TMD - Operators**

- (A) We believe that the pharmaceutical model is appropriate to ensure that there is no potential duplication, inconsistency and uncertainty as to who is responsible to ensure that any advice or dealing in the product is consistent with the TMD.
- (B) As s993DE(2) refers to a "regulated person" – as drafted, this could include both an operator and a licensed financial adviser providing financial product advice. For an advised IDPS product, potentially both the licensed financial adviser and the platform operator have an obligation to ensure that any advice or dealing in the product is consistent with the TMD.
- (C) We believe that potential duplication, inconsistency and uncertainty issues raised above are unintended outcomes of this obligation in the platform sector.
- (D) We are proposing that "reasonable steps" outlined previously for the pharmaceutical model are appropriate to ensure that where a platform is a "regulated person" in this context, it is able to discharge the obligation to ensure that the dealing or advice is consistent with the TMD.
- (E) Guidance in the EM would be useful to provide further details and clarification around these proposed "reasonable steps" in this situation.
- (F) Practically and operationally speaking, on a platform, an operator is relying on a licensed financial adviser's determination that their client meets a product's TMD.

(9) **Giving effect to a TMD – Managed Funds /SMAs on offered via platforms**

- (A) An offeror of products (managed funds / SMAs) that are available to clients indirectly via a platform, where it is the operator's custodian that is the investor on record, via section 993DE(1) has the obligation to take "reasonable steps" to ensure that the dealing or advice given is consistent with the TMD for that managed fund /SMA. The policy position would appear to be looking to ensure that there is a look through and that underlying clients meet the TMD.
- (B) However, we are of the view that in order for the offeror to be able to meet this obligation, it would be appropriate to agree that it also fits within the pharmaceutical model. On that basis, provided that it can be satisfied (via the operator) that either the underlying client has received financial product advice from a licensed financial adviser or client certification has been received, it can be deemed to have taken all "reasonable steps" to ensure that the dealing or advice given is consistent with the TMD of that managed fund/SMA.
- (C) Guidance in the EM would be useful to provide further details and clarification around these proposed "reasonable steps" in this situation. Ideally, this should be reflected in regulations and/or ASIC Guidance.

(10) **Investor Directed Products**

- (A) Where Licensees provide execution only services, or do not know or do not have a relationship with their end investors, it is not possible for them to know whether the product is generally likely to meet the target market's objectives, financial situation and needs and so what would be reasonable for them to do by way of reasonable steps must be very limited, delivering little discernible benefit to investors.
- (B) We do question why it is it considered that an IDPS requires a TMD, given that IDPSs have a PDS exemption and issue an IDPS guide. Only IDPS-like schemes require a PDS and therefore, technically, will be required to make a TMD. This difference between the two types of platforms would have no policy basis, so the preferred course would be for IDPS-like schemes to be treated the same as IDPSs, and not be required to make a TMD.

- (C) If the TMD is to apply to IDPS-like schemes, the approach could be to make clear that the platform operator only needs to determine the target market for the platform itself, and is not regarded as a distributor of the underlying funds, because they are "investor directed". It will also be important to make it very clear which entity, if any, has obligations under the DDO and in what capacity.
- (D) As well as platforms, there are other circumstances where an investor-chosen product should not be caught by the DDO regime. These include direct on-line investments without advice or marketing, and purchasing funds through the mFund platform and other quoted products by unsolicited orders, where the only contact of the client is with a broker, in many cases an on-line brokerage service with no human interaction.
- (E) These are all circumstances where there is no logical policy basis or a practical opportunity for the DDO to apply, because there is really no "distribution" either by an issuer or an intermediary. The acquisition of the product is entirely at the initiative of the investor (unless of course they have a financial adviser, an aspect which is already adequately regulated under FoFA).

(11) **Proposed platform exemptions**

- (A) Given these issues, the FSC recommends excluding all these platforms (IDPS and IDPS-like) from DDO obligations.
- (B) However, to the extent this recommendation is not adopted, the FSC submits that either the Exposure Draft needs to be refined or a specific regulation-making power drafted, including appropriate consultation on the permutations and combinations of the regime in these cases, to help ensure the provisions operate effectively and as intended or Division 3 of Schedule 1 requires amendment or a regulation-making provision (to complement 993DB(1)(d) in Division 2).
- (C) Please see part (c) of the Appendix for more submissions in relation to issues particular to platforms and investor directed products.

(d) **Specific Issues in relation to Insurance and Legacy Products**

We note that there are some instances for life insurance products where a product may be closed to new business but still requires the issue of a PDS.

These instances include:

- (1) the issue of retail life insurance pursuant to the exercise of a continuation option in a group life scheme;
- (2) the restructure of an individual life insurance policy to a superannuation policy, or vice versa; and
- (3) an additional investment by an existing investor into a managed investment scheme that is closed to new investors.

The underlying terms of the product do not change in these situations and the original product may have been issued many years in the past. The FSC submits that the preparation of a TMD and the associated obligations should not be required in these circumstances. This could possibly be addressed via regulation.

2.3 Scope and extent of the DDO

(a) Employer-sponsors

In summary, employers nominate employees to join their default superannuation plan and product issuers are then required to provide disclosure documents (e.g. the PDS) to those employees with a welcome letter when they join the plan.

Employers are mere conduits of information related to the employees' superannuation (in some cases, providing disclosure documents) and should be exempted from the distributor obligations.

- (1) The definition of regulated person in s993DA is very wide, being based on the definition in s1011B, and extends to employer-sponsors arranging for the issue of a superannuation product to employees.²
- (2) The FSC submits that employer-sponsors should not be subject to the DDO in relation to giving effect to the superannuation benefits being provided to employees as an incident of the employment relationship.
- (3) The FSC requests that the definition of regulated person in s 993DA is amended to exclude employer-sponsors by excluding the persons described in Corporations Regulation 7.6.01(1)(hc).

(b) Point of sale application

There have been differing interpretations and concerns in relation to the extent to which the DDO imposes review and ongoing obligations on responsible persons after the issue of the relevant financial product.

² Employer-sponsors fall within para (f)(ii) of the definition of regulated person in s1011B by virtue of their Australian financial service licence exemption under s911A(2)(k) and Corporations Regulation 7.6.01(1)(hc).

- (1) We understand that the DDO is intended to apply at the point of issue or sale of the relevant product and that if a TMD changes over time, responsible persons are not required to notify existing investors and prompt them to revisit their holding.
- (2) We request that the EM confirms that this is the case, to provide certainty on this important point for industry.

(c) **Additional contributions**

There have also been differing interpretations in relation to whether the DDO applies when an existing investor makes an additional contribution for which a PDS is not required to be given.

- (1) We understand that the DDO is not intended to apply to the additional contribution in that circumstance, but that as and when a further additional contribution requires the giving of a PDS, the DDO obligations apply in relation to that further additional contribution.
- (2) Again, we request that the EM confirms that this is the case, to provide certainty on this point for industry.

(d) **Products “containing” multiple products**

We also believe the Exposure Draft lacks clarity about how the DDO applies to products structured to contain multiple products within it, where only certain elements are caught by the DDO.

(e) **Digital Marketing**

The proposed amendments to section 1018A regarding advertising/promotional material for a financial product appear to be acceptable, particularly given the wording, ‘or specifies where the description is available’.

This alternative is necessary particularly if space/time is limited, eg: digital banners, TV/Radio advertising.

It would also be beneficial to obtain regulatory guidance or clarity regarding the displaying of disclaimer text including issuer details and the proposed new s.1018A text etc in the digital marketing space generally, particularly where space or permitted characters are extremely limited such as social media (eg; twitter), SMS, internet search engine marketing etc.

2.4 Personal advice

- (a) As Treasury knows, the distinction between general advice and personal advice poses significant challenges for industry even under the current regulatory regime and that significant penalties can arise if personal advice is inadvertently provided. The provision of personal advice to retail clients is subject to significantly more regulation than the provision of

general advice, including through the application of the best interests duty and the requirement for a statement of advice.

- (b) Many Australian financial services Licensees (**Licensees**) operate a general advice only model in their product issue or distribution businesses, often because:
 - (1) they are not licensed to give personal advice;
 - (2) they do not have sufficient staff who have undergone the required training under ASIC Regulatory Guide 146;
 - (3) they do not choose to give personal advice and assume the associated regulatory burden; or
 - (4) their knowledge of their customer base indicates that their customers would not be prepared to pay for personal advice.
- (c) It is very important for these Licensees to have regulatory certainty that, in complying with the DDO, they are not inadvertently moving out of their general advice model, into giving personal advice (which could amount to a breach of their Australian financial service licence or result in a breach of the Act, both of which carry serious and significant regulatory consequences for Licensees).
- (d) While paragraph 1.39 of the EM provides "*The use of the language does not reflect a requirement to take into account the personal circumstances of any particular person or to provide personal advice*" we are concerned that the reference to these factors will cause responsible persons to consider that they should make enquiries of investors' circumstances and needs, which will put them on the path to giving, or being taken to give, personal advice.
- (e) The FSC also understands that it is not Treasury's policy intention that the DDO intrudes in the personal advice space. However, regulated persons are concerned that:
 - (1) in taking reasonable steps to ensure that dealings and advice are consistent with the TMD under s993DE; and
 - (2) in collecting distribution information (including in relation to the proportion of issues and sales that are consistent with the TMD) under s993DF(2),their obligations under the DDO will in practice require them to make enquiries as to the personal objectives, financial situation and needs of the end consumers and so requires them to give personal advice in order to discharge their DDO obligations.
- (f) To put this beyond doubt and provide certainty to the industry on this very important point we request that this intention is made clear by a modification of the definition of personal advice in section 766B(3) that confirms that making enquiries as to a person's objectives financial situations and needs for the purpose of compliance with the DDO is not

personal advice, in the same manner that this clarification is stated in paragraph (a) of that section as it relates to similar compliance enquiries for the purposes of the *Anti-Money Laundering and Counter-Terrorism Financing Act 2006*.

- (g) We also suggest that generally there be greater recognition in the DDO regime of the existing protections provided under the personal advice framework. We address this issue in further detail in the following paragraph.
- (1) However, one approach may well be to reconsider whether products recommended under an appropriate personal advice regime should be excluded from DDO obligations (as the 2016 Consultation Paper indicated).
 - (2) Another approach would be to accept the inclusion of these products but, as indicated below, provide that in the circumstances of acquisition of a product pursuant to personal advice, the requirement to take reasonable steps will be deemed to have been satisfied.
 - (A) Given the significant standards in place under the regulation of personal advice to align the advice with the needs of the client, we are unclear why the earlier position that products provided under personal advice would be exempt from DDO has changed. That approach would still provide significant protection to consumers while avoiding complicating and duplicating requirements.
 - (B) As a minimum, to put this beyond doubt and provide certainty to the industry on this very important point we request that this intention is made clear by a modification to s993DE(3) to include a specific reference that products recommended under personal advice are deemed to have met the reasonable steps test.
- (h) It is also important however to note, that issuers and distributors should not be obligated to provide any level of personal advice in order to meet the design and distribution obligations (unless of course, the intended target market is more consumers who have received personal financial advice).
- (1) For less complex products, obligations should be limited to ensuring that the investor is aware of the intended target market.
 - (2) Issuers should not be required to enquire about the client's personal circumstances or needs, or draw uninformed conclusions about the client's suitability to a product based on the limited information provided through an application form.

(i) **Conflicts of duty**

- (1) The December 2016 consultation proposed that Licensees providing personal advice would not be subject to the DDO, which, given the potential conflict of duty between the duty to act in the best interests of clients and DDO duty was sensible (eg where the Licensee reasonably determines that a product is suitable and in a client's best interests despite the current TMD).
- (2) Given that Licensees providing personal advice are now subject to the DDO, we request that Treasury considers what consequential amendments are needed or helpful in relation to the laws relating to the delivery of personal advice, including the best interests safe harbour and the obligation to give appropriate advice, so that Licensees who give personal advice, (which may be required by a distribution condition), are able to manage their compliance and to deal with conflicting duties and obligations.
- (3) We also propose, as noted above, that where the adviser's best interest duty is demonstrably satisfied, this should displace any requirement to take other reasonable steps. Put alternatively, the reasonable steps obligation should be taken to be met if personal advice has been given which is in the investor's best interests. We are concerned that s993DE as currently drafted does not achieve this outcome.
- (4) Another suggestion here is that the list of 'relevant matters' in the definition of "reasonable steps" in s993DE(3) is expanded to include 'whether the investor has received personal advice from a licenced advisor' or similar wording.
- (5) In this context, we also suggest that the defences in s993DD(2) in relation to prohibition on dealing/advising if there is no TMD (but there should be one) under s993DD(1), should be amended to include additional relief for regulated persons to rely on the non-existence of a TMD as a valid defence for failing to comply with this prohibition.
 - (A) Unless this is introduced, each time an adviser arranges for an investment to be made for a client or recommends a product where there is no TMD, they are going to have to make their own enquires and legal assessment of whether the product ought to have a TMD (or whether it is excluded from the DDO or under the transitional provisions).
 - (B) While Approved Product Lists might be able to do some of the work in this regard, this

obligation would still be onerous in an adviser scenario.

2.5 Target market determination

(a) **Issues outside the TMD are not prohibited**

Given that the DDO requires:

- (1) the collection of distribution information in relation to the proportion of issues/sales that are inconsistent with the TMD under s993DF(2)(e); and
- (2) responsible persons to report 'significant dealings' that are inconsistent with the TMD under s993DG,

we understand that:

- (3) the DDO architecture itself contemplates that products will be issued or sold to persons outside the TMD (for example where personal advice has been provided that the product is suitable for a particular investor notwithstanding that they are outside the TMD or where the investment in the product is appropriate when it forms a part of a larger balanced portfolio,³ given the composition of the portfolio as a whole); and
- (4) the DDO is not intended to prohibit dealings or advice that are inconsistent with the TMD.

We ask that this understanding be confirmed in the EM to put this beyond doubt and to give certainty to industry that dealings and advice that are inconsistent with the TMD are not prohibited.

(b) **Objectivity in determining the TMD**

- (1) We suggest the following amendments to the determination of the target market under s993DB(10) to facilitate the determination of the TMD having regard to clearly objective considerations:

- (10) A target market determination for a financial product must be such that it would be reasonable to conclude that, if the product were issued or sold to persons in the target market in accordance with the distribution conditions, the product would be reasonably likely to generally meet the ~~likely~~-objectives, financial situations and needs ~~of the that~~ persons in the target market would reasonably be expected to have.

- (2) Paragraph 1.40 of the EM notes that "all relevant factors" must be taken into account when a responsible person is determining whether a product

³ Paragraph 1.38 of the EM.

is likely to meet the objectives, financial situations and needs of persons within the target market and that relevant factors may include the circumstances of persons within a particular market, such as their understanding of product features, capacity to meet financial obligations or bear losses, and whether their investment needs are the same as those the product seeks to meet.

(3) We suggest that the examples provided in the EM in 1.40 of factors that should be taken into account are expanded by making the following amendment to the second bullet point:

- "the circumstances of persons within a particular market, such as their understanding of product features, capacity to meet financial obligations or bear losses, whether their investment needs are the same as those the product seeks to meet and any intangible/emotional benefits such as peace of mind that their risks in retirement (such as inflation risk, market risk and longevity risk) can be adequately managed."

(4) These factors overlap with the factors in the personal advice definition.

(c) **Including the TMD in a disclosure document**

(1) As a practical matter, we anticipate that:

- (A) the TMD will often be included in the PDS or prospectus or posted on the responsible person's website in order for all regulated persons to be on notice of it and able to comply with their DDO obligations; and
- (B) application forms for products sold directly to customers may need to include confirmations from investors that they have read the TMD and whether they are or are not in the target market.

It would be very helpful for industry if the EM could acknowledge that this approach may be taken.

(2) We also request that ASIC confirms (by regulation ideally, or failing that a regulatory guide) that a TMD is not information that would be required to be included in a PDS under s 1013E.

While some PDS issuers may volunteer to include a TMD in the PDS (and volunteer to keep the PDS up to date when the TMD it includes is updated), to assist them in complying with the DDO, this clarification would assist responsible persons who prefer to communicate the TMD in another way or who consider another communication tool to be more

effective and value a flexible approach to the DDO implementation.

2.6 ASIC guidance

- (a) We consider that detailed ASIC guidance in relation to:
- (1) the factors that may be or should be taken into account in making a TMD;
 - (2) the events and circumstances that are likely to constitute 'review triggers' suggesting that the TMD is no longer appropriate;
 - (3) the maximum period between reviews;
 - (4) how to determine the nature and degree of harm for the purposes of s993DD(3)(b);
 - (5) what are 'reasonable steps' for the purposes of 993DE(3); and
 - (6) what is a significant dealing for the purposes of s993DG,
- will be essential to help industry prepare for the DDO and implement it in an efficient and consistent manner. In relation to 'review triggers' it would also be useful for Treasury to confirm that a change in law or taxation that impacts a product type, is not an immediate cause to alter the TMD for all affected products.
- (b) It would be helpful for us to understand what regulatory guidance is proposed and when a draft would be available for industry input. We would very much like to have the opportunity to provide early input and industry materials to ASIC to assist in the preparation of this guidance.
- (c) We anticipate that a uniform and consistent approach to making TMDs and describing the target market across the industry will be important to enable distribution channels to operate efficiently and to promote understanding of TMDs by investors.
- (1) The more that responsible persons and regulated persons develop individual or bespoke TMD approaches and styles, the greater the challenges for dealer groups, brokers and wrap operators in discharging their obligations under s993DE.
 - (2) We would like to propose that we and other industry bodies take the lead on identifying standardised criteria in this regard, for review and consultation by ASIC.

2.7 Responsibility for making the TMD

- (a) In relation to an offer of financial products under a PDS the TMD must be made by the responsible person for the PDS, defined in s1013A(3) as the person who prepares or on whose behalf the PDS is required to be prepared.

- (b) In practice where the PDS is issued by an issuer in relation to a product designed by a distributor or by a professional responsible entity and several persons are involved in the PDS preparation, there may be confusion as to who is the responsible person required to make the TMD or there may be several persons who will need to work together to agree and make the TMD.
- (c) To provide certainty in such a situation we request that the EM clarifies that where there are multiple preparers of a PDS, the issuer of the PDS will be solely responsible for making the TMD.

2.8 Ostensible knowledge of review triggers

- (a) If a responsible person knows, "or reasonably ought to know", that:
 - (1) an event or circumstance has occurred that would reasonably suggest that the TMD is no longer appropriate; or
 - (2) a review trigger has occurred,then they must not deal in or provide advice in relation to the product until the TMD is reviewed and updated if applicable⁴.
- (b) This actual or ostensible knowledge also triggers an obligation to notify responsible persons not to deal, give advice or distribute until the TMD has been reviewed and updated if applicable.
- (c) Paragraph 1.63 of the EM notes that this test is based on existing s1021J, which "makes similar arrangements" for defective PDSs but in fact s1021J only imposes criminal liability for distributing a defective PDS when the person is actually aware that it is defective (ie there is no concept that the person ought to have been aware of the defect in that section).
- (d) We request that, given that a breach of either of s 993DC(4) or 993DC(5) gives rise to criminal and civil penalty liability, the knowledge requirement in s993DC(3) is limited to actual knowledge.

2.9 Distribution information

- (a) **Who is bound**
 - (1) There is ambiguity in relation to who is required under s993DF(2) to collect and keep distribution information (and provide it to ASIC on request under s 993DH(1)).

The seventh line of s993DF(2) provides that the obligation is on the person (being the responsible

⁴ s 993DC(3) and s993DC(4).

person referred to in s993DF(2)(a)) "or" the regulated person (being the person referred to in s993DF(2)(b)).

It is essential that this section is amended to provide clarity in relation to the person subject to the distribution information obligation.

- (2) We do note that in a practical sense, a responsible person may hold some data and in some cases would have larger scale to implement any obligations. However issuers generally will not have access to data collected by Licensees that would be pertinent to the distribution data ASIC would be seeking. This links to the issues in this submission concerning the interaction of the DDO regime with the current personal advice framework. In our view, the matter requires further consideration.
- (3) Identifying where the distribution information obligations start and stop is particularly relevant for platforms and wraps, where multiple entities may be involved (eg Licensees, regulated persons and responsible persons) and there is a greater potential for inefficiency, duplication in responsibility and record keeping and wasted costs.
- (4) In addressing this ambiguity we also note that it would not be efficient or proportionate (and would lead to unnecessary duplication and wasted costs, for no discernible benefit) to impose these distribution information obligations on both responsible persons and regulated persons.
- (5) We appreciate that there is another analysis here, i.e. that the obligation should be imposed on the responsible person on the basis that the issuer of the product (assuming s761E applies) is the appropriate person to collect information and keep records for paragraphs 993DF(2)(c)-(e), which is the person who makes the TMD as referred to in s993DF(2)(a). This dichotomy serves to highlight the ambiguity which potentially applies in a range of given situations. We suggest that this topic be the subject of further consideration and consultation. Mechanically, how this obligation is introduced may well need to be articulated by regulation supplemented by ASIC guidance.

2.10 Issues of products

- (a) The categories of distribution information in s993DF(2)(c)-e refer to 'issues and sales' of the product.
- (b) Although 'sale' is defined in s993DF(3), 'issue' is not defined in the Exposure Draft, and so we assume that the definition of 'issue' in s761E applies.

- (c) There are a number of technical issues arising in the drafting of the distribution obligations which have a broad ranging impact on the structure of the legislation where section 993DF(2) refers to 'issues and sales' of the product. In relation to this we note as follows:
- (1) If the assumption that the definition of 'issue' in s761E applies is correct, section 761E(3) provides that a superannuation product is issued when 'the person becomes a member of the fund concerned'.
 - (2) If the relevant issue for superannuation investors is becoming a member of the fund, then can a similar approach apply to issues of interests in a managed investment scheme, so that the first issue to a member is the relevant issue, rather than all issues that arise where there is a need to give a PDS?
 - (3) In the case of an insurance product, this is ordinarily issued to a person when the insurer accepts cover for the person.
 - (4) The language used in section 993DF(2) is '*issues of the product that the person makes*'. As that language is not consistent with s761E, we suggest that consideration be given to the expression 'issues ...of the product in accordance with s761E' where they appear in section 993DF(2).
 - (5) Please also consider adding a definition of 'issue' in s993DA, for example to provide that it has the meaning given by s761E.

(d) Scope of the distribution information obligations

- (1) The distribution information obligations have the potential to duplicate and overlap with obligations of Licensees.
 - (A) The best interests duty already addresses the intent of requirements of paragraphs 993DF(2)(f) and (g), namely, ways in which dealings or advice given occurred and reasonable steps.
 - (B) We suggest that to the extent that the distribution information obligations apply to regulated persons, the obligations should be limited to notifying of significant inconsistencies with the TMD (section 993DF(5)) in situations where personal advice is not given and the best interests requirements do not apply.
- (2) By way of general observation, we note that many of our members have a significant number of distributors. For example, one of our members has in excess of a thousand distributors. The obligation accordingly, will result in that issuer monitoring the activities of this cohort of distributors.

- (3) Quite often the commercial arrangements between issuers and distributors are such that the issuer has little effective control over the activities of a distributor. The scheme and content of distribution agreements in these scenarios will need to alter and there may well be other consequences (for example, the loss of FOFA grandfathering as discussed below at part 2.11).
- (4) As we understand it, the policy intent of s993DF(2) is to ensure issuers obtain *exception reports* from distributors. As we have indicated, it is not clear to us that the policy intent flows through to the drafting, which may well not be practicable. One approach may well be to consider an approach along the following lines:
- (A) the scope of s993DF(2)(e) is limited to direct distribution only issuers. This would remove the enormous burden for issuers to require the data from advisers;
 - (B) in these circumstances, the requirements of s993DF(2) applying to regulated persons could be removed, given that the provision appears to have limited application to distributors;
 - (C) consideration should be given in relation to the drafting of s993DF(5) so as to ensure that distributors who are regulated persons collect and provide issuers with exception reporting as it occurs. This may well obviate the need to change distribution agreements and clarifies a distributor's obligations in reporting exceptions; and
 - (D) in addition, the notice should be permitted to be sent as a single notice on behalf of a group of associated regulated persons. For example, an advice Licensee should be permitted to send a notice with details covering all of their relevant financial advisers, rather than each individual financial adviser needing to provide a separate notice.
- (5) In relation to s993DF(2)(f), we would ask that this provision be reconsidered. Its potential application is unclear and ambiguous and it may well be that it is redundant in terms of implementing the policy intention. For example:
- (A) the purpose of the provision in relation to issues and distributors is unclear;
 - (B) the scope of records which need to be collected from advisers also is unclear; and

- (C) advisers already keep records of advice, primarily through SOAs, which ought to suffice in terms of record retention.

(c) Scope of the obligation for Superannuation Products

- (1) Paragraphs 40 and 41 of the Explanatory Memorandum relate to the obligations of the issuer and distributor. We would ask that Treasury reconsider how these distribution information proposals might operate in respect of issuers of superannuation products. We do appreciate the context in which these comments are made, however, for the reasons which we have set out we think these might require further attention.
- (2) As you would be aware, the trustee of a superannuation fund may enter into an arrangement with a distributor or promoter in respect of the superannuation product.
 - (A) APRA has made it clear that it considers that such arrangements generally would constitute a material outsourcing arrangement. As such, the trustee must comply with the obligations set out in APRA's prudential standard on outsourcing (SPS 231) which include closely managing and monitoring the activities of the distributor/ promoter as a service provider.
 - (B) Even if the view was formed that the arrangement is not a material outsourcing, the obligations of the trustee under superannuation law and at general law would require such measures to be in operation.
- (3) The legal and regulatory governance obligations of the trustee to monitor and control the activities of its distributor or promoter appear to be inconsistent with the statements in paragraphs 40 and 41 of the EM.
- (4) Set out below is a link to a letter to superannuation trustees issued by APRA. Our members' experience is that APRA's position on this topic has strengthened. Further APRA recently has indicated that it does apply more scrutiny to intra-group outsourcing arrangements, than to third-party outsourcing arrangements.
<http://www.apra.gov.au/Super/Publications/Pages/Letter-to-trustees-RSE-licensees-and-fund-promoters.aspx>

(e) Knowledge

The obligation to collect and keep the various categories of distribution information (which includes the proportion of those issues that were consistent with the product's TMD) is an absolute obligation to collect and keep records of

information, not limited to information actually known by the person who is subject to the obligation.

- (1) We assume that it is not Treasury's intention to require the person who is subject to the obligation to make enquiries and undertake investigations to obtain information that it does not have and that this obligation must be intended to apply to information actually known by the relevant person.
- (2) Failure to comply with this obligation is a criminal offence and a civil penalty provision. Given the serious consequences of a breach of this obligation, we request that the definition of distribution information in s993DF(2) is amended to be limited information 'actually known by' the relevant person.
- (3) This approach is consistent with:
 - (A) the language of s993DG which requires a responsible person to notify ASIC of a significant dealing "of which they become aware" is not consistent with the TMD; and
 - (B) the language of s993DH(1) which refers to providing information "in the person's possession or to which they have access".

(f) **Provision of distribution information to ASIC**

Responsible persons and regulated persons are required to provide distribution information to ASIC on request under s 993DH(1) by "the date specified in the request".

- (1) Failure to comply with this obligation is a criminal offence and a civil penalty provision.
- (2) Given the serious consequences of a breach of this obligation, we request that:
 - (A) this section is amended to either provide a minimum period of time to respond to the request (eg 5 business days) or provide that the information must be provided 'in a reasonable time'; and
 - (B) consideration is given to providing a reasonable excuse defence, similar to the 'reasonable excuse' defence in section 63(5) of the ASIC Act.

2.11 FOFA grandfathering

- (a) In our March 2017 submission we requested that the DDO contains a saving provision for "grandfathered" distribution arrangements under FOFA.
- (b) It is commercially important for responsible persons and regulated persons wishing to amend their distribution agreements that are grandfathered for DDO compliance, for example to impose contractual TMD reporting obligations on

a distributor, not to be subject to the penalty of the loss of grandfathering. Imposing a penalty on a Licensee for action taken to facilitate the implementation of the DDO would be unfair and may deter compliance improvements and good practice updates to distribution agreements.

- (c) This is a significant commercial consideration for industry and we request again that the Act is amended directly or by regulation to provide that grandfathering is preserved where amendments are purely for DDO compliance.
- (d) It would also be helpful for the EM to confirm that it would not be regarded as a 'reasonable step' for a responsible person to amend its contractual arrangements for the DDO changes (eg the collection of 'distribution information') where that would cause it to lose its FOFA grandfathering.

2.12 DDO stop orders

- (a) ASIC can issue a stop order if ASIC is satisfied that a provision of Division 2, or section 993DD or 993DE, has been contravened in relation to a financial product.
- (b) Given the serious consequences of a stop order, we request that this subjective test in s993DI(1) is made objective, ie that ASIC must be satisfied 'on reasonable grounds'.
- (c) The stop order can include a statement that specified conduct engaged in contrary to the order is deemed to be a breach of a 'specified provision of this Part'.⁵
 - (1) Deeming breaches (and imposing liability for deemed breaches) of provisions of the law that are not in fact breached by the conduct is unusual and has the potential to be unfair.
 - (2) Given the uncertainty that this may generate, it would be helpful for the EM to explain the rationale for deemed breaches and provide some examples of how breaches would be deemed to arise.
 - (3) If it is necessary to provide for deemed breaches, we request that this is limited to specified conduct which in fact constitutes a breach of Part 7.8A, so that, for example, if a regulated person has taken reasonable steps as required by the DDO, the stop order does not deem that those steps were not reasonable and that they breached the law.

2.13 Changes to self-reporting require broader consideration

- (a) Section 993DD(3) creates a self-reporting obligation for breaches of s993D(1). That obligation should not, for Licensees be duplicative of the existing obligation under s912D. Further, it should be aligned with s912D and contain a materiality threshold.

⁵ s993DI(3)

- (1) Importantly, it should not be designated a civil penalty provision prior to a final determination (following exposure drafts and consultation) to accept the recommendations of the ASIC Enforcement Review Taskforce (Position and Consultation Papers 1 & 7) as regards making s912D a civil penalty provision.
 - (2) Presently, a breach of s912D may constitute an offence but only if the requisite fault elements under the Criminal Code are satisfied.
- (b) To render penal all failures to self-report, no matter whether innocent, unintentional and not caused by recklessness is a serious step which has not yet been taken, and raises profound policy considerations.
 - (c) In that circumstance, s993DD(3) ought not pre-empt a necessary and broader consideration of these questions in regard to s912D. There is no consideration of these matters in the exposure draft EM.
 - (d) Similar concerns arise in connection with proposed s993DG.

2.14 Reasonable steps

- (a) Sections 993DE and 993DI impose obligations on a person to take reasonable steps "to ensure" particular matters or outcomes. Subject to the clarification and our submissions below on s993DE(1) being accepted, the context of these obligations require a person to take reasonable steps to ensure matters that are, in many cases, wholly outside of their control. This is also the case with the obligation in s993DI(8).⁶
- (b) Given the inability to control the particular outcome of an action not initiated by the person themselves, we submit that the obligation should be revised so that it does not refer to or suggest an obligation of surety or guarantee. For example, the obligation in s993DE(1) could be framed as an obligation to take reasonable steps:
 - (1) not to deal in or provide financial product advice in relation to; and
 - (2) not to permit a dealing in, or financial product advice in relation to, the product if it would be inconsistent with the most recent TMD.
- (c) S993DC(5) requires a person that makes a TMD for a financial product to take reasonable steps "to ensure" that regulated persons, that deal in, or provide advice in relation to, the product, are given directions in certain circumstances.

⁶ Contrast this with the obligation in s601FD(1)(f) where a director of a responsible entity has an obligation to take all steps that a reasonable person in his or her position would take to ensure that the responsible entity do certain things. Given the director's relationship to the responsible entity and the director's ability, and indeed, duty, to control the responsible entity, the use of the words "to ensure" in this context are appropriate.

- (1) In many cases, the person with this obligation will not know who is dealing in or advising in relation to the product, and even if they did, there may be no contractual relationship between them.
 - (2) The obligation in this clause should, therefore, be amended so that the person has an obligation to take reasonable steps to publish a generally available written notice available to those who deal in or provide advice in relation to the product written notice to the effect of the required matters.
- (d) An obligation to take reasonable steps, in particular, where it pertains to ensuring an outcome, is a test that changes with the context and time. The Australian High Court has recently set quite a high standard for active steps to be considered "reasonable", in relation to the status of politicians under section 44 of the Australian Constitution.
- (e) Although s993DE(3) attempts to define reasonable steps, the factors listed in subsection (3) may be largely unknown to a person charged with the obligation of taking reasonable steps.
- (1) For example, a person that prepares a TMD may not know the degree of harm that might result to persons who are not in the target market.
 - (2) The provision suggests that, not only must a person take into account persons who are in the target market, but also all persons who are outside of the target market.
- (f) Accordingly, given that the obligation to take reasonable steps is so heavily dependent on the context, the definition of "reasonable steps" in subsection (3) may be worthy of further consideration and refinement. It may also be helpful if the EM provided some insight into the thinking of the nature of the reasonable steps that are to be taken in order to satisfy this obligation.
- (g) We request that Treasury clarifies whether the responsible person's obligation in s993DE(1) applies:
- (1) in relation to their own distribution; or
 - (2) in relation to distribution by third party regulated persons (if any); or
 - (3) both their own distribution and any distribution by third party regulated persons.

The current provisions could be interpreted as requiring a person who makes a TMD to take reasonable steps to ensure that other persons' dealings and advice on the product are consistent with the TMD.

- (4) However, other persons are already required by s993DE(2) to ensure that their own dealings and advice in relation to a product are consistent with the most recent TMD.

- (5) Given the obligation in s993DE(2), the scope of the obligation in s993DE(1) should be restricted to the person that had the obligation to make TMD. This clarification would remove the ambiguity in this section and provide certainty to responsible persons in relation to the scope and extent of their new obligation.

2.15 Civil liability and criminal liability

- (a) The DDO creates 20 new criminal offences and 20 new civil penalty provisions and eleven of these new criminal penalties carry maximum penalties of 200 units or 5 years in jail or both.
- (b) We would invite Treasury to review the number of penalties created and the maximum penalties applicable to them, to confirm that the sanctions balance of the new part 7.8A is appropriate and proportionate when compared to other parts of the Act.
- (c) Proposed section 993DM(3) provides investors with a right to recover loss or damage because of a failure of an issuer or distributor to take the reasonable steps required under the DDO.
 - (1) As drafted, this could allow investors to seek compensation for a downturn in equity markets, or for losses resulting from risks which were clearly disclosed to them and which they willingly undertook in order to seek a higher return on investments.
 - (2) Civil liability of this kind also attaches to contravention of an intervention order⁷.
 - (3) See also part 3.3 below regarding the definition of significant detriment.
 - (4) We note that the outcomes of an application of subsections 993DM and DN are significant. This includes the power of the court to avoid a contract if it thinks it necessary 'to do justice between the parties'. Potentially, this may well result in an issuer or distributor bearing all market movement risk in relation to a financial product over whatever period between the issue of the product and the bringing of action by the customer.
- (d) The FSC proposes that these remedies are not necessary or appropriate, given that there is already a wide range of existing Australian causes of action that create civil liability for inadequate disclosure of risks, and issuers should not be exposed to an additional liability regime arising out of ex-post analysis of suitability assessment processes.

⁷ It seems this may require constant monitoring of the ASIC website by distributors, including brokers, to ensure that a product in which a person proposes to invest, has not been banned, or its TMD modified.

- (e) If class actions, initiated by litigation funders and without the involvement of ASIC, are brought following a general market decline, this could in theory undermine the viability and solvency of issuers and distributors of financial products. This would not necessarily be beneficial to the investing public and the stability of the financial system. Any such rights to take civil action heighten the importance of precision in prescribing exactly what “reasonable steps” are required to be taken to fulfil DDO obligations, so that market participants can proceed with reasonable certainty that they will not be subject to claims which amount to providing a capital guarantee, or underwriting the performance, for all investment products offered.
- (f) The laws of the United Kingdom, where there is also a DDO regime, do not operate to allow these types of claims. The same is true of the United States. Australia’s existing civil liability regime for financial products is already more onerous than the American or British comparators, given the absence of requirements for intent or knowledge under a wide range of statutory provisions and Australia’s unique class action system.
- (g) Exposure to civil and criminal penalties, accompanied by ASIC’s intervention power, should ensure adequate compliance by issuers and distributors.
- (h) As noted by the Law Reform Commission:

“It is not practicable or economically efficient for laws and regulations to try to protect individual investors from a fall in overall market values or a decline in value of a particular investment. The law governing collective investment schemes cannot – and should not – eliminate investment risk. The cost of doing so would be too great, and fund managers would be discouraged from devising innovative financial products.”⁸

The principle that the investor, and not the product provider, should bear market risk was reflected in the drafting of the laws concerning the cooling-off rights for acquirers of financial products, which provide that although a product may be returned, the amount of money given back is adjusted so that the investor bears the market risk in the period between acquisition and exercise of their cooling-off right.⁹
- (i) Treasury will also recall the difficulties that have arisen as a result of expanding the remedies for shareholders on account of breaches of continuous disclosure laws.
 - (1) An unintended consequence of those reforms was that equity holders might in practice have creditors’

⁸ Law Reform Commission / CAMAC Report No 65 Collective Investments – other people’s money (June 1993).

⁹ See in particular section 1019B of the Act and Corporations Regulation 7.9.67.

claims when a company is in difficulty (for example, *Sons of Gwalia Ltd v Margaretic* (2007) 231 CLR 160).

- (2) Parliamentary intervention has been needed to limit those remedies.¹⁰
- (j) Similarly, in these circumstances, it is important to strike some balance between protecting the rights of consumers and making every consumer potentially a creditor with de facto downside protection or a guarantee in relation to the performance of his or her investment.

2.16 Asia Region Funds Passport

We understand that products issued by passport funds under the Asia Region Funds Passport will be subject to the DDO through an amendment to the definition of recognised offer in s 1200B.

It may be helpful to note this in the EM, to confirm the regulatory intention that ARPF products (in addition to New Zealand mutual recognition offers) will be on a level playing field with Australian products.

3 Product intervention power (**PIP**)

3.1 Financial products in scope of PIP

- (a) The PIP applies to financial products generally other than those specified in regulations under s1022CB.
- (b) In its March 2017 submission, the FSC had asked for a range of categories of product to be excluded, including MySuper.
- (c) We consider that the arguments in favour of excluding MySuper from PIP continue to be relevant and apply, given the significant degree of regulation and consumer protection already in place for MySuper, including under trustee law, fiduciary obligations, the *Superannuation Industry (Supervision) Act 1993* (Cth) (**SIS**), and the regulation of registrable superannuation entity (**RSE**) licensee holders with the Australian Prudential Regulation Authority (**APRA**), including the enhanced trustee obligations in s29VN (b)-(d) of SIS and the 'best interests' duty under s52 of SIS.

In view of the existing extensive regulation of MySuper we consider that it is unnecessary to extend PIP to MySuper.

- (d) In this regard, we also refer to the quite similar position which should be taken in relation to Eligible Rollover Funds (**ERFs**). We discuss this in more detail in part (j) in the Appendix. In short, we also suggest that ERFs be excluded from the regime.

¹⁰ See the current form of section 563A of the Act introduced by the *Corporations Amendment (Sons of Gwalia) Act 2010* (Cth).

3.2 Grounds for an order

- (a) ASIC may make an intervention order where it is 'satisfied' that the financial product has resulted or will or is likely to result in significant detriment.
- (b) Given the serious consequences of an intervention order, we request that this subjective test in s1022CC(1) is made objective, ie that ASIC must be satisfied 'on reasonable grounds'.

3.3 Significant detriment

- (a) Significant detriment is not defined in the Exposure Draft. We appreciate that as a drafting matter, it may well be difficult to define with any degree of precision this concept.
 - (1) While some parameters around the concept are contained in the Exposure Draft, we suggest that appropriate inclusionary examples are included in the Exposure Draft or EM and supplemented by ASIC guidance to the extent possible.
 - (2) As noted above, we look forward to working with ASIC to finalise regulatory guidance in relation to this concept.
- (b) We would like to propose that the factors to be taken into account when determining significant detriment in s1022CD(1) will not include:
 - (1) any significant detriment which arises or occurs to the extent of market movements, market risk or general investment exposure risk; and
 - (2) any significant detriment the risk of which was adequately disclosed to the investor in the disclosure document.

All investments carry a degree of risk and investors should not be, or expect to be, insulated from market risk.

Without specifically excluding these factors from significant detriment, the Exposure Draft creates significant risk of the Government bearing a cost burden as investors may feel their investments are underwritten by the Government (via ASIC) who will step in to protect them. Inadvertently, this may remove the incentives for investors to have an appropriate regard for risk and result in an increase in moral hazard.

3.4 ASIC Guidance

- (a) We consider that detailed ASIC guidance in relation to:
 - (1) identifying significant detriment;
 - (2) the types of orders that ASIC may make and what is 'specified conduct';

- (3) in what circumstances the banning power is likely to be used and when lesser remedies such as warnings and disclosure document or distribution channel modifications are likely to be used;
- (4) whether there are certain types of product or feature that are more likely to attract the use of PIP;
- (5) when class or market wide interventions may be likely to arise;
- (6) how ASIC will implement interventions in relation to a sole issuer or a sole product; and
- (7) ASIC's approach to consultation for the purposes of s1022CE,

will be essential to help industry prepare for the PIP and manage concerns in relation to the uncertainty of its potential use and the potential to stifle innovation.

- (b) It would be helpful for us to understand what regulatory guidance is proposed and when a draft would be available for industry input. We would very much like to have the opportunity to provide early input and industry materials to ASIC to assist in the preparation of this guidance.

3.5 Scope of the intervention order

- (a) The EM explains that there is an 'extensive range' of orders that ASIC can make.
- (b) The orders that ASIC can make under s1022CC(1) include ordering a person to 'not engage in specified conduct' but the classes and types of specified conduct are not defined and could be very wide eg not enforcing a contractual right to a payment of an instalment or payment of a fee.
- (c) We request more granularity and guidance in relation to the types of orders that may be made.
 - (1) A particular concern for issuers of quoted products and for continuous issuers, is whether PIP orders may require amendments to the terms of products.
 - (A) Where quoted product terms are amended, as all the products on issue in the class must be fungible in order to be quoted and freely tradeable, by necessity the amendment must affect all products on issue, including those issued before the PIP commencement date.
 - (B) Although paragraph 2.76 of the EM notes that PIP is not retrospective, it will be where the order requires amendments to the terms of issue for a product issued prior to the PIP commencement date.
 - (2) We also request that the order made should be one that is reasonably necessary in order to address or

cure, and is proportional to, the relevant significant detriment.

We look forward to working with ASIC in relation to developing a regulatory guide to provide guidance in relation to the types of intervention orders that may be sought in a range of circumstances or in response to certain types of 'specified conduct'.

- (d) The order can include a statement that specified conduct engaged in contrary to the order is deemed to be a breach of a 'specified provision' of Chapter 6D or Chapter 7.¹¹
 - (1) As noted above, deeming breaches (and imposing liability for deemed breaches) of provisions of the law that are not in fact breached by the conduct is unusual and has the potential to be unfair.
 - (2) Given the uncertainty that this may generate, it would be helpful for the EM to explain the rationale for deemed breaches (particularly given that the Exposure Draft provides that a claim under the civil liability provisions in s1022CN does not limit any liability under any other law) and provide some examples of how breaches would be deemed to arise.
 - (3) If it is necessary to provide for deemed breaches, we request that this is limited to specified conduct which in fact constitutes a breach of a provision of Chapter 6D or Chapter 7 which regulates or prohibits the conduct the subject of the intervention order and is proportionate in the circumstances. For example, a failure to apply a warning in advertising under an intervention order should not be deemed to be giving a defective PDS with the attendant liability and legal consequences for having given a defective PDS.
- (e) The December 2016 consultation paper proposed that intervention orders would not extend to remuneration. The Exposure Draft now provides that it can, where the remuneration is conditional on the achievement of objectives directly related to the financial product.
 - (1) As a matter of principle we query the necessity and appropriateness of PIP being used to regulate employment terms, which are subject to their own regulation under workplace agreements, collective bargaining arrangements and state and federal legislation and can represent a fine balance of employer and employee interests.
 - (2) It is not clear what degree of connection is needed between the remuneration and the objectives. If remuneration arrangements are conditional on a number of objectives including one which directly relates to the relevant financial product and several

¹¹ s1022CC(4).

which don't, what threshold of connection is needed to trigger this intervention? Should the threshold be 20% or 50% for example?

- (3) Should the objectives be limited to objectives directly related to the "issue or distribution" of the financial product?

3.6 Consultation

Adequate and meaningful consultation in relation to the use of the PIP is essential to provide due process and procedural fairness.

(a) Amendments and permanent orders

We request that the consultation requirement in s1022CE is extended to amendments to orders (which would be consistent with s1022CJ(2)(d) which requires ASIC to publish the consultation it has taken on the amendment to the order) and making orders permanent.

If consultation is not required in relation to amendments to orders, it renders the consultation on the initial order redundant and otiose because any limits agreed in the initial consultation could be removed without consultation or a right of reply.

(b) Reasonable period

Also, in order for the consultation to be meaningful and effective, we ask that s1022CE(1)(a) is amended to require ASIC to 'undertake reasonable consultation for a reasonable period' with the affected persons.

We also ask that you consider whether for certainty, some guidance can be provided as to what would be a minimum reasonable period eg at least 10 business days.

This reasonable period is particularly important if the consultation can be 'deemed to be complied with' if ASIC simply provides a description of the order on its website under 1022CE(2).

(c) Private consultation

- (1) In particular in relation to interventions concerning a single product, as opposed to a class of products, our members place significant importance and a great deal of value on the ability to consult privately before an intervention order is made or published on ASIC's website.

- (2) A private opportunity to consider ASIC's concerns and voluntarily modify or withdraw the product, or potentially demonstrate why the order should not be made affords benefits to investors, ASIC and product issuers and distributors alike, with the potential to deliver the regulatory outcome that ASIC is seeking in a more time and cost efficient manner, without adversely affecting consumer confidence and the market.

- (3) We are concerned that absent a right to consult privately, particularly in relation to a proposed intervention with respect to a sole issuer or sole product, there is a real risk that unnecessary reputational damage may arise and that innovation may be stifled.
- (4) There potentially also is a risk if an intervention order is published on line consumers may be extremely concerned, even panicked, and seek to exit the investment immediately, crystallising a loss. This would increase consumer detriment where the investment itself is penalised in value due to such an order being made public and a large number of sales or exits could create such a negative impact on the product that the basis of ASIC's order is irrelevant.
- (5) We would hope that ASIC would be happy to commit to engaging in private consultations in order to demonstrate accountability to industry and promote confidence in fair PIP outcomes.

(d) **Public consultation**

- (1) Our preferred option is that consultation be private for the reputational and market reasons we have mentioned. If the Government regardless determines that consultation can be 'deemed to be complied with' if ASIC simply provides public information on its website under 1022CE(2) then we submit that, in the interests of natural justice:
 - (A) the order must be published in full. A summary is insufficient for consultation as important distinctions arise in the detailed drafting of an order; and
 - (B) notice of the website publication should be given in writing to the product issuer and potentially any distributor named in the product disclosure statement/prospectus for the financial product.
- (2) Also, we request that s1022CJ(1)(c) and a1022CJ(2)(a) are amended to delete "or summarises" so that orders and amended orders are published in full on ASIC's website. We submit that a summary of an order or an amendment is insufficient to enable industry participants to understand how the PIP is being used and anticipate how the PIP may be used going forwards.

This understanding is important for Australian financial services providers to be able to manage concerns about uncertainty of outcomes and to remain competitive in a global financial services industry, particularly post ARFP, where innovation will need to be encouraged and Australian financial services businesses will need to be encouraged to

continue to invest in and grow their Australian businesses.

- (3) Given that the FSI recommended that the PIP was to be an instrument of last resort, we request that Treasury considers amending s1022CJ(1)(f) to provide disclosure in relation to why other remedies were not appropriate in the circumstances.

(e) **No consequence of failure to consult**

- (1) It is proposed, under s1022CE(3), that ASIC's failure to consult does not invalidate the order.
- (2) We submit that there should be a consequence for failing to consult when required, in order to incentivise reasonable engagement with affected persons, particularly in the absence of the oversight of a court in the exercise of the intervention power.

3.7 Making temporary orders permanent

A temporary order may be made permanent by legislative instrument of the Minister after considering a report from ASIC, under s1022CG.

We request that the affected person (eg the product issuer) is given a copy of this ASIC report and an opportunity to reply to it and make submissions to the Minister before the order becomes permanent.

3.8 Amending orders

- (a) A permanent order may be amended (by legislative instrument) of the Minister after considering a report from ASIC, under s1022CH(1). We request that the affected person (eg the product issuer) is given a copy of this ASIC report and an opportunity to reply to it and make submissions to the Minister before the permanent order is amended.
- (b) A temporary order may be amended by ASIC under s1022CH(2) provided that the term of the order is not extended beyond the prescribed period.

This means that it is possible for the scope of the order to be amended to increase the burden on the product issuer. Given this potential, for procedural fairness and natural justice reasons, we request that either:

- (1) ASIC is required to consult with the affected persons in relation to the amendment; or
- (2) the amendment power is limited so that the scope of the order cannot be expanded beyond the proposed order originally consulted on under s1022CE.

3.9 Additional notifications

ASIC can require someone who has dealt in or given advice in relation to a product to notify the retail client of the order.¹²

- (a) We request that this is amended to clarify that this obligation is discharged by providing notice to the last postal or email address provided by the retail client so that if they have changed their contact details without updating the financial services licensee the licensee is not required to find them to give notice?
- (b) Also ASIC can specify the way in which these notifications are made. Can it be clarified that this does not permit ASIC to require notifications which require contact information that licensees do not have (eg that ASIC cannot require email notifications where licensees do not have the retail investors' email addresses)?

3.10 Review of ASIC's decisions

In its March 2017 submission the FSC had suggested that a panel of industry professionals have the power to review ASIC's PIP determinations, to provide a level of accountability in the exercise of this wide power.

Given that the Financial Services and Credit Panel now has been established to review ASIC decisions in relation to banning individuals for misconduct in relation to financial services or credit activities, we suggest that you consider if this panel or another appropriate panel may be suitable to provide oversight of PIP orders.

3.11 Object of the PIP

- (a) The object of Part 7.9A, as set out in s 1022CA, is to give ASIC powers to reduce the risk of significant detriment to retail clients resulting from financial products.
 - (1) The FSC requests that this object is extended to include *'while not stifling innovation in the financial services sector in Australia'*.
 - (2) We also request that this object or the EM notes the FSI's statement in relation to recommendation 22 that *'the intervention power is expected to be used infrequently and as a last resort'*.
- (b) We understand that ASIC will be preparing guidance in relation to the frequency and types of intervention that it anticipates, which will be extremely important for industry to prepare and be able to manage concerns around uncertainty.
- (c) Although it appears that Government is set to proceed with the introduction of the PIP, we do question whether it is really necessary to have a power of that breadth, given ASIC's existing powers under the Act eg to stop defective

¹² s 1022CM.

disclosure documents and the new power that ASIC will have under s993DI to issue a stop order if it is satisfied that there has been a dealing without a TMD, or reasonable steps have not been taken to apply a TMD.

- (d) The PIP would be unusual in Australian law, being an enforcement tool that requires no actual or suspected breach of the law. The Financial System Inquiry interim report stated that:

*'A number of pre-requisites underpin a well-functioning financial system, including a predictable rule of law ...', and the rule of law requires that "no discretion should be unconstrained so as to be potentially arbitrary"*¹³.

- (e) We ask that Treasury consider whether the stop order power could be regarded as sufficient to enforce the DDO regime, particularly given the ambiguities created by the principles-based, rather than black-letter law, manner of legislative drafting of the DDO.

- (f) We also request confirmation in relation to how the exercise of the power would be subject to the usual administrative and judicial review processes applying in respect of other ASIC powers.

Finally, given the size and importance of the financial services sector in Australia and the importance of our industry remaining globally competitive and innovative, we request that the effect of the DDO and PIP and the extent of regulatory action under them is reviewed and reported on by the Government once they have been in operation for say, three to five years.

Should you have any questions in relation to our comments, please contact us on 02-9299-3022.

We look forward to discussing this matter further in due course.

Yours Faithfully



Paul Callaghan
General Counsel

¹³ Tom Bingham (former Master of the Rolls and Lord Chief Justice), *The Rule of Law*, 2011 Allen Lane.

APPENDIX: SPECIFIC PRODUCTS AND PLATFORMS: PARTS 2.2 (b) AND 2.2(c)

(a) Basic Banking Products

The FSC understands that the ABA is making submissions in relation to the inclusion of basic banking products in the scope of the DDO.

The FSC supports those submissions and shares the ABA's concerns in relation to the value of requiring a TMD in relation to such everyday products, which are expected to be suitable for most consumers.

(b) Quoted products

(1) The integrity and efficiency of Australian financial markets depends on the volume, spread and frequency of trading, including through participation of retail clients in on-market trading. It is critically important that the introduction of the DDO should not diminish trading by retail clients, as this would, ironically, harm retail clients themselves by reducing the liquidity of their investments and the accuracy of price discovery.

(2) The FSC submits that the simplest and most effective way to ensure that financial markets are protected would be to exclude, along with ordinary shares, all products listed or quoted on licensed financial markets, on the basis that those markets are transparent and effectively regulated. In this regard we refer you to the submissions on this matter which we expect you will receive from the Australian Financial Markets Association, with which we agree.

(3) However, if this request is not accepted, the Exposure Draft needs to be clarified to avoid unintended harm to markets. As currently drafted, sections 993DB(5), (10) and (11) do appear to give the result that a TMD is required for an issue of a product that is or will be traded on a financial market where a PDS or prospectus is required, but not for the subsequent on-market trading in the product, so long as it is not (for example) a sale amounting to indirect issue that itself requires a PDS or prospectus.

(4) However, in a scenario where Treasury is not prepared, as the FSC had requested in earlier submissions and above, to exclude quoted products from the DDO regime entirely, it is acknowledged that the approach of excluding secondary sales is helpful, in that it sensibly excludes from coverage of the DDO circumstances where anonymous counterparties are trading with each other on-market so that the seller will never have the information or control to determine or enforce a TMD. The FSC is

concerned to ensure that the exclusion from the DDO of all on-market trades, including on the AQUA market, should be absolutely clear so as not to harm market participation. This could be achieved either in the legislation or the Explanatory Memorandum.

(5) Examples where clarification is required include the following:

(A) Section 993DB(5) states that if a PDS “must be prepared or given for a financial product” the responsible person must make a TMD. Clearly, a PDS must be prepared whenever a product to be traded on the listed market of ASX is launched, because this is required by ASX and retail participation is normally needed to achieve the spread of investors required for listing.

(B) Although the term “sold” in section 993DB(10) and 993DE(3) is defined so that it does not include a normal sale on market, the starting point of having to prepare a TMD under 993DB(5) could lead to confusion that the product remains covered by the DDO regime through its life, and that no regulated person (including a stockbroker) can deal except within the original TMD that related to the issue.

(C) We are grateful for Treasury’s indication in face-to-face consultations that it is not intended that TMDs apply to on-market trading, but given the importance of this point, either a clarification in the Exposure Draft, or a clear statement of how these provisions are intended to operate in the EM, is needed.

(D) Currently, paragraph 1.15 only refers to the anti-avoidance purpose of section 1012C, and does not explain that the definition of “sold” is intended to exclude the DDO regime to market trading.

(6) **ETFs**

A specific example where market participants may have difficulty in applying the legislation to their products is exchange traded funds.

(A) Index tracking ETFs are a common, relatively low cost and relatively conservative investment, including for self-managed superannuation funds. An ETF generally issues units only to stockbrokers, who then sell them on market, including to retail clients.

- (B) Our understanding of the Exposure Draft is that assuming the normal practice of a PDS being given to the stockbroker for the issue¹⁴, because the sale to retail clients on market of the units will not require a PDS, a TMD is to be prepared by the issuer with the target market being stockbrokers, and no TMD is required for the on-market sales.
- (C) Another way of viewing these arrangements is that where a broad retail client focussed TMD is required for an ETF product, then the reasonable steps needed in the downstream distribution (by brokers and other intermediaries) are confirmed to be scaled down and limited because as we have said, the DDO obligations should apply to issues as such and not on-sales.
- (D) Although not intuitive, this outcome is important for the continued operation of the substantial ETF market. It would be an absurd result to require a TMD to cover all retail clients who may acquire products on ASX, as only products with the lowest level of risk (ie suitable to all including the most risk-averse) could be traded.

(7) **ETPs**

In the similar example of an exchange traded product (**ETP**) which is actively managed as opposed to index-tracking, these products often allow direct applications from retail clients on a daily basis, so a PDS is continuously required.

- (A) In this case the target market for the TMD is all retail clients who subscribe (as the issuer may be able to have some control of distribution), but not retail clients who acquire on market, where the identity of the acquirer is entirely out of the hands of the issuer.
- (B) The Exposure Draft and EM should make clear that on-market sales are not caught, both for ETFs and ETPs.

(8) **mFunds**

A different example is the mFund platform, an increasingly popular method of investing in managed funds that are not market traded, using the CHESSE settlement system to settle applications and redemptions for units.

¹⁴ Even though a PDS is not strictly required to be prepared or given to a wholesale client such as a stockbroker.

- (A) Investments may be transacted through a stockbroker or on-line trading account. A PDS is required to be given for each fund the investor selects.
 - (B) This is similar to an IDPS, except that the mFund platform has no relationship with the investor and the product issuers will not be able to determine or enforce a TMD because they will have no information about investors.
 - (C) The transactions would not be excluded as secondary sales, as in the case of ETFs and ETPs. It is difficult to see how issuers and stockbrokers could continue to participate in this service once the DDO regime is in force, except with the very lowest risk products that would be suitable for all retail clients, unless the Exposure Draft is modified.
 - (D) One approach could be to exempt mFund "trading" from the DDO, on condition of a simple risk-based warning system, where products are tagged on trading platforms with a simple label to identify the level of risk, such as traffic lights or ski-run gradings. This could also be helpful for other direct investments – see (e) below.
- (9) It is also essential in the case of listed investment companies, listed investment trusts and listed property trusts to be clear that only the initial issue and distribution of these products is captured by the DDO, and not any secondary trading on market.
- (c) **Platforms, including IDPSs, Superannuation Wraps and Separately Managed Accounts**
- (1) **General Comments**
 - (A) Particular issues arise from the DDO architecture in relation to the role that platform operators take in respect of the products held on their menus. The operator in this context has the role of direct 'wholesale' investor in the product (using the example of a managed fund) as well as the operator of the service by which indirect investment is obtained by 'retail' platform members. We understand that Treasury's policy intention is not to require platform operators to assess target markets for products held on a platform where the issuers of those products have already made those determinations. We request that the EM confirms this intention to provide clarity on this point for industry.
 - (B) We agree with this policy approach because duplicating determinations in this manner is

likely to create both uncertainty and inconsistency in approach across products where a platform operator forms a different view on a product compared with the offeror.

- (C) It is a matter of significant concern also that the provisions of proposed sections 993DB and 993F(2) create friction and confusion in the context of these kinds of products. When applied in this area there is the conflation of the responsibilities of offeror and distributor and a potential duplication of responsibilities. In these types of scenarios, participants may have a multi-tiered role and this confusion of obligation has implications for the market and the effectiveness of the regime.
- (D) Given that the intention is to add these types of products by regulation, we strongly suggest that there be a specific regulation-making power included in Division 3 itself. In this way, the permutations and combinations and practical implications of the regime to these types of products can be adequately addressed by appropriate regulation.

(2) **SMAs**

- (A) Equivalent issues arise for responsible entities of separately managed accounts structured as registered managed investment schemes. In these offerings, the responsible entity generally allows investment access to a range of model portfolios, which are constructed from other products. To the extent that other offerors for those products are preparing determinations (such as if the models are constructed around managed investment schemes), the EM confirmation requested would again provide certainty for SMA operators.

(3) **Platform operators**

- (A) Notwithstanding the above, we acknowledge the policy intention of having interlocking obligations on both offerors and distributors to ensure that products are not misdirected. In this regard, there is a countervailing argument that platform operators serve a key stakeholder function as both an issuer or service provider and also distributor.
- (B) The FSC believes a safe harbour is desirable to specifically identify what constitutes "reasonable steps" in relation to the obligations imposed on issuers by the fourth design obligation being the requirement to

notify ASIC of significant dealings that are not consistent with a product issuers TMD.

(C) The industry model for many products includes not only issuer to consumer and issuer to distributor to consumer relationships but in the case of platforms, an issuer to issuer to distributor/consumer relationship.

- As a result, the issuer of a financial product, for example a managed investment scheme, often has an indirect relationship with the consumer to the extent that the information available to the issuer regarding the consumer is limited in scope and would not allow an issuer to determine whether the consumer was within a TMD for a product.
- It is therefore critical whether via amendment to the Exposure Draft, clarification in the EM or via ASIC guidance, the indirect relationship an issuer may have with a consumer is recognised and clarified to provide certainty to issuers in relation to the scope and extent of the new obligations.

(D) We understand that Treasury's policy intention is to require platform operators to make a TMD with respect to their platform and the target market of users of that platform.

(E) Given that platforms cater for an extremely wide of customers, by virtue of the wide range of products that they offer, and that they do not give personal advice to the ultimate end investor and are rarely in a position to really know their end customers, as a practical matter it is difficult to make an appropriate TMD for a platform and a platform TMS may be so broad that it adds no value to the end users.

(4) **Proposed exclusions and limitations**

(A) For these reasons we request that platform operators are excluded from the definition of responsible persons under the DDO, at least in relation to platform operators who are not required to issue a PDS in relation to the issuer of interests in their platform.

(B) In the alternative, we submit that if Treasury or the policy makers are not minded to exempt platform operators from the DDO

requirements applying to responsible persons, the law (or subsequent regulations) should at least be framed in a manner which allows platform operators practically to perform both their roles and delineate the obligations accordingly.

(C) In this regard, we make the following submissions for consideration:

- platform operators should not have be exempted from having to take into account all the products held on their menus in making TMDs for their platform. This would provide more focussed TMDs which deal with the specific characteristics of the platform;
- if accurate to do so, a platform operator should be able to make a broad determination to the effect that the target market for its offering is appropriate for a wide range of (if not all) investors assuming the platform offers a sufficiently broad range of investment options to meet investors' needs, but without operator having to impose a condition that each person does in fact make investment choices that suit that person's particular needs and circumstances;
- if applicable, exemptions made available to platform operators (as described above) should have equivalent application, where appropriate, to responsible entities of SMAs;
- a safe harbour is desirable to specifically identify what constitutes "reasonable steps" when platform operators (as distributors) are taking steps to ensure the operation of the platform and provision of access to products held on platform is consistent with the most recent TMD for those products;
- relevant amendments to the Exposure Draft or clearly articulated regulations would be preferable and at the very least, interpretive guidance in the EM would be useful to clarify that in making a TMD, where an offeror's product is only held "on platform" and not offered directly to

investors, that the class of persons that the offeror needs to take into account is the indirect investors and not the platform operator;

- further interpretive guidance would be helpful to enable operators to better understand whether (assuming they are to be treated as responsible persons) in meeting the obligation to ensure their TMD is adequate, the platform operator is required to account for the menu construction process or composition of menu products (including the proportion of third party products offered on those menus); and
- s993DD(2) provides a defence where reliance is placed by a platform operator as distributor (ie a regulated person) on the determination having been made by an offeror of a product made available on the platform (ie on menu), but is qualified to the extent that this reliance on being notified of a determination is "reasonable". It is critical for platform operators to understand specifically what is reasonable in the context of a notice given by the offeror of a product held on menu. Interpretive guidance in the EM would be of assistance in this regard.

(5) **IDPS**

- (A) The EM states that the Government intends, via regulations, to include within the regime custodial arrangements which are not currently subject to the disclosure provisions. This captures an IDPS which is defined in the EM as a 'product'.
- (B) As noted in part 2.2(c) above, the FSC submits that regulations should not be made to cause IDPSs, as opposed to the products offered through them, to be subject to the DDO regime.
- IDPSs are effectively administration and tax management platforms. They are not presently regulated as 'financial products' in their own right (although superannuation funds operating as wraps/platforms or 'hybrid' platforms are financial

products and regulated as such – see further below).

- An IDPS typically provides access to a wide range of separately issued products with associated PDSs for each accessible financial product (unless the products are otherwise exempt under existing disclosure provisions basic banking products).
- We would anticipate that the intent of Government would be to achieve 'equivalent' treatment of, and consistency in, TMDs regardless of whether a 'product/option' is acquired directly from the issuer or via intermediated vehicles including superannuation funds (noting that superannuation trustees have significant fiduciary and statutory obligations to IDPS operators – see below).

(C) For all these reasons, the view of the FSC membership is that IDPSs and IDPS-like schemes should be excluded from the DDO.

(D) A TMD for an IDPS could potentially cover most or all retail clients given acquisitions could be made in varied combinations and proportions particularly where such products are acquired through financial advisers. This does not currently appear to be reflected in the legislation.

(E) To the extent that platforms and IDPSs are captured, a platform provider (whether a superannuation wrap product issuer or an IDPS operator if they are to be covered) should be able to make a broad TMD to the effect that the target market for its wrap or IDPS platform is appropriate for any investor as the platform offers a sufficiently wide range of investment options to meet any investor's needs, but without the IDPS or superannuation provider having to impose a condition that each person does in fact make investment choices that suit that person's particular needs and circumstances.

(F) IDPS operators will need to be able to readily identify whether their role is that of a 'responsible person' (the issuer) or a 'regulated person' (the distributor) and the obligations and liabilities associated with each role and each 'financial product'. The drafting of Division 3 of Schedule 1 is likely to be

particularly problematic for these entities given the aggregation of obligations. As part of this, clear protocols regarding which entity has the obligation to manage communication of, and reporting about, the 'distribution condition' to the PDS product issuers on the IDPS (and/or to the IDPS operator) will also be crucial (noting that an entity, such as a superannuation fund, may be both an issuer and a distributor for different products – see part 2.9 above).

- (G) As with 'direct offers', currently there are no frameworks for product distributors (ie advice licensees and their representatives) to report to the IDPS operator, super wrap trustees or other PDS product issuers, the acquisitions made by particular cohorts of retail clients and this could be across potentially hundreds of PDS products for an IDPS or super wrap.
- (H) If this is to proceed, the law will need to be drafted to clearly enunciate how an IDPS operator's TMD would be constructed separately and distinctly from the TMDs associated with the 'disclosure based products' captured under s993DB ('PDS products') and the associated obligations for each. That is, the regulations must be very clear on which TMD applies for which purpose to reduce confusion and avoid duplication of liability or accountability including record keeping and reporting.
- (I) Given the potential for overlapping obligations it is our submission that that Division 3 of Schedule 1 in the Exposure Draft includes a broader regulation provision to deal to the delineation in roles and obligations especially for custodial arrangements (whether IDPS, IDPS-like or superannuation).

(6) **Superannuation funds – additional considerations**

- (A) A number of superannuation funds operate as 'IDPS-like' vehicles effectively offering investment options that would, if offered directly, constitute, and be regulated as, third party financial products (including listed exchange securities), with associated tax and administration-tracking attribution to individual members. These funds are frequently referred to as 'superannuation wraps' or 'superannuation platforms'. However, many public offer superannuation funds operate as 'hybrid' platforms providing

- investment options specific to the fund (including MySuper) as well as options which are also third party financial products (with pooling of tax and administration tracking).
- (B) In any of these cases, a superannuation platform can be considered both a financial product and a platform which provides investment options where an investment option may be, for example, either exposure to a pool of investments obtained by the trustee on wholesale markets but not being a single discrete product that could be offered in its own right externally, or a separate 'sub' financial product from a third party backed by separate PDS' (sub-product). For the third party 'sub-products' which sit on the platform, the platform administrator would generally seek to rely on the issuer's TMDs for its products. A trustee, given its fiduciary obligations, may impose additional restrictions for these 'sub-products' but would have regard to the TMD of the PDS provider.
- (C) A further complexity for superannuation more generally (whether IDPS-like or hybrid or other) is the lack of clarity around what constitutes separate 'financial products'. Strictly speaking, the general rule under the Act is that a superannuation fund member is issued with a superannuation product when they first become a member of a particular super fund, as noted above in part 2.10(c)(2). Members may frequently choose from a menu of investment options following that acquisition but that does not amount to the issue of a further product to the member.
- (D) Over time 'special' rules have been developed in the Corporations Regulations to deem certain events to involve the issue of a further superannuation product to a person who is already a member of a fund; these events are an election to move from accumulation phase to pension phase and a move between "sub-plans"¹⁵. These rules are predominantly for disclosure purposes.
- (E) In addition the MySuper regime introduced the concept of a "MySuper product" being a "class" of beneficial interest distinct from the other classes of defined benefits and the "choice product" class – but without the law actually treating MySuper as a necessarily

¹⁵ See Corporations Regulations 1.0.02, 7.9.01, and 7.9.02.

distinct “financial product”. Subsequent fee disclosure provisions in the Act and regulations draw a distinction between a “MySuper product” and “investment options” but within a legal framework that allows the MySuper product and the (other investment options) to be part of the same single product if that is how a trustee wants to structure its product offer.

- (F) Given the above and the obligations of superannuation trustees under trust law, and statute particularly s52(6) of SIS and the APRA Standards (particularly SPS 530, and SPS 231) consideration should be given to exempting superannuation funds and platforms from the DDO.

(7) **Conclusion for both super and IDPS platforms**

Before the finalisation of any DDO laws it is important that there be clarity about:

- (A) What responsibility a platform operator would have as a product issuer of its platform-level product and hence as a “responsible person” if IDPSs are included in the DDO.
- (B) What responsibility (if any) a platform operator will have as a product issuer of an issuer of indirect equitable interests in the underlying legal products issued by other product issuers to the platform operator.
- (C) Related to the previous 2 points, how much a platform operator can leverage the underlying TMDs done by underlying product issuers and have a broad general TMD for its own platform product.
- (D) What responsibility (if any) a platform operator will have as distributor/dealer (and hence a “regulated person”) in relation to indirect acquisitions of underlying products made by platform clients.
- (E) How that responsibility will interact with the responsibility of an advice Licensee and its adviser representatives as an adviser/dealer (and hence also a “regulated person”) for the very same indirect acquisitions that the advice Licensee or its advisers advised on.
- (F) In summary, how to avoid ambiguity in allocation of responsibility between all these parties and avoid excessive duplication (or triplication) of responsibility amongst these parties e.g. for ensuring consistency of sales with the TMD, and record keeping.

(d) **Life insurance**

We ask that Treasury reconsider the inclusion of life insurance products within the DDO regime.

- (1) The life insurance industry has experienced significant regulatory oversight in recent years and the industry and regulators need time to fully analyse and understand the impacts of the recent changes before determining whether additional regulation regarding product design and distribution is actually necessary.
- (2) In our March 2017 submission we outlined reasons why consideration ought to be given to the exclusion of certain life insurance products. More specifically, in that submission (at part two, paragraph 22), we suggested that a possible exclusion could be products which satisfied the requirements of the FSCs Life Insurance Code of Practice (**Code**).
- (3) The Code was implemented effective 30 June 2017 and *Code 2.0* is now in development and, at this stage, is likely to be implemented 30 June 2018, we suggest the time is right to revisit a Code based exclusion for life insurance sold under personal and general advice.
- (4) We also note the Life Insurance Framework (**LIF**) came into effect on 1 January 2018 and will be reviewed by ASIC in 2021. As the LIF reforms are intended to improve distribution of life insurance to retail clients, we are of the view that LIF represents an additional reason to recommend for life insurance products sold under personal advice to be excluded.
- (5) As mentioned in the body of our March 2017 submission, the impact of the regime on adviser Licensees who sell or, rather, distribute, life insurance products under a personal advice Australian financial service licence, should be reconsidered. Such advisers are already subject to multiple regulatory oversights including SOAs and best interests obligations. When **full advice** is provided the customer's objectives, financial situation and needs are already considered as part of the advice process, so the regime appears to duplicate existing rules.
- (6) Moreover, a customer under the personal advice model will undergo a comprehensive underwriting process in order to obtain cover, which relies on detailed customer disclosures of health, lifestyle and medical conditions to assess a life, total permanent disability (TPD) or trauma cover that is appropriate to their circumstances and needs. The risk that a customer could be mis-sold life insurance under an underwriting process would be minimal. For example,

it would be very unlikely that a customer could be sold death cover when he or she has terminal cancer. The DDO reforms are effectively redundant where underwriting is involved and serve only to increase costs from a manufacturer and distributor perspective, which will ultimately be borne by consumers.

- (7) In respect of insurance products sold under a general advice model, we question how the distribution obligations should apply to products sold online. While issuers can define target markets for such products (typically simple life insurance products), because consumers are making self-guided choices as to whether or not to purchase a product it is very difficult for issuers to ensure purchases are contained to the target market. Mechanisms to ensure such an outcome are likely to increase complexity and costs to consumers, which we assume is not the intention of the regime. We therefore recommend that consideration be given to exclusion of insurance products sold online under a general advice model.
- (8) In summary, our view is that inclusion of life insurance products in the regime is unlikely to benefit consumers for the following reasons:
 - (A) advisers are already subject to considerable regulatory oversight on customer best interest duties, and whilst the regime appears to duplicate or encroach upon many of the existing obligations and is unlikely to provide any greater protection for consumers;
 - (B) moreover products sold via a personal advice model also contain the insurer's underwriting process which means that target markets will not be provided with insurance cover that is not appropriate to their circumstances. We note that an underwriting process could apply to insurance products sold through other channels as well. The risk of mis-selling to customers who may be subject to underwriting would be minimal;
 - (C) in a digitised economy, the experience of our life insurance members is that customers are increasingly moving to self-fulfilment and the DDO as currently proposed will not provide greater protection for consumers who shop online and may even reduce consumers options in the future;
 - (D) with the recent introduction of LIF and the Code, time needs to be given to fully understand their impacts and meaningful gaps, before additional regulation is enacted

that will increase compliance costs which will ultimately be passed on to consumers; and

- (E) potentially reduced innovation in the life market due to increased costs and complexity associated with compliance.
- (9) In addition, our life insurance members (and this is likely to extend to other commercial contexts as well) would be grateful for any further clarity regarding the following matters:
- (A) In a situation where life insurance is offered within a superannuation product, where does the design and distribution obligation rest? Is it ultimately the issuer of the product or is it both the product issuer (i.e. superannuation trustee) and the insurer? If the latter this will add additional complexity.
 - (B) Whether Treasury has considered all aspects of the FSC submission from March 2017, particularly in regards to life insurance and where our policy submissions in that regard have not been accepted, some insight into why that is the case.

(e) Ordinary units

While the FSC welcomes the exclusion of ordinary shares from the DDO to facilitate ordinary fundraising, the FSC requests that Treasury considers also excluding ordinary units issued by registered schemes that carry on a business (ie not schemes which offer exposure to an investment strategy, the scheme equivalent to investment companies) from the DDO.

This would create a level playing field for fundraising between companies and businesses which operate their businesses through a trust structure.

(f) Listed entities which are comparable to trading companies

The FSC requests that, consistent with the exclusion of ordinary shares in a listed company that needs to raise capital from the DDO, Treasury consider the extent to which, at a policy level, listed entities which are not primarily investment fund vehicles should also be excluded.

The ability for Australian business to raise capital should not be inhibited because a business, which is functionally similar to a trading company, happens to include a trust or stapled structure. If, for example, Government wishes to encourage private investment in infrastructure, a modification of the regime for listed infrastructure trusts and stapled entities could be considered.

(g) **Offers to all existing members**

- (1) There are several circumstances where a PDS may be required for an offer or issue of units in a listed trust to retail clients, but an assessment of the target market by way of a TMD would be neither practical nor useful because the target market is required to be all of the existing unit holders.
- (2) One of these is an emergency capital raising for a trust where the exemption from providing a full PDS is not available because the units have been suspended from trading for more than 5 business days in the past year or has been listed for less than 3 months (section 1012DA(5)).
- (3) It may be necessary for the offer to be pro rata to fit within ASX Listing Rule requirements, and it could contravene section 601FC(1)(d) to treat the members differently.
- (4) Similarly, in the case of a merger or restructure such as by way of a trust "scheme of arrangement" where a compulsory transfer process, approved at meetings and by the Court, applies to all unit holders, there can be no distinction as to how unit holders are treated, so it is pointless and inappropriate to assess whether they are within a notional "target market". In these circumstances the target market is fixed by law.
- (5) We request that there be an exception from the TMD requirements where a PDS or prospectus covers an offer only to all existing members (with the permissible exclusions eg of foreign holders) of a listed trust or listed investment company, or a stapled group which includes a trust or LIC.

(h) **CHES Depositary Interests (CDIs)**

We note that CDIs over ordinary shares which are foreign shares cross-listed on ASX are not, themselves, ordinary shares and so are not excluded from the DDO.

It is not clear whether Treasury has deliberately included foreign ordinary shares from the excluded category, or if this is an oversight. For example, does Apple Inc. need to prepare a TMD to offer interests in its shares on ASX? We ask that this be clarified, preferably by extending the exclusion for ordinary shares to CDIs over ordinary shares.

(i) **Comprehensive Income Products for Retirement (CIIPRs)**

The Exposure Draft does not contemplate the exclusion of CIPRs.

The Government's proposal for CIPRs includes an obligation on trustees in offering CIPRs that they are designed to be in the best interests of members of the fund, using information

available about their membership, such as average retirement age, gender and average account balance.

We submit that CIPRs should be excluded from the DDO to avoid duplication of the tailored suitability regime to be applied to this type of product.

(j) **Superannuation products generally**

- (1) We do note the exemption for MySuper products. This exemption in itself technically may be problematic as generally a MySuper product is a sub-product or investment option of a broader superannuation scheme.
- (2) Having said that, we do confirm our previous comments in relation to the broad inclusion of superannuation products within the regime. We will not repeat all of the arguments we have raised previously in our March 2017 submission. However, in summary, providers of superannuation products generally are subject to very rigorous and robust laws which are administered, putting to one side SMSFs, by APRA and the ATO. APRA issues prudential standards. This is supplemented by extremely far-reaching superannuation regulatory legislation and general law rules.
- (3) We are not certain what the end benefit for consumers might be in including trustees of such funds in the arrangements.
- (4) We have touched upon the issue of distribution of superannuation products above. If it is intended to include superannuation entities and distributors within the regime, then there will need to be careful consideration of the overlay and interaction with these various statutory provisions and general rules of law.
- (5) Detailed consideration will also need to be given to the scope of any such obligations – which presumably may be outlined in regulations.
- (6) The EM notes that some financial products requiring a PDS are not subject to the new design and distribution regime, including MySuper products which are subject to special rules under SIS. Eligible Rollover Funds (**ERFs**) are special purpose superannuation funds which are subject to specific authorisation from APRA with additional legislative requirements that the governing rules of the fund provide that the only purpose of the fund is to be a temporary repository for amounts transferred to the fund from other regulated superannuation funds in circumstances allowed by the RSE licensee law and a single diversified investment strategy is adopted in relation to all assets of the fund.

- (7) Similarly to MySuper products, there are enhanced director obligations applicable to ERFs under Section 242L of SIS.
- (8) In light of the above, we request that ERFs are excluded, in the same way that MySuper products are excluded, from the DDO regime.

(k) **Specific Issues in relation to Insurance and Legacy Products**

As mentioned in the body of our submission, there are some instances for life insurance products where a product may be closed to new business but still requires the issue of a PDS. These instances include:

- (1) the issue of retail life insurance pursuant to the exercise of a continuation option in a group life scheme; and
- (2) the restructure of an individual life insurance policy to a superannuation policy, or vice versa.

The underlying terms of the product do not change in these situations and the original product may have been issued many years in the past. The FSC submits that the preparation of a TMD and the associated obligations should not be required in these circumstances. This could possibly be addressed through an appropriate regulation.