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Dear Manager

Design and Distribution Obligations – exposure draft bill

Thank you for the opportunity to comment on the exposure draft of the Treasury Laws Amendment (Design and Distribution Obligations and Product Intervention Powers) Bill 2018.

This submission is focused on the design and distribution obligations and the proposal to apply them to basic banking products, as stated in paragraph 1.29 of the Explanatory Memorandum.

COBA is the industry association for Australia's customer owned banking institutions, i.e. mutual banks, credit unions and building societies. Collectively, our sector has \$110 billion in assets, 10 per cent of the household deposits market and four million customers.

Customer owned banking institutions comprise 70 per cent of domestic ADIs.

Summary

Under the regime's framework, which is based on existing disclosure provisions in the Corporations Act, basic banking products are – appropriately – out of scope. However, according to the Explanatory Memorandum, it is the government's intention to deliberately import them into the regime via regulation.

There is no policy case made for this position. It is red tape without rationale.

Basic banking products are low-risk, simple and well understood. This is reflected in their treatment under various existing consumer protection provisions of the Corporations Act.

There is no evidence that basic banking products are not being targeted at the right people.

COBA asks the government to confirm that basic banking products are excluded from the regime and that it has no intention of using the regulation-making power to include basic banking products.

Regulation of basic banking products

The simple, safe and well-understood nature of basic banking products is already well recognised in the regulatory framework and policymakers have taken considerable care to reduce as far as possible the regulatory burden on issuers of these products. This reflects

the critical 'everyday' importance of these products for all consumers and as the chief source of funding for the banking system.

Basic banking products are subject to much less onerous regulatory requirements than those applying under the Corporations Act to most other financial products:

- AFS licensees are not required to provide a Product Disclosure Statement when recommending or issuing a basic banking product, as long as certain disclosures are made
- licensees are not required to provide a Statement of Advice when providing personal advice about a basic banking product
- the ban on conflicted remuneration under the Act does not apply in relation to basic banking products
- in relation to the Act's 'best interests' duty, advisers on basic banking products only need to follow the 'modified' steps set out in the legislation to obtain the benefit of its safe harbour regime, and
- ADI staff and representatives who only provide personal advice in relation to basic banking products are not required to be registered on ASIC's Financial Adviser Register.

Explicit exemption of basic banking products from the proposed new design and distribution obligations would be consistent with this treatment.

Basic banking products market

The market for basic banking products, i.e. deposit products and facilities for making non-cash payments, includes more than 100 product issuers, each with a range of products including transaction accounts, savings accounts and term deposits with various features and access options.

Some products have very broad target markets, e.g. "everyday accounts". Other target markets include children under 13, youth, students, first home savers and retirees. Other examples are bonus saver accounts, Christmas Club accounts for managing end-of-year funding needs and Community Partnership accounts which allow the holder to support a community group of their choice. Term deposits have variable features such as monthly interest payments or interest paid at maturity. Accounts may have a credit overdraft attached.

Access channels and applications attached to accounts include ATM and branch access, EFTPOS, Bank@Post, internet, mobile, card schemes (e.g. Visa, Mastercard), Apple Pay, Android Pay and, soon, features utilising the New Payments Platform (e.g. Osko, PayID).

Target markets for many of these products are self-evident. There is no need to impose legislative obligations to make target markets for these products. For practical and commercial reasons, target market determinations and reviews occur now without the need for prescriptive legislated obligations backed by significant civil and criminal penalties.

Tailoring of basic banking products for particular market segments and constant improvement of products to meet consumer needs should be encouraged, not encumbered by red tape.

Application of proposed new regime

The regime generally applies to a financial product if it requires disclosure in the form of a PDS or disclosure to investors under Part 6D.2 of the Corporations Act.

The regime is not comprehensive in coverage. A number of products are specifically excluded, such as ordinary shares, MySuper products and margin lending facilities. All credit products (e.g. home loans, credit cards) are out of scope.

Ordinary shares are specifically excluded "as they are fundamental to corporate fundraising and because there is a level of understanding regarding such securities among consumers."

Basic banking products are fundamental to everyday life for every consumer and are the simplest and best understood financial product. Because they do not require a PDS they are automatically excluded from the regime.

However, as noted above, the government proposes to use a regulation making power to deliberately include basic banking products.

The contrast in treatment between ordinary shares and basic banking products defies logic. A financial product that is within the natural boundary of the regime, i.e. an ordinary share, is to be left out and a product that is outside the natural boundary of the regime, i.e. a basic banking product is be dragged in.

COBA does not object to the regulation-making power, and does not have a view about whether that power should be used to apply the regime to debentures, but it should not be used to apply the regime to basic banking products.

The FSI Final Report, in recommending a “targeted” design and distribution obligation, said “simple low-risk products such as basic banking products would not require extensive consideration, and may be treated as a class with a standard approach to their design and distribution.”¹ As outlined below, if the exposure draft legislation is to apply to basic banking products “extensive consideration” will certainly be required and there is no capacity within the legislation to treat basic banking products as a class with a standard approach.

Obligations of proposed new regime

There are four design obligations, five distribution obligations and a separate obligation relating to advertising and promotional material.

The obligations are:

- make a target market determination
- review the determination
- keep records in relation to the determination
- notify ASIC about significant dealings that are not consistent with the determination
- prohibit dealing or advising on a product until the determination is in place
- not to deal or advise where a determination may no longer be appropriate
- ensure products are distributed in accordance with the determination
- collect information related to the distribution of a product
- notify the issuer of a product of any significant dealings in the product that are not consistent with the determination, and
- refer to target market in advertising and promotional material.

In meeting the design obligations, an issuer must take into account “all relevant factors” in determining whether a product is likely to meet the “objectives, financial situations and needs” of persons within the target market. The Explanatory Memorandum cites examples of relevant factors and says there are likely to be other factors that need to be taken into account.

Information to be collected under the obligation to collect distribution information includes “the ways in which the person’s dealings in, or provision of advice in relation to, the product occurred.”

In relation to the obligation to take reasonable steps to ensure compliance with the target market determination, the Explanatory Memorandum says “what constitutes ‘reasonable steps’ will ultimately depend upon the circumstances of each case.”

¹ Financial System Inquiry Final Report, November 2014, page 199

In terms of the “significant” dealings that are not consistent with the target market determination, the Explanatory Memorandum says “ultimately whether or not a dealing is significant would be a matter to be determined in the circumstances of each case.”

The obligations are new, complex and unclear. There are significant civil and criminal penalties for breaching them.

They will require issuers of basic banking products to devote staff time and resources to:

- understand the new obligations and their impact on the business
- establish a design and distribution policy
- review and assess existing products, any changes to existing products and new products
- assess and determine a target market for each product
- establish an approval and sign-off process
- establish new monitoring and supervision arrangements for sales and marketing, and
- develop and implement new reporting and record-keeping processes.

Compliance costs mentioned in the Regulation Impact Statement (RIS) include client categorisation, record-keeping, updating documentation and staff training, monitoring changes in the external environment, developing policies and procedures, changing product review and distribution standards, and communicating with other distributors and issuers as relevant.

“The costs include updating IT systems to ensure that existing systems are compliant with requirements and that they will be able to monitor products and customers on an ongoing basis,” the RIS says.

Consumer protection

The chief risk that the regime is intended to address is consumer loss. The FSI final report section² supporting the design and distribution proposal focuses on consumer detriment from financial investment scheme failures.

There have been no such failures in relation to basic banking products. Consumers have not suffered loss from basic banking products. They are protected from loss by the prudential regulatory framework and the Financial Claims Scheme deposit guarantee.

Other layers of consumer protection that are intended to ensure consumers get the right product and are treated appropriately include the Corporations Act general obligations for AFS licensees, access to external dispute resolution, and the requirements of industry codes such as the Customer Owned Banking Code of Practice and the Code of Banking Practice.

Assuming that the proposed new regime would actually deliver an additional layer of protection for consumers of basic banking products, is such an extra layer needed?

There are tens of millions of basic banking products held by consumers, given that most Australians other than small children hold at least one basic banking product and many consumers hold multiple basic banking products. Yet, customer disputes taken to external dispute resolution are quite low for deposit taking and payments systems. According to the Financial Ombudsman Service Annual Review 2016-17, disputes about deposit taking comprised 7 per cent of accepted disputes and disputes about payments systems comprised 5 per cent. The total number of disputes across these two categories was 3,192.

The objective of the regime is to improve consumer outcomes.

² Financial System Inquiry Final Report, November 2014, page 199

In relation to basic banking products, there is no evidence that the regime will improve consumer outcomes and there is a clear risk it will lead to worse consumer outcomes. This is because the regulatory compliance burden of the regime could have the following impacts:

- dampening innovation
- reducing agility and speed in product development
- inconveniencing customers, and
- increasing costs for providers.

What is absolutely beyond doubt is that it will impose significant new compliance costs on banking institutions.

COBA understands Treasury has not attempted to estimate the compliance costs of the regime in relation to basic banking products but across the industry the annual cost impact is estimated in the RIS to be \$232 million.

A regime costing almost a quarter of a billion dollars per year, every year, should be based on a sound policy case. For basic banking products, there is no such case.

Compliance costs will ultimately be passed on to customers and will harm the competitive position of smaller banking institutions. The regulatory compliance burden is effectively a competitive advantage for the major banks because they have vastly greater resources and capacity than their smaller competitors to cope with new regulatory obligations.

COBA also notes that increasing regulatory compliance costs raises barriers to entry to new players in banking. The Productivity Commission's draft report this week on competition in the financial system³ recommends that the Government should prioritise reforms that reduce regulatory barriers to entry and expansion in banking.

Specific issues

Preliminary feedback from COBA members indicates universal support for basic banking products to be exempt from the regime. COBA members identified the following issues and questions posed by the proposed new obligations.

Will target market information have to be provided to consumers at the point of sale in a prescribed format such as 'this product is only suitable for you if...' either in writing (online) or verbal (face to face or phone)? This would be difficult to manage and would negatively impact on customer experience.

If it is suggested that individual records be kept of individual customers against the target market definition this would prove exceptionally onerous and provide little benefit to the consumer and would impact on the customer experience.

The obligation to notify ASIC of any significant dealings in a product that are not consistent with the product's target market determination would require us to capture and report on complex and personal details that currently may not be captured.

The distribution obligations could deliver an unnecessary burden on the bank's sales resource training and advice provision, data and information reporting and management, as well as online channel management.

If a review triggers changes to the product benefits and features, is there an obligation for the bank to review all customers' suitability for the target market determination?

³ <http://www.pc.gov.au/inquiries/current/financial-system/draft>

Does the regime require customer acknowledgement that the product is suitable for their current needs and that they were given all relevant information to make an informed decision? This would be detrimental to the customer experience.

The obligation relating to advertising and promotion will have an impact on marketing production costs and could mean that certain media, e.g. TV, are no longer used for specific products.

How do we account for 'live testing' environments where we are piloting products and using agile work practices to do so?

We operate on a general advice model. The proposed distribution obligations require reasonable steps to ensure the product is distributed within the target market. Is it an expectation that personal advice would have to be provided?

The requirement to refer to the target market in advertising and promotional material could confuse consumers in relation to products with a broad target market, e.g. all consumers. If the target market is 'everybody', what is the point of imposing this regime?

Will issuers of basic banking products have to engage third parties to do research to determine target markets?

Conclusion

COBA asks the government to confirm that basic banking products are excluded from the regime and that it has no intention of using the regulation-making power to include basic banking products.

This will have the following benefits:

- the regime will be better targeted at sources of genuine risk of consumer detriment and loss
- it will remove a potential threat to product development and innovation
- it will avoid imposing an unnecessary compliance cost burden on issuers
- smaller banking institutions will not have to divert scarce resources away from other priorities that will benefit their customers, and
- ASIC will not have to devote time and resources to administering (e.g. providing guidance & conducting surveillance) the regime for products that are extremely low risk.

As noted in the Explanatory Memorandum, should new consumer risks with basic banking products or any other exempt product emerge in future the regulation-making power provides the flexibility necessary to future-proof the regime and ensure its ongoing relevance and effectiveness.

Please do not hesitate to contact me on [REDACTED] or at [REDACTED] to discuss an aspect of this submission.

Yours sincerely,



LUKE LAWLER
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