

13 November 2018

Consumer and Corporations Policy Division
The Treasury
Langton Crescent
PARKES ACT 2600

By email (Word and PDF formats)

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Dear Colleagues

**Consultation on Corporations Amendment (Design and Distribution Obligations and Product Intervention Powers) Regulations 2018
released 23 October 2018**

1 Introduction

The Financial Services Council (**FSC**) is a leading peak body which sets mandatory standards and develops policy for more than 100 member companies in Australia's largest industry sector, financial services. Our full members represent Australia's retail and wholesale funds management businesses, superannuation funds, life insurers, financial advisory networks and licensed trustee companies. Our supporting members represent the professional services firms such as ICT, consulting, accounting, legal, recruitment, actuarial and research houses.

The financial services industry is responsible for investing almost \$3 trillion on behalf of more than 14.8 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 fourth largest pool of managed funds in the world.

We refer to the exposure draft Consultation on Corporations Amendment (Design and Distribution Obligations and Product Intervention Powers) Regulations 2018 released on 23 October 2018 (Regulations) and explanatory memorandum for the Regulations (EM) also released on 23 October 2018 for consultation in relation to the proposed:

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

Thank you for the opportunity to make a submission in relation to the Regulations and the EM.

This letter sets out the FSC's submissions in relation to the Regulations and EM. 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 Regulations 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.

2. ETF Uncertainty in terms of DDO and PIP

Members have expressed concern as to uncertainty in relation to:

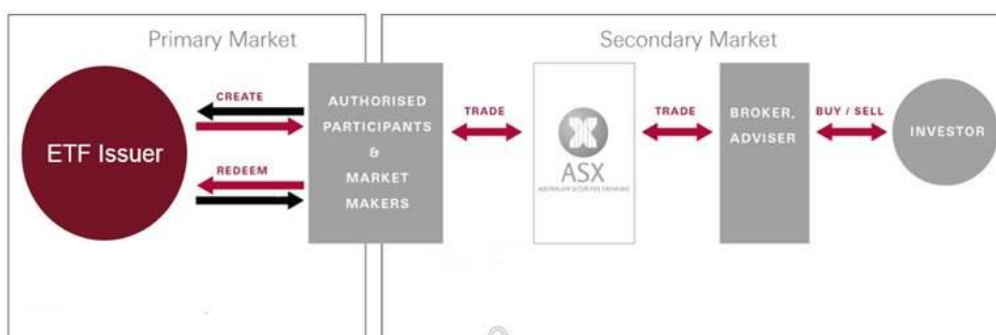
- (a) whether it is intended that the Regulations apply to the secondary sales of ETFs; and
- (b) if so, how they will apply in practice to the secondary sales of ETFs.

3. Background on the ETF structure

An ETF is a collective investment vehicle whereby interests in that vehicle (usually known as “units”) can be traded on a stock exchange in the same way as ordinary shares.

As an exchange quoted product (i.e. ASX), ETFs are required to meet the rules of the exchange to be admitted for quotation. These rules seek to ensure that admitted products are based on a portfolio of securities that are liquid and sufficiently transparent. In addition, there are enhanced disclosure requirements, including publication of the PDS on the issuer’s website and the market announcement platform.

Unlike an unlisted managed fund where units are issued directly to the end investor (or indirectly through a platform) via a Product Disclosure Statement, ETF units are only directly issued to institutional brokers (referred to as Authorised Participants). As the below diagram illustrates, Authorised Participants then facilitate the secondary market by creating ETF units with the issuer and selling the units to the market at large on the exchange.



4. Impact of the Design and Distribution Obligations on ETFs

Member concerns referred to above include in relation to lack of clarity in the Regulation and EM as to whether and how the design and distribution obligations will apply to ETFs.

Whilst Members understand that making target market determinations will become part of the product design process for ETFs, there are two important practical challenges to highlight in relation to distribution obligations applying to ETFs:

- (a) For issuers - the limited legal relationship that an issuer of an ETF has with the end investor; and

- (b) For distributors - the accessibility of ETFs through execution only service providers, once they are admitted to the relevant market exchange

This uncertainty arises because of the way ETFs are distributed as outlined above in that they are not offered directly to retail clients through a Product Disclosure Statement (**PDS**) but rather made available on an exchange through secondary market trading via brokers. It is also noted that the proposed Regulation 7.8A.01 specifically covers product distribution scenarios that give rise to “an indirect” offer as contemplated by s1012C(6)(C)(i) or (ii) and while not entirely clear, has the potential to capture ETFs in the regime.

5. Recommendation

Accordingly, it is recommended that there be greater clarity in the Regulations and/or the EM whether the DDO apply to the secondary sales of ETFs and to clearly state if included or excluded. If applicable, the Regulations should address the following issues:

- (a) how the distribution obligations would apply in the context of ETF distribution – where ETFs are issued directly to Authorised Participants and don’t have direct sale interactions with retail clients?
- (b) whether distribution obligations will apply to retail brokers for execution only services?
- (c) what the expectations would be on ETF issuers to provide oversight for third party distribution of ETFs (including advice provided in relation to ETFs)?

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



David McGlynn

Senior Legal Counsel