DESIGN AND DISTRIBUTION OBLIGATIONS AND PRODUCT INTERVENTION POWER

DRAFT LEGISLATION

SUBMISSION TO THE TREASURY

15 August 2018

Public

EXECUTIVE SUMMARY

1. ANZ thanks Treasury for the opportunity to comment on the draft *Treasury Laws Amendment (Design and Distribution Obligations and Product Intervention Powers) Bill 2018* (**Bill**).

2. ANZ supports the introduction of the design and distribution obligations (**Obligations**) and the product intervention powers (**Powers**). Implemented well, these measures will help improve product governance through the financial system to the benefit of retail clients and underpin a stronger Australian Securities and Investments Commission (**ASIC**).

3. The Bill addresses many of the comments that we raised on the draft *Treasury Laws Amendment (Design and Distribution Obligations and Product Intervention Powers) Bill 2017* (**2017 Bill**). Our comments on the Bill in this submission are directed towards aligning the operation of the Obligations with their stated policy intent and highlighting the interaction of the Obligations with other Government policy objectives.

4. These comments include:

   - Ensuring the safe harbour from the definition of 'personal advice' provided for activities connected with the Obligations is effective
   - Clarifying whether reviews need to occur once a product is no longer available for issuance (or regulated sale)
   - Providing certainty that adherence to the Obligations will not inadvertently require or result in the provision of personal advice
   - Considering the benefit of including basic deposit products in the Obligations as these are excluded from disclosure obligations and are likely to have wide target markets
   - Clarifying that wholesale ADI debentures will not be caught by the Obligations
   - Stating in the law that secondary market activity is excluded from the Obligations

5. As Treasury finalises the Bill, and ASIC considers its guidance and position on the Obligations and Powers, we would ask that both bodies consider the interplay between the policy goals of protecting financial consumers and ensuring consumers have sufficient opportunities for engagement with the financial services market. Careful calibration of these policy goals could be achieved through the levers of (a) the severity of the sanctions that attach to breaches of the Obligations (b) the degree of legislative clarity on the meaning of the obligations (noting that ASIC guidance is not binding on courts and the sanctions are significant) (c) the detail of the Obligations themselves and (d) ASIC's approach to the exercise of the Powers.

COMMENTS ON SPECIFIC CLAUSES

CLAUSE 766B(3A)

1. This proposed new section provides that the acts of asking for information solely to determine if someone is in a target market and informing someone of that determination do not, of themselves, constitute personal advice.

2. We appreciate the clarity offered by this clause on whether acts involved in meeting the Obligations constitute personal advice. However, we wonder whether the proposed section is as well adapted to this objective as possible.

3. Specifically, it is possible that compliance with the Obligations could give rise to circumstances in which a distributor has considered (or could reasonably be concluded to have considered) one or more of a person's objectives, financial situation and needs without the distributor having asked for information from the client and/or informing them directly whether they fall within a target market determination.

4. For example, an issuer publishing a target market determination for a financial product and then offering a customer that product (as a distributor) could lead to the implication that the issuer/distributor considers that the customer's circumstances match those in the target market determination.

5. We would suggest that Treasury consider exempting all acts involved with meeting the Obligations from the definition of personal advice. This would provide more certainty for issuers and distributors when attempting to meet the Obligations. We also note that the effect of a conclusion that retail product distribution conduct was in fact personal advice would be to remove such conduct from the operation of clauses 994D and 994E (as it would be excluded conduct). We do not believe that this is Treasury's intent.

6. If the current drafting formulation of clause 766B(3A) is retained, we would ask that the adjective 'solely' be deleted as the acts mentioned by the draft clause could be undertaken for reasons other than meeting the Obligations. This should not prevent the section from excluding those acts from the definition of 'person advice'.

CLAUSE 994A 'REVIEW PERIOD' DEFINITION/CLAUSE 994B/CLAUSE 994C

7. Issuers have substantial flexibility to set review periods under clause 994B(5). However, it is not clear whether these review periods, or the obligation to update target market determinations following trigger events, continue after the financial product is no longer on offer for acquisition by issue or regulated sale (for example, after the conclusion of the offer period).

8. We note that the obligation imposed by clause 994C(2) to review a target market determination is limited to situations where the product is on offer for acquisition by issue or regulated sale at any time during the review period. However, clauses 994C(3)-(5) are not limited in the same way.

9. Further, the operation of these clauses is not limited to the occurrence of trigger events during 'review periods'. The clauses could be interpreted as imposing obligations that continue indefinitely. Depending on how the term 'retail product distribution conduct' is interpreted, this could have unintended consequences. This could be problematic because 'giving' a PDS or prospectus (an act that constitutes 'retail distribution conduct') could continue after issuance has ceased if 'giving' means 'making available' (ie on a website) (see further comments below).

10. If Treasury intends that reviews only occur while a product is available for acquisition by issue or regulated sale, could we suggest:

    a. Making clear that review periods end on (or do not need to continue beyond) the cessation of issuance or regulated sale of a financial product; and

    b. Amending clauses 994C(3)-(5) to similarly limit the operation of these obligations?

CLAUSE 994A 'RETAIL PRODUCT DISTRIBUTION CONDUCT' DEFINITION

11. 'Retail product distribution conduct' is a key concept relevant to the application of the Obligations. Limbs (b) and (c) of clause 994A specify 'giving' a disclosure document or PDS as a type of 'retail product distribution conduct'.

12. It would be helpful to obtain clarity as to what is meant by 'giving' a disclosure document or PDS. Is the term 'giving' intended to be limited in scope to giving the document in the course of an offer/regulated sale of the financial product? Alternatively, does it extend to any distribution/publication of the document?

13. We consider the first of these interpretations of 'giving' (i.e., giving in the course of an offer/regulated sale) to be more consistent with the legislative intention evidenced in the Explanatory Memorandum and the terms of the Obligations. This is consistent, for example, with the intention to exclude secondary market sales from the terms of the Obligations (as to which, see further comments below). However, we would suggest that the meaning of the term 'giving' be clarified so as to provide certainty to persons subject to the regime. There are significant differences between the compliance obligations that would flow from each of the interpretations described above. For example, see our comments above as to the scope of review obligations under section 994C.

14. There are a number of circumstances where an issuer of a financial product may choose, or be required, to make a prospectus or other disclosure document available to the public once the product is no longer available for acquisition by issue.

15. For example, an issuer of capital securities under a prospectus or other formal disclosure document regulated by the Corporations Act 2001 (Cth) (**Corporations Act**) must lodge the prospectus with ASIC. Where the issuer is also listed on ASX, the prospectus or disclosure document must also be lodged with ASX (and would therefore appear on the issuer's ASX feed for anyone to access at any time), particularly if the securities being offered are to be quoted on ASX.

16. There can also be a separate requirement under the Corporations Act for the prospectus or disclosure document to otherwise be made available publicly during the 'exposure period' prescribed by the Corporations Act. At this stage of any public offer process, the prospectus/disclosure document may be made available before any solicitation activities are undertaken (indeed, no applications are allowed to be received during an exposure period and therefore the document is not made available with application forms).

17. Following the close of any offer (and after the issuer's solicitation activities are completed), for regulatory purposes issuers are required to maintain the prospectus and disclosure documents on its website. The issuer will typically make the prospectus or other form of disclosure document available for public download from its website on an ongoing basis.

18. In these cases, the prospectus or other disclosure document would be 'publicly' available at different times and for different purposes. In the case of a public offer, the solicitation activities would only endure for the duration of the offer period. At all other times, it would be publicly available to meet regulatory requirements and/or for informational purposes only.

CLAUSE 994B(2)

19. We note that the Explanatory Memorandum indicates that certain products that do not require disclosure will be made subject to the Obligations through regulations. At paragraph 1.35, the Explanatory Memorandum indicates that Treasury will make debentures issued by banks and basic deposit products subject to the Obligations through this regulatory mechanism.

20. As we stated in our submission on the 2017 Bill, we would ask Treasury to consider what net benefit may arise from subjecting all basic deposit products to the Obligations. Simple deposit products are likely to be suitable for such a wide target market that no meaningful distribution conditions could be attached to them. It is unclear how imposing regulatory obligations with potential criminal sanctions for this level of policy impact can be justified.

21. Applying the Obligations to these products appears inconsistent with their express exemption from the disclosure regime. In the language of the Explanatory Memorandum, the principal problem that the Obligations seek to address is the shortcomings of that regime. It is difficult to understand how simple deposit products can suffer from this problem when the Government has made a considered policy decision to exclude them from the disclosure regime.

22. If Treasury believes certain basic deposit products should be subject to the Obligations, it would be able to include those products without capturing all basic deposit products.

23. In the event that ADI debentures are made subject to the Obligations, we would ask that the Explanatory Memorandum be amended at paragraph 1.35 to make clear that the regulations will only bring ADI debentures offered to retail clients in Australia within the scope of the Obligations. At present, the language in paragraph 1.35 could be read as applying to ADI debentures issued to wholesale clients. This would be inconsistent with the schema of the Obligations, which only apply to issuances of financial products to retail clients.

24. Regulations would need to be made for the purposes of section 944B(1)(d) in order for the Obligations to apply to ADI debentures issued to retail clients. If such regulations are made, care should be taken to ensure that those regulations do not unintentionally extend the regime to ADI debentures issued to wholesale clients. The intended effect could be made clear by drafting the regulations so as to apply to ADI debentures in respect of which, 'save only for section 708(19) of the Corporations Act, a person would be required under Part 6D.2 to prepare a disclosure document.'

CLAUSE 994B(5)/994B(8)

25. Clause 994B(8) defines when a target market determination will be appropriate. This definition has two parts:

    a. Clause 994B(8)(a) requires that it is likely that the retail client to whom the product is issued will be in the target market; and

    b. Clause 994B(8)(b) requires that the issue will likely be consistent with the likely objectives, financial situation and needs of the retail client.

26. Clause 994B(8)(b) could be interpreted as requiring consideration of the client's actual objectives, financial situation and needs (ie acts consistent with giving personal advice). We would suggest that the apparent policy intent of clause 994B(8) could be achieved in a way that avoids this potential interpretation by:

a. Using clause 994B(5) to provide that the target market specified for a product should be those clients, considered as a class, for whom the product would likely meet their likely objectives, financial situation and needs; and

b. Deleting clause 994B(8)(b).

27. The effect of this would be to:

a. Provide some clarity about how target markets should be defined;

b. Avoid an interpretation that the circumstances of individual members of the class need to be considered; and

c. Still require that persons to whom products were issued are in the target market, and thus part of the class for whom the products would likely meet their likely objectives, financial situation and needs.

28. We would also ask for further clarity on when a product will be considered to be likely to meet the likely objectives, financial situation and needs of a retail client. Important issues concerning how much research issuers need to conduct are raised by the Obligations and industry would benefit from clarity concerning their scope. While we appreciate that guidance from ASIC will elucidate this component of the Obligations, we would ask that Treasury explicitly recognise in the legislative provisions that the prior experience of a client with a financial product or its issuer (e.g., through the holding of a similar, or more risky product, issued by that issuer) is relevant to whether the products would likely meet the client's likely objectives, financial situation and needs.

CLAUSE 994B(8)

29. We understand that the Obligations are not intended to apply to secondary market sales for listed products. This intention is specifically indicated in the Information Note on page 2. However, further certainty could be provided on the obligation issuers and distributors have towards those who buy financial products in the secondary market, including on listed markets.

30. This clarity could be a statement in the Explanatory Memorandum that the Obligations do not extend to such secondary market sales (we appreciate that 'regulated sales' fall within the Obligations). Alternatively, Treasury could insert a provision in clause 994B(8) that makes clear that merely because a retail client who is not in a target market acquires a financial product does not mean that the determination is not appropriate. This would be equivalent to the safe harbour granted to issuers in clause 994E(2)(b). Another approach might be to clarify this position via an amendment to the definition of 'retail product distribution conduct'.

CLAUSE 994B(9)

31. It is unclear how long the obligation to make a target determination public persists. Under the current drafting of clause 994B(9), the obligation is indefinite. We would interpret this provision as currently requiring a determination to be published on a website (or similar).

32. We would also ask Treasury to consider whether the sanction that applies to a breach of this section is proportionate. The threat of imprisonment for five years appears incongruent with the impact that a failure to make a determination public could have. This is particularly so when the primary protection under the Obligations is adherence of retail product distribution conduct with the distribution conditions, not the disclosure of the determination.

CLAUSE 994E

33. Clause 994E(1) requires a person who makes a target market determination to take reasonable steps to ensure that retail product distribution conduct is consistent with the target market determination. It would be helpful to clarify whether this obligation relates only to retail product distribution conduct by that person, or to retail product distribution conduct by others.

34. If the former is intended, it may be necessary to limit the operation of clause 994E(1) in the same way that clause 994E(3) is limited, namely:

    a. Restriction of the obligation to the period when the financial product is available for acquisition by issue, or regulated sale to retail clients; and

    b. Disapplication of the obligation to 'excluded conduct'

    If this is not done, then an issuer may be obliged to take reasonable steps concerning retail product distribution conduct by clause 994E(1) in situations to which clause 994E(3) does not apply.

35. If clause 994E(1) is intended to relate to retail product distribution conduct by others, we wondered how long after making the determination would such an obligation apply? Presumably the intention is that these obligations would only continue for so long as the financial product is available for acquisition by issue, or regulated sale to retail clients (ie the same time limitation as operates in clause 994E(3)).

36. We note that clause 994E(2) specifies certain circumstances in which a person is not taken to have failed to comply with clause 994E(1). We suggest it would be helpful to specify that procuring the listing of a security will not, of itself, constitute a breach.

CLAUSE 994F(1)

37. The record keeping obligation in clause 994F(1) appears open ended. We wondered whether the obligation to keep these records is intended to be limited to five or seven years, consistent with either sections 1101C(1)/(3) and 1101C(2), respectively, under the Corporations Act. If a defined period is intended, it should be made clear when this commences (e.g., from the making of the target market determination or from the receipt of a particular complaint).

CLAUSE 994N

38. Clause 994N would allow a court to void a contract entered into by a client who suffered loss or damage relating to a financial product in connection with contraventions of clauses 994C, 994D or 994E. We note that this is similar to section 1022C of the Corporations Act (for disclosure failures concerning financial products). We would ask that Treasury think through the implications of voiding a contract connected with capital securities on the capital position of ADIs.

39. We note that there is a requirement under clause 1023F for ASIC to consult with APRA in relation to the exercise of the Powers in relation to a body regulated by APRA. We see this as a helpful mechanism to balance the exercise of the Powers with public policy objectives associated with prudential regulation. We would suggest giving further consideration to whether any similar mechanism can imposed in relation to giving of remedies of the type described in clause 994N.

CLAUSE 1023D

40. Clauses 1023D(1) and (3) (and the equivalent proposed provisions of the *National Consumer Credit Protection Act 2009* (Cth)) empower ASIC to give product intervention rules. On the face of the provisions, it does not appear necessary that the orders are directed at addressing the detriment that enlivens the power to give them. They merely need to *relate to* the financial product (or class of financial product).

41. This approach can be contrasted with Article 40(2)(a) of MIFIR which requires that a proposed action may be taken under the equivalent power of the European Securities and Markets Authority if it '…*addresses* a significant investor protection concern or a threat to the orderly functioning and integrity financial markets or commodity markets or to the stability of the whole or part of the financial system in the Union' (emphasis added).[1]

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[1] *Regulation (EU) No 600/2014 of the European Parliament and of the Council of 15 May 2014 on Markets in Financial Instruments and Amending Regulation (EU) No 648/2012* [2014] OJ L 173/84, art 40.

Thus, the Article predicates the enlivening of the power upon its use to address a concern, rather than, as the Bill does, enlivening the power based on a concern but not requiring its use to resolve that concern. It may be helpful if the Powers were similarly directed to addressing the concern that gives rise to their availability to ASIC.

42. Further, the concept of 'significant detriment' would benefit from regulatory guidance. Clarifying how ASIC will interpret this concept will give industry and the public helpful notice about the power's scope. In particular, it would be helpful to explore whether 'significant' will be interpreted in light of what detriment is proportionate to the nature of the financial instrument.

CLAUSE 1023J

43. We would suggest that the obligation on ASIC to consult before making a product intervention order should also apply to proposals to amend an order. As clause 1023J is currently drafted, ASIC could make an order that did not affect an ADI (and thus does not invoke clause 1023F(1)(b)'s requirement to consult with APRA) but then amend the order so that it did affect an ADI without needing to consult either the ADI or APRA.

ENDS