



NATIONAL AUSTRALIA BANK SUBMISSION

**Consultation on Treasury Laws
Amendment (Design and Distribution
Obligations and Product Intervention
Power) Bill 2018**

15 August 2018

I. Introduction

National Australia Bank (NAB) welcomes the opportunity to respond to the Department of Treasury's further consultation on the exposure draft of the *Treasury Laws Amendment (Design and Distribution Obligations and Product Intervention Powers) Bill 2018* (draft Bill) and related exposure draft Explanatory Memorandum (EM).

NAB has participated in the 2014 Financial System Inquiry (FSI) and previous Treasury consultations on this issue. As previously stated, good customer outcomes are at the centre of a strong, transparent and fair financial system as well as a sustainable banking model and NAB continues to support reforms which aim to promote these outcomes, including this regime.

In this context, considered consultation is important and NAB welcomes Treasury's revisions to some aspects of the exposure draft consulted on previously, including the longer timeframe provided to implement what will be significant changes to some systems and processes.

NAB's submission seeks to highlight some matters which would benefit from further clarification to ensure certainty and assist relevant issuers and regulated entities ('distributors') to implement the regime and meet its intended policy aims.

In summary, NAB's submission raises the following key issues for clarification:

- The delineation between personal and general advice;
- The obligations of issuers and distributors;
- Reporting obligations and implementation time frames; and
- The term 'significant detriment' as it relates to the Product Intervention Power (PIP).

NAB would be pleased to discuss this submission with Treasury in further detail.

Personal advice – s766B(3A)

As previously noted by NAB, the regime will necessarily require product issuers and distributors to give consideration to the objectives, financial situation and needs of a class of customers.

NAB welcomes the inclusion of the proposed clarifying provision in s766B(3A) that means information gathered to confirm a person's status under the target market determination (TMD) is not personal advice.

However, NAB is concerned the proposed amendment to s766B does not adequately address the reach of the second arm of clause 766B(3)(b), in that the proposed amendment focuses on the actions of the provider of the advice and not whether a reasonable person might have expected that personal information was considered in preparation of the advice. This concern is reinforced by the EM at paragraph 1.49 given reference to 'the retail client' and 'a retail client'.

There remains risk that processes designed to meet the 'reasonable steps' requirements in s994E could be perceived to constitute personal advice under s766B(3) – or may generate claims by customers or regulators to this effect. Further, the intent stated in the EM at 1.53 – that an issuer is not required to take into account the personal circumstances of any particular person or to provide personal advice – is not reflected in s994B.

We are also concerned that a reference to 'solely' in 766B(3A) may mean processes designed to satisfy the 'reasonable steps' requirements in 994E cannot be combined with other processes such as requesting or providing other preliminary information. This could impact the development of efficient processes and result in a negative customer experience, particularly for digital offerings.

For certainty, NAB suggests an addition to the amendment to s766B(3A) so that it reads as follows:

(3A) However, despite subsection 766B(3), the acts of providing a target market determination or asking for information solely to determine whether a person is in a target market (as defined in subsection 994A(1)) for a financial product, and of informing the person of the result of that determination, do not, of themselves, constitute personal advice.

Target Market Definition (TMD)

Review triggers

NAB acknowledges the importance to the DDO regime of the timely identification of situations in which customers may be taking up a product that is not suited to their circumstances or needs.

Section 994B(5)(h) requires issuers to specify the 'kinds of information' needed to enable the issuer to promptly identify whether another event or circumstance has occurred that would reasonably suggest that the TMD is no longer appropriate. NAB is concerned this may create uncertainty for issuers in the context of the definition of a 'review trigger' as an event or circumstance 'that would reasonably suggest that the determination is no longer appropriate' (s994B(5)(d)) and requests further clarification in the legislation or EM.

This is particularly of relevance given the requirement that distribution of a product must cease within 10 days where a review trigger or other event or circumstance occurs (subject to any review and revision of a TMD that is undertaken within that timeframe). Significant automation will need to be undertaken and supporting policies and processes will need to be uplifted to comply with these requirements. Accordingly, timely draft regulations and regulatory guidance

will be critical to ensuring that this aspect of the regime can be implemented compliantly, accurately and in the spirit of the regime's intent.

With regard to ceasing distribution within 10 days when a trigger event or other event or circumstance occurs (s994C(3)), NAB seeks clarification on how this requirement operates when a customer is part way through the acquisition of a product but has not completed the process.

Appropriateness of a TMD: s994B(8)

NAB supports the intent of the TMD in a framework aimed at protecting retail consumers from inappropriate acquisitions of unsuitable products.

Subject to our comments above regarding personal advice, we acknowledge the re-drafting of the provision removes some of the issues raised previously, particularly the concern that the prior drafting required a financial product to meet 'all' of the objectives, financial situation and needs of the target market and issuers to know individual customers.

Consistent with our previous submission however, we have some concerns with the requirement that an issuer conclude that a product 'likely be consistent' with the 'likely' objectives, financial situation and needs' of 'the' retail client. This remains a subjective test and, without experience and robust guidance, could create substantial uncertainty for issuers.

In this context, we also note the EM at 1.54 states that 'all relevant factors' must be taken into account when determining whether a product is likely to be consistent with the likely objectives, financial situations and needs of persons within the target market.

We agree product issuers should be compelled to consider those factors they identify as relevant to making the determination at the time the product is developed for issue (and through subsequent review processes).

However, as currently drafted NAB believes it is probable in many situations there will inevitably be some factors that will not have been taken into account simply because they were not evident at the time. That is, taking into account 'all relevant factors' is an unattainable threshold and with the benefit of hindsight there is a real risk of retrospective review finding a breach of this section. NAB recommends removing the reference to 'all relevant factors' and instead consider language such as 'factors that were reasonably considered relevant and material at the time of making the target market determination'.

As well, NAB notes that the examples of relevant factors set out in the EM at 1.54 include the risk profile (over the lifetime of the product) and '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'. NAB seeks clarification in the EM that consideration of these factors in forming a TMD (and corresponding obligations when distributing a product) does not require ongoing testing of a product's appropriateness for a person who has acquired the product over the lifetime of the product or the circumstances of persons within a particular market over that lifecycle.

As stated in our previous submission, NAB seeks clarification in the legislation that the requirement that a customer reasonably be within a TMD only takes into account factors reasonably known at the time the TMD is made. As well, to the extent acquisitions have been made, there should be no ongoing obligation to ensure those customers who have already acquired the product remain in the target market subsequently. This should be clarified in the

wording of other sections, for example distribution obligations at s994E(1) and the record-keeping obligations.

NAB also requests confirmation in the legislation that the TMD has been developed based on the likely objectives, financial situation and needs of a 'class' of customer not particular individuals who do acquire the product. This could be achieved by minor amendments as shown below:

(8) A target market determination for a financial product must be such that it would be reasonable to conclude that, if an issue, or a regulated sale, of the product were to occur:

(a) in accordance with the distribution conditions to a retail client—it would be likely that the retail client is in the target market; and

(b) to a retail client in the target market—it would likely be consistent with one or more of the likely objectives, financial situations and needs of the retail clients in the target market.

TMD to be available to the public free of charge – s994B(9)

NAB requests clarification on whether compliance with this requirement can be met through publication on an issuer's website, or whether paper copies must also be provided. In the latter case, is it sufficient to include the TMD in the Product Disclosure Statement (PDS) or disclosure document for the relevant product? As well, NAB notes this intersection of this obligation with amendments under s1018A, which will require advertising and promotional material for a financial product to describe the target market or specify where the target market determination is available. NAB notes that these amendments will add length to advertisements; in the case of advertisements involving distribution of financial products it is already necessary to make extensive disclosures. Regulatory guidance in these areas would be useful.

Distribution obligations

NAB notes the distribution obligations set out in s994E(1) require an issuer to 'take reasonable steps that will, or are reasonably likely to, result in retail product distribution conduct in relation to the product (other than excluded conduct) being consistent with the determination'. NAB believes that the terminology 'that will' suggests an absolute requirement which is inconsistent with the 'risk management' approach required by the obligation to take reasonable steps.

Similarly, s994E(3) requires a regulated person 'to take reasonable steps that would have resulted in, or would have been reasonably likely to have resulted in, the retail product distribution conduct being consistent with the determination'. Again, NAB is concerned that inclusion of the phrase 'that would have resulted in' raises similar issues to those outlined in relation to s994E(1).

'Retail product distribution conduct'

As drafted, the definition of 'retail product distribution conduct' includes giving a PDS or disclosure document for the product to the retail client. PDS and disclosure documents for relevant products are publicly available and do not require a customer to begin an acquisition process to access them. For example, a prospectus for a listed hybrid instrument is required to be lodged with ASIC and the ASX and is therefore available to the general public. NAB believes that the definition of 'retail product distribution conduct' should link the distribution conduct to the actual offering, sale or acquisition process for a product that requires a PDS or disclosure document. Otherwise, NAB would welcome ASIC guidance, clarifying that 'giving' a PDS or disclosure document does not extend to its mere publication in accordance with existing legal or regulatory requirements.

NAB notes that where a product is renewed or reinvested (for example an annual insurance product or term deposit), this amounts to a new issuance of the product under DDO, with the relevant distribution conditions and obligations applicable once again.

Under ss994E and 994F(2), issuers and distributors are required to take reasonable steps to ensure a product is distributed in accordance with a TMD, and collect information such that it is apparent if any review trigger events occur (or indeed if there are significant dealings outside the target market). NAB is concerned that as drafted, these provisions do not allow for a scalable approach to these obligations in the event that a customer already has a product (i.e. the various obligations must be met in the same manner as would be the case the first time a customer takes up a product), negatively impacting on the customer experience.

For example, with regard to term deposits we note that pursuant to ASIC Class Order (CO) 14/1262, ADIs must take steps when 'rolling over' a customer's deposit for a new term. NAB believes it would be appropriate that any distribution obligations for subsequent reinvestment of a term deposit reflect current policies and processes (consistent with existing conditions within CO 14/1262) where there is no substantive change to the product terms and conditions, rather than a new process to run in parallel.

In this situation, NAB also requests clarification in the legislation or EM regarding what actions must be taken if a customer does not provide the relevant information (required as part of any distribution or other information that must be collected) or is no longer within the target market for a product. In the latter case, if NAB is required to take any action because the customer is no longer within the target market, we question whether this would amount to personal advice (as per our concerns raised above).

Whether NAB is required to take action is particularly an issue for investment holdings such as basic deposit products (including term deposits) because the ADI (or relevant institution for other investment holdings) continues to hold the customer's funds awaiting instructions/mandate, which can be contrasted with insurance products for which cover may cease to apply (subject to alerts or warnings).

Where there are multiple 'distributors' (platform products)

NAB reiterates its concerns, expressed in our prior submission and by the Financial Services Council, regarding the inclusion of custodial arrangements. However, noting the reiteration of the intention that these be captured separately through regulations we wish to emphasise the need for clearer provisions and clarifications regarding roles and actions by parties particularly in the Wrap or IDPS/IDPS-like space.

Such clarity is needed in relation to:

- Requirements to issue a TMD (or multiple TMDs) and which entities are responsible and to what extent; and
- More particularly, clarity of roles, reporting and liabilities where it is likely some entities will have concurrent issuer and distributor designations or obligations (when one product effectively sits within another).

We acknowledge it is intended these further provisions will emerge from regulations and that further guidance will be produced subsequent to passage of the Bill. However, given the complexity of roles and likely provisions, we remain concerned the commencement date, while extended, does not take into account the very significant items that are yet to be addressed (only some of which were included in our prior submission).

For example, under s761E of the Corporations Act, issuance of a superannuation product to a person occurs when the person becomes a member of the fund. NAB seeks clarification that this does not require a superannuation fund to establish whether all investment options within the fund meet the likely objectives, financial situation and needs of a prospective member (as would seemingly be required under the current draft Bill). Such a construction of the DDO regime may see a significant reduction in the ability for customers to access superannuation funds with multiple investment options which are expressly intended to meet different investment needs and aims.

NAB believes a better solution would be a tiered approach to ‘products within products’, whereby there is a TMD for the underlying fund or platform, with sub-TMDs for each relevant product distributed within it. This accords with the requirement in s1012 which means a person must be given a PDS for a financial product (here, for example an investment option on a platform).

In this regard, NAB also proposes that consideration be given to the capacity to extend the commencement date within the draft Bill, for a given class of product or services intended to be captured under these provisions.

For this purpose, scope for a different commencement date via regulations might be addressed generically under Clause 2 of the Exposure Draft Bill with respect to the regulation making powers in the draft Bill.

As flagged in NAB’s previous submission, clarification in the EM as to whether the regime is intended to capture employers (as distributors) in a superannuation context would be welcomed. NAB does not believe it is appropriate for employers to be captured by the regime as distributors, but if this is intended, it is critical this is made evident in the EM.

‘Reasonable steps’

NAB notes s994E(5), which requires that an issuer must take all steps they are ‘reasonably able to take’ to ‘ensure’ distribution in line with a TMD. As previously stated, NAB is concerned about the current drafting of this section. ‘Taking into account all relevant matters’ means that issuers will be unable to be certain they have complied with these requirements. On a literal interpretation, this includes any and every conceivable step it was reasonably possible to take regardless of whether it would or could be reasonable in the circumstances at the time, and there is a serious risk of retrospective review finding non-compliance.

The words in s994E(5) “*to ensure that retail product distribution conduct in relation to the financial product is consistent with the target market determination for the product*” are redundant as s994E(1) already specifies the objective of the steps. As stated above, the inclusion in that redundant phrase of the word ‘ensure’ also gives the impression that it is an absolute standard. NAB therefore suggests that s994E(5) therefore be amended to read:

What are reasonable steps

*(5) Without limiting subsections (1) and (3), **reasonable steps** in relation to a person are steps that are reasonable in the circumstances, ~~the person is reasonably able to take to ensure that retail product distribution conduct in relation to the financial product is consistent with the target market determination for the product~~, taking into account all relevant matters that are reasonably considered relevant and material including:*

Implementation

Per the EM at 1.89, a risk management approach for implementation of the distribution obligations will require issuers to review all current distribution arrangements and relationship or contract management processes. Given the significant detail that will be required in further regulations and / or regulator guidance, NAB suggests that a Ministerial power be included in the legislation such that the compliance date (two years after Royal Assent) can be delayed if these materials are delayed.

NAB also requests a staged implementation period for the design of the reporting framework between issuers and distributors. This has to be predicated on the initial design of the TMD and associated distribution networks with appropriate education and engagement. In this regard, NAB would recommend that the reporting framework have a transitional design period, potentially with facilitative regulatory oversight, for another 12 to 24 months from commencement.

Record keeping and notification obligations

Distribution information

The distribution information requirements set out in s994F(2) require the collection of information which allows an issuer to 'promptly identify review triggers or other events or circumstances that suggest the determination is no longer appropriate' (EM at 1.94). NAB is concerned that this will still require collection of a significant volume of granular data, as review triggers will necessarily involve consideration of the proportion of customers outside the target market taking up a product.

'Significant dealings'

We note the requirement to report 'significant dealings' outside of a TMD within 10 days to issuers or ASIC as required by sections 994F(5) and 994G respectively. While the term has been left intentionally undefined, NAB has concerns regarding how both issuers and distributors can be sure they have complied with the provisions. This is particularly so with reference to the EM at 1.74, which notes that 'significant dealings' will encompass dealings outside a TMD which would be 'worthy of [ASIC's] attention'. In particular, NAB believes there is a risk that ASIC, an issuer and a distributor may all have different interpretations of the phrase, with a real risk that liability may be applied retrospectively for determinations made in good faith. Particularly given that failure to comply with this section constitutes an offence, NAB believes it is appropriate to provide a clearer framework to ensure a consistent approach to reporting.

Products within scope

NAB notes and agrees with the ABA submission regarding hybrid securities and debentures issued by ADIs.

Product Intervention Power

NAB reiterates its concerns regarding the language in s1023E. We note that 'significant detriment' might potentially occur even where a person has complied with their obligations under the DDO regime (s1023E(3)). On its face, this seems to imply that significant consumer detriment could include products performing within their risk profiles – for example, where there is a cyclical downside in investment performance. NAB strongly believes that the legislation or EM should be clarified to note that 'significant detriment' does not extend to protecting customers from any loss or realisation of risk where a product is operating within its disclosed risk parameters.