

MinterEllison

12 February 2018

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

Email: productregulation@treasury.gov.au

Dear Sir/Madam

Design and Distribution Obligations and Product Intervention Power – Draft Legislation

We appreciate the opportunity to provide feedback on the exposure draft of the Treasury Laws Amendment (Design and Distribution Obligations and Product Intervention Powers) Bill 2018 (**Bill**).

MinterEllison is a full service commercial law firm. We advise major financial institutions, including banks, insurance companies and superannuation funds, as well as specialist fund managers, financial advice firms, stockbrokers and other financial intermediaries in Australia and overseas.

The views expressed in our submission are however ours alone and do not necessarily reflect the views of our clients.

1. Overview

- 1.1 We strongly support the need for a strong regulatory regime to maintain and enhance trust and confidence in the financial system by consumers and market participants. This is crucial for Australia's future economic prosperity.
- 1.2 We therefore support key measures in the Bill, including the proposal to require product issuers to make target market determinations and to provide ASIC with a product intervention power. We still have reservations about potential impact of aspects of the proposed regime in the Bill on innovation, efficiency and competition in the financial system. We have not raised all of those concerns again in this submission.
- 1.3 We are however particularly concerned about the approach proposed in the Bill in relation to target market determinations. In its current form, the Bill will have a dramatic impact on the financial sector, increasing vertical integration at the expense of small businesses and the ability to develop innovative solutions tailored to client needs.
- 1.4 Under the proposed regime, product issuers will be required to determine how their products can be distributed and distributors will be required to follow the restrictions imposed. The effect of this regime will be to make issuers responsible for the conduct of distributors. It effectively makes the separate licensing of distributors redundant and returns the industry to the days when distributors were agents of issuers. It undermines the best interests duties recently imposed on personal advisers by the Future of Financial Advice (FOFA) regime because it takes the responsibility for determining suitability for clients away from advisers and moves it to the product issuer. It is also inconsistent with the drive to enhance the financial advice profession – increased professionalism should mean increasing responsibility not decreasing it.



- 1.5 The proposed regime would mean that the person responsible for deciding whether products are suitable for a client is not the adviser who has the contact with the client and who is required to understand their individual circumstances. It is instead the product issuer who typically has much less contact with individual clients. This will ultimately affect both innovation and effectiveness of services able to be delivered to retail clients by reducing the capacity to service individual needs.
- 1.6 We agree that retail product issuers should be required to make target market determinations. However, the purpose of the determination should be to identify who the issuer believes the product may be suitable for and why. It should then be a matter for distributors to take that information into account when deciding which clients to distribute the product to. That is particularly true for personal advisers who have independent obligations to ensure the advice they give is in the client's best interests. Issuers are not in a position to second-guess the actual needs and requirements of particular clients and it is not therefore appropriate for target market determinations to be binding on distributors.
- 1.7 Our detailed comments on the Bill are set out in the Attachment. Other key concerns include the following:
- (a) As noted in our previous submission on the Proposals Paper, we believe that industry will require a longer transition period for the design and distribution obligations than the 12 month period proposed in the Bill, particularly in light of the regulatory burden currently experienced by the industry in responding to various other regulatory changes and investigations, including the Financial Services Royal Commission. We suggest at least 2 years for new products and at least 3 years for existing products that remain open to new clients.
 - (b) We are concerned about the impact of the new regime on annually renewing general insurance products. As it stands, it appears that insurance companies will be required to comply with the new regime on renewal of existing products which is inconsistent with the way the regime will apply to other product issuers.
 - (c) Permanent intervention should only occur under appropriate Parliamentary oversight. We do not believe that the Minister should have the ability to make product intervention orders permanent. This should require an Act of Parliament.

2. Previous submissions

We reiterate the following submissions made in our previous response:

- (a) Simpler and highly regulated products should not be subject to the design and distribution obligations in Part 7.8A of the Bill or the product intervention power in Part 7.9A of the Bill. This includes basic banking deposit products, non-cash payment products, listed products and securities, superannuation products (not only MySuper products) and simple managed investment schemes.
 - (b) We believe that the product intervention power should only be available where there is an actual or suspected breach of the law, including the new product design and distribution duty. The proposal that it should be available to address 'significant consumer detriment' will create significant uncertainty for the sector. Whether or not the power is used, its existence will act as a powerful disincentive to innovation.
 - (c) Product issuers should have clear appeal rights if product intervention order is made or made permanent.
- 2.2 As we submitted previously, we strongly support restricting the new duty and power to products while they are available to retail clients. We note that the Bill proposes to enable regulations to make additional products subject to the design and distribution obligations in Part 7.8A of the Bill (clause 993DB(1)(d)). This should be limited to products offered to retail clients.

We would be very happy to discuss or provide further details about any aspect of our submission.

Yours faithfully
MinterEllison

A handwritten signature in black ink, appearing to read 'R. Batten', with a long, sweeping underline that extends to the right.

Richard Batten
Partner

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ATTACHMENT – COMMENTS ON PROVISIONS

Provision	Concern	Recommendation
Commencement and transition		
Clause 2 Commencement date	We do not believe that 12 months is sufficient time to prepare for the introduction of the Part 7.8A regime.	We believe that the transition period should be two years for new products and three years for existing products.
Item 14 of Schedule 1, clause [](2) Transition period	<p>We welcome the extended transition period for existing products, although as noted above we believe that the transition period for existing products should be three years not two.</p> <p>However, we note that this provision will have an anomalous effect for general insurance products which unlike other products are typically issued on an annual renewal basis. This means that technically a new product is issued every 12 months, although it may otherwise be on identical terms as the policy in force immediately before renewal. The current version of the transitional provisions means that unlike other product issuers who will not need to comply with Part 7.8A for clients who were issued with a product before 12 months after the commencement date, general insurers will be subject to the regime for all clients who hold renewing products from this time. We submit that the regime should only apply to new general insurance clients and not existing clients.</p>	<p>We recommending adding the following at the end of paragraph (2)(b)(ii):</p> <p><i>other than a further issue which arises from the renewal of a general insurance product</i></p>
Target market determinations		
Clause 993DB(1)(d) Regulations can extend application	We understand that Part 7.8A is only intended to apply to products available to retail clients. Paragraphs 993DB(1)(a) to (c) is consistent with this. The ability to make regulations to extend the application of the Part 7.8A should therefore be limited to products available to retail clients.	<p>We recommend amending this provision as follows:</p> <p><i>(d) the product is <u>issued to retail clients and is of a kind prescribed by regulations made for the purposes of subsection (7) (see subsection (7))</u>.</i></p>
Clause 993DB(3)(a) Ordinary shares	We support the submissions of the Australian Financial Markets Association on the extension of the regime to ordinary shares if the company's constitution provides that ordinary shares may be converted into	<p>We recommend the provision be amended by adding the following at the end:</p> <p><i>and the company issued the shares with the intention of converting them to preference shares within 12 months after</i></p>

Provision	Concern	Recommendation
	preference shares.	<i>their issue.</i>
<p>Clause 993DB(9) Target market determinations</p>	<p>The target market determination is required to describe the class of persons who comprise the target market. While the singular includes the plural, it should be made clear in the provision that the issuer may determine that the product is suitable for more than one class of persons and that different conditions may apply to different classes.</p>	<p>Insert 'or classes' after 'the class' in paragraph (a). Insert 'applying to a class of persons who comprise a target market for the product' after 'any conditions and restrictions' in paragraph (b).</p>
<p>Clause 993DB(10) Target market determination to be appropriate</p>	<p>We are concerned that the requirement for the product to 'generally' meet the 'likely' objectives, financial situations and needs of the target market is inherently subjective. It is therefore difficult for issuers to be confident they have met the test. Furthermore, it should be sufficient for the issuer to determine that the product is suitable for any objective, financial situation or need of the target market, rather than all of them as is suggested by the current language of the provision. Finally it is not clear how a product would 'meet the likely ... financial situations' of a person. We are also concerned that there could be a risk that a target market determination could be viewed as financial product advice. This should be specifically carved out.</p>	<p>We recommend deleting sub-clause (10) and adding the following at the end of sub-clause (9):</p> <p><i>(c) describe how the person who is required to make the target market determination reasonably believes that the product will assist persons in the target markets to:</i></p> <p><i>(i) achieve one or more of their objectives;</i> <i>(ii) address one or more of their needs; or</i> <i>(iii) implement one or more of their financial strategies.</i></p> <p>We also recommend amending section 766B by adding the following: <i>(1C) Making, providing or giving a target market determination made under subsection 993DB(4) does not constitute the provision of financial product advice.</i></p>
<p>Clause 993DB(13) Review period</p>	<p>While we appreciate the flexibility of this provision by not setting a minimum review period, we believe that some more guidance should be provided in the Explanatory Memorandum.</p>	<p>We recommend including a statement in the EM that even for complex products with a high risk profiles issuers would not be expected to have a review period of less than one year.</p>
<p>Clause 993DC(2)(b) Review target market determinations during review period</p>	<p>We understand that issuers are required to review target market determinations at or before the end of the review period, rather than during the review period.</p>	<p>Replace ' during' with 'at or before the end of'.</p>
<p>Clause 993DC(3)(b)(i) Where target market determination is no longer appropriate</p>	<p>We are concerned that this test is subjective and inherently uncertain for product issuers.</p>	<p>We recommend replacing the provision with the following: <i>(i) an event or circumstance has occurred that would cause a person in the circumstances of the person who made the target market determination to reasonably believe that the target</i></p>

Provision	Concern	Recommendation
		<i>market determination is no longer appropriate; or</i>
<p>Clause 993DC(4) No dealings until review</p>	<p>This provision is too restrictive as it prohibits all dealings and financial product advice. It is not limited to issuing new products, but extends to variations and terminations, including for example insurance claims.</p>	<p>We recommend the following amendments: <i>The person must not deal in issue, sell, or arrange for the issue or sale of, or provide financial product advice in relation to the issue or sale of, the product until the person has reviewed the determination and, if the determination is not appropriate, made a new determination in accordance with section 993DB.</i></p>
<p>Clause 993DC(5) and (6) Notifying regulated persons</p>	<p>We have serious concerns about the operation of this provision. We do not believe that it is appropriate for issuers to control the manner in which its products are distributed. Issuers are not able to determine all of the circumstances in which a product may be suitable for a client, or all of the types of clients for which the product may be suitable. Therefore, while we agree that issuers should be required to consider these matters and notify their conclusions to distributors, we do not believe it is necessary or appropriate for issuers to require distributors to cease promoting a product while the issuer is reviewing the target market determination. It should be sufficient for the issuer to notify distributors the issuer is aware of that the issuer is reviewing the determination and the reasons for the review, as well as the outcome of the review when that occurs.</p> <p>Furthermore, issuers cannot be expected to know of every regulated person who may distribute offer documents for, deal in or give financial product advice about the product. The notification obligation should therefore be limited to regulated persons that the issuer is aware of.</p>	<p>We recommend replacing these provisions with the following: <i>(5) The person (issuer) must, as soon as practicable but no later than 10 business days after this subsection starts to apply, take reasonable steps to notify each regulated person that the issuer is aware of or ought reasonably be aware of who deals in or provides financial product advice in relation to the financial product or is reasonably likely to do either of those things that an event referred to in paragraph (3)(b) has occurred.</i> <i>(6) A regulated person contravenes this subsection if:</i> <i>(a) the person is given a notice referred to in subsection (5); and</i> <i>(b) the person deals in or gives financial product advice in relation to the product after that time either:</i> <i>(i) without determining whether the person should cease to deal in or given financial product advice, or change the circumstances in which the regulated person deals in or provides financial product advice, in relation to the product; or</i> <i>(ii) in breach of such a determination.</i></p>
<p>Clause 993DD(2) Distributor's defence</p>	<p>We found the language used in paragraph (a) confusing. It also does not seem to provide a defence if the issuer told the distributor that a target market determination was not required.</p>	<p>We recommend replacing paragraph (a) with the following: <i>(a) the person who is required to make the target market determination (issuer) notified the regulated person of the</i></p>

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	<p>The requirement that reliance is reasonable will in effect require the distributor to second-guess the issuer. We believe this requirement should be deleted.</p>	<p><i>determination made by the issuer or notified the regulated person that a target market determination is not required; and</i></p> <p>We also recommend deleting paragraph (c).</p>
<p>Clause 993DD(3) Breach reporting</p>	<p>We submit that it is not necessary to impose a separate breach reporting obligation on distributors as licensees will already be subject to the significant breach reporting obligation in section 912D. If a separate breach reporting obligation is to be imposed, it should only apply to significant breaches. A breach should only need to be reported to ASIC where it has or is likely to have a significant impact on clients. If a distributor is satisfied that a product is suitable for a client (and is liable for that assessment), the mere fact that a target market determination has not been made should not need to be reported to ASIC.</p>	<p>We recommend deleting sub-clause (3). Alternatively it should be subject to a significance test, such as the test that applies to section 912D.</p>
Distribution		
<p>Clause 993DE Distributors to give effect to target market determination</p>	<p>This provision changes the balance of responsibilities between issuers and distributors in a way that disadvantages clients by preventing distributors making their own assessment of the needs of their clients, particularly where they provide personal advice. In so doing, the proposed approach is likely to have a significant impact on the ability of distributors and issuers to develop innovative approaches for clients.</p> <p>Issuers are in a position to design their products for particular purposes and should be held responsible for that process. However, they are not in a position to assess whether each dealing in a product or piece of advice related to a product is consistent with the target market determination. Issuers who do not give personal advice (and most do not) cannot know the needs of individual clients or group of clients in the same way as those who have direct dealings with clients.</p>	<p>We recommend the following changes:</p> <p><i>(1) <u>Subject to subsection (1A), a person who makes a target market determination (issuer) for a financial product must take reasonable steps to ensure that any personal advice provided by the issuer to a client about the product and any dealings in, and financial product advice provided in relation to, the product by the issuer which occur within 12 months after giving such personal advice are consistent with the most recent determination.</u></i></p> <p><i>(1A) <u>Subsection (1) does not apply to an issue of a product on the instruction of the client where the client has been informed that the product may not be suitable for the client.</u></i></p> <p><i>(1B) <u>A person who makes a target market determination for a financial product must also take reasonable steps to ensure that persons who deal in, or provide financial product advice in relation to, the product, or are</u></i></p>

Provision	Concern	Recommendation
	<p>Issuers should therefore only be responsible for ensuring that they comply with their own target market determinations where they give personal advice relating to the product and for taking reasonable steps to ensure that distributors are made aware of target market determinations.</p> <p>The restriction on dealings should also only apply to issues of new products and should not apply to renewals of general insurance products where there is no personal advice relating to the renewal.</p> <p>We have not proposed a specific exemption for personal advice as our suggested approach would not require such an exemption. However, if our approach is not adopted we believe that a personal advice exemption should be made consistent with the proposals in the consultation paper.</p> <p>Furthermore, the provision needs to recognise that clients may make choices which are inconsistent with a target market determination or products recommendation. For example, a client may choose to invest in a low risk fund that is not designed for them or acquire insurance which does not cover flood despite living in a flood-prone area. We believe that consumers must be free to make these types of decision, provided they are aware of the risk they are taking. Currently, the provision prohibits inconsistent dealings which would prevent an issuer or distributor issuing or arrange for the issue of a product to a customer where the issuer had deemed it not be suitable for the type of customer.</p>	<p><u>reasonably likely to do either of those things, are made aware of the terms of the most recent determination.</u></p> <p><u>(2) A regulated person who deals in, or provides financial product advice in relation to, a financial product for which a target market determination has been made must:</u></p> <p><u>(a) take reasonable steps to identify whether a target market determination has been made in relation to the product and, if so, the terms of the most recent determination; and</u></p> <p><u>(b) ensure that the dealing or advice is consistent with take the most recent determination into account when dealing in or providing financial product advice in relation to the product.</u></p>
<p>Clause 993DA Definition of regulated person</p>	<p>The definition of regulated person refers to the definition in section 1011B which includes any person relying on a licensing exemption. We believe that this definition result in the distributor provision having too broad an application. While it may be appropriate for some exempt persons to be subject to the distributor obligations in Part</p>	<p>We recommend excluding paragraph (f) of the definition of regulated person in section 1011B from the definition in clause 993DA and adding the ability to make regulations prescribing additional persons to be regulated persons for the purposes of Part 7.8A.</p>

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	7.8A, there are many exemptions which recognise that the parties benefitting from the exemption should not subject to financial services regulation. Examples of this include the exemption for group purchasing bodies, such as employers and sporting associations in ASIC Class Order 08/1.	
ASIC powers		
Clause 993DH Information to be provided to ASIC on request	We recommend that consideration be given to giving a similar power to product issuers to assist them to obtain the information they will need to make and review target market determinations. This will reduce the need to amend distribution agreements and thereby reduce costs for the industry, increasing efficiency.	Include a similar power for product issuers to require distributors to provide distribution information to the issuer.
Clause 993DF(2) Record keeping	As a technical observation, we note that much of the information listed in sub-clause (2) will not apply to a distributor because they will not normally 'issue' or 'sell' the product. We assume this is an error and have suggested how this can be addressed. We are also uncertain about what information is required to be recorded by paragraph (2)(f).	After 'makes' in paragraphs (2)(c), (d) and (e), insert 'arranges or recommends'. We also recommend clarifying the requirement of paragraph (2)(f).
Clauses 993DF(5) and 993DG Notice of inconsistent dealings and advice	We have two concerns with these requirements: <ul style="list-style-type: none"> For the reasons discussed above, we are concerned that these obligations do not give sufficient recognition of the role of distributors in understanding the needs of their own clients and assumes that any inconsistent dealing automatically disadvantages affected clients. There is significant uncertainty in the obligation proposed to apply to distributors. Paragraph 993DF(3)(b) appears to apply to any regulated person, not matter how infrequent such activities have been or how long ago they may have been. Paragraph (c) appears to 	We believe that these obligations are not appropriate and should be removed from the Bill. However, if they are retained, then we recommend the following changes be made to sub-clause 993DF(5) and clause 99DG: <p><i>(5) If:</i></p> <p><i>(a) a target market determination for a financial product has been made; and</i></p> <p><i>(b) a regulated person deals in, or provides financial advice in relation to, the product; and</i></p> <p><i>(c) <u>within 12 months after the event referred to in paragraph (b) occurs, the regulated person becomes aware of a significant dealing in the financial product that is not significantly inconsistent with the determination;</u></i></p> <p><i>the regulated person must, as</i></p>

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	<p>apply to any activity the regulated person becomes aware of, whether by the regulated person or anyone else. It is not clear what a 'significant dealing' is. We acknowledge the comment in the Explanatory Memorandum that 'significant' will take its ordinary meaning in the context of the provision. However, we are unsure what factors would differentiate a 'significant' dealing from one that is not. It would be more appropriate to use the term to define the extent of inconsistency with the determination.</p>	<p><i>soon as practicable, and in any case within 10 business days, give written notice to the person who made the determination.</i></p> <p><i>993G A person who makes a target market determination for a financial product must give written notice to ASIC, as soon as practicable, and in any case within 10 business days, if the person becomes aware of a significant dealing in the financial product that is <u>not significantly inconsistent with the determination.</u></i></p>
<p>Clauses 993DI(3) and (10) and 1022CC(4) ASIC can determine conduct breaches Part 7.8A, Chapter 6D or Chapter 7.</p>	<p>The Explanatory Memorandum does not explain the purpose of these provisions. They appear to have the effect that ASIC can determine that particular conduct is breaches relevant provisions of the Corporations Act. If so, this appears to give ASIC both legislative and judicial authority and we are concerned that it could breach the Constitution.</p>	<p>We recommend deletion of these provisions. Failing that, the Explanatory Memorandum should provide an explanation of their purpose and intended effect.</p>
<p>Clause 993DI(6) ASIC can make interim stop order during hearing</p>	<p>ASIC will have a power to make an interim stop order under clause 993DI(5), but only if ASIC considers that any delay in making a stop order would be prejudicial and only for 21 days. We submit that the power to make stop orders during a hearing should also be subject to these limitations.</p>	<p>We recommend the following changes:</p> <p><i>(6) At any time during the hearing, ASIC may make an interim order under subsection (2) if ASIC considers that any <u>delay in making an order under subsection (2) pending the completion of a hearing would be prejudicial to the public interest.</u> The interim order lasts until:</i></p> <p><i>(a) ASIC makes an order under subsection (2) after the conclusion of the hearing; or</i></p> <p><i>(b) the interim order is revoked;</i></p> <p><i>or</i></p> <p><i>(c) 21 days after the day on which the interim order is made; whichever happens first.</i></p> <p><i>(6A) For the avoidance of doubt, ASIC may make one or more further interim orders under subsection (6) on the expiry of an interim order under that subsection if the requirements of that subsection are met.</i></p>

Provision	Concern	Recommendation
Civil liability		
Clause 993DM(2)(a) Reliance on target market notice	The word 'with' in this provision appears superfluous.	Delete the word 'with'.
Clause 993DM(3)(b) Reasonable steps requirement	This provision requires a person to take 'all those reasonable steps' to avoid civil liability. This formulation is not consistent with other provisions requiring reasonable steps to be taken in the Chapter 7 and appears to require a person to take all possible reasonable steps. We recommend the same approach be used in this provision as other provision in Chapter 7.	We recommend the following changes: <i>(b) the first person fails to take all those reasonable steps; and</i>
Advertising		
Item 4 of Schedule 1	Requiring advertisements to describe the target market will add too much length to advertisements and is likely to confuse consumers.	We recommend against making this change.
Product intervention orders		
Clauses 1022CG to 1022CI and 301G to 301J Making product intervention orders permanent	We are strongly opposed to giving the Minister the power to make product intervention orders permanent. This is directly contrary to the temporary nature of the proposed power that was recommended by the Financial System Inquiry and adopted by the Government. Making an order permanent should require an Act of Parliament, with all the scrutiny that involves.	These provisions should be removed from the Bill.
Clauses 1022CK(b) and 301L(b) Re-making product intervention orders	Similarly, ASIC should not be able to remake product intervention orders, with or without Ministerial approval.	These provisions should be removed from the Bill.