

DESIGN AND DISTRIBUTION OBLIGATIONS  
AND PRODUCT INTERVENTION POWER

DRAFT LEGISLATION

SUBMISSION TO THE TREASURY

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9 February 2018

## 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 2017 (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. Our comments, set out in the following section, are intended to help the clarity and effective operation of those provisions. Our primary comments are summarised below. These concern the products covered by the Obligations, the relationship of the Obligations with the existing personal advice regime and the need for an appropriate calibration of what constitutes 'reasonable steps' in meeting the Obligations.
  - First, we would ask for certainty that non-retail debentures will not be caught by the Obligations. The Explanatory Memorandum contains some ambiguity concerning Treasury's intent on this point and we believe it is important for banks' credit intermediation activities that such debentures are outside the remit of the Obligations. This is because non-retail debentures are used by banks to access wholesale funding markets.
  - Second, the intended treatment of listed products under the Obligations would benefit from clarification. The Obligations could require issuers to set conditions concerning dealing and advice and which apply at the time of issue that ensure the product would generally meet the likely objectives, financial situations and needs of persons who buy products on the secondary market. As issuers cannot feasibly control who purchases a product on an open market, this does not seem a workable expectation and we would encourage Treasury to clarify that listed products are excluded from the Obligations once they enter the secondary market.
  - Third, the interaction of the Bill with the personal advice regime warrants further detailed consideration in two respects. First, to determine whether a client falls within a target market, distributors may need to consider one or more of their client's objectives, financial situations or needs. If so, then they may be deemed to be providing personal advice. We have suggested an amendment to avoid this result. Second, it may be important to clarify that the best interests duty overrides target market determinations. Thus, advice providers should not be able to rely on a target market determination to meet their best interests duty. Conversely, if compliance with the duty suggests a client would benefit from a product, then a target market

determination indicating that the client is outside the target market should not preclude the product's recommendation.

- Fourth, we would ask that Treasury consider an alternative anti-avoidance mechanism with respect to ordinary shares convertible into preference shares (currently in clause 993DB(3)). The current test of whether a company's constitution permits conversion appears overbroad and would capture the ordinary shares of companies that have such permission for the purposes of convenience (such as ANZ) rather than avoidance of the Obligations. We note that we otherwise support the Bill containing anti-avoidance mechanisms to prevent circumvention of the Obligations.
  - Fifth, the proposed application of the Obligations via regulation to basic deposit products will capture simple savings and transaction accounts that are appropriate for the entire market. Because the products will have such a large target market, they will likely have no substantive distribution conditions. This raises the question of what consumer protection benefit is gained from applying the Obligations to them. We would ask that Treasury consider what additional financial products should be subject to the Obligations from the perspective of the potential consumer benefit and corresponding compliance cost.
  - Sixth, the reasonable steps that both issuers and distributors need to take to comply with distribution conditions may benefit from reflection and clarity. Thus, we would ask Treasury to consider whether, to comply with the Obligations, issuers will need to establish contractual relationships with or police all distributors. This would be a very onerous obligation. Further, where a retail client outside a target market believes, unilaterally and reasonably, that a product would benefit her or him, the Obligations may discourage issuers and distributors from dealing with the client. For those clients who justifiably believe that they have sufficient financial literacy to make their own decisions, this may lead to a poor customer experience. It would be preferable if there were some mechanism to allow for informed client choice in a way that does not derogate from the overall policy intent of the Obligations.
4. As a general comment, we would ask that ASIC prepare its guidance on the Obligations and the Powers as soon as practicable. Although the draft Bill provides for 12 months before compliance with the Obligations is necessary for products being issued for the first time, the precise nature of the Obligations will be unknown until ASIC releases its final guidance on topics such as the expected content of target market determinations, what constitutes reasonable steps for the purposes of clause 993DE and what is a 'significant dealing' for the purposes of clauses 993DF(5) and 993DG. Ideally, the Obligations would commence 12 months after that guidance is finalised. This guidance will be critical when designing and implementing processes and controls to meet the Obligations.

## COMMENTS ON SPECIFIC CLAUSES

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### CLAUSE 993DA(1)

1. We note that the definition of 'regulated person' is broad and will capture employers that are distributing non-My Super superannuation products to their employees. Treasury may like to consider the impact of the Obligations on these entities which sit outside the financial system. In particular, these entities may lack the organisational and compliance arrangements that are required by the Obligations (particularly those in clauses 993DE and 993DF).

### CLAUSE 993DB

2. We note that there are financial products which require disclosure because they are sold to retail clients but which are also sold to non-retail clients. We would suggest that clause 993DB contain a provision clarifying that none of the Obligations concern persons who acquire financial products as non-retail clients.

### CLAUSE 993DB(3)(a)

3. Clause 993DB(3) of the Bill provides that ordinary shares will be subject to the Obligations if 'the company's constitution provides that ordinary shares may be converted into preference shares'. From the Explanatory Memorandum, we understand this provision is intended as an anti-avoidance provision to prevent companies issuing ordinary shares outside the scope of the Obligations and then converting those shares into preference shares.
4. While an anti-avoidance mechanism is understandable, the mere presence of permission in a company's constitution for the conversion of ordinary into preference shares does not appear to be an appropriate criterion on which to enliven it. ANZ's constitution and the constitutions of other ordinary share issuers that may be subject to Part 6D.2 disclosure obligations contain such permission as a matter of convenience only and not to underpin regular programs of issuing ordinary shares that convert into preference shares. The proposed anti-avoidance mechanism will mean that capital raisings using ordinary shares requiring disclosure will become subject to the Obligations even if the issuer has no intent of converting the ordinary shares into preference shares.
5. It would be preferable if the anti-avoidance mechanism were given an alternative structure. For example, a dominant purpose test could be used to assess the reason for the issue of the ordinary shares.

## CLAUSE 993DB(7)

### *Debentures*

6. We note that the Explanatory Memorandum indicates that Treasury intends to extend the Obligations by regulation pursuant to this clause to debentures of a body that is an Australian ADI.
7. We would ask that such extension does not go so far as to capture debentures issued to non-retail investors, and that this is made clear in the next draft of the Explanatory Memorandum. It is important for certainty in the funding and capital requirements of ADIs that such debentures are outside the remit of the Obligations. The non-application of the Obligations to non-retail debentures would be consistent with the Obligations' scope of application with respect to other financial products and securities.

### *Basic deposit products*

8. We also note that Treasury intends to extend the Obligations to basic deposit products. Such products, defined by section 761A of the Corporations Act, would capture a broad range of deposit options available to consumers. Included in this definition would be transaction and savings accounts that are appropriate for the broadest market conceivable. With such a broad target market, these products may have no substantive distribution limitations.
9. As such, we would ask Treasury to consider whether the Obligations will actually improve consumer outcomes in respect of these products by promoting better distribution. If the Obligations cannot do so, then perhaps their only impact would be a compliance cost on issuers and distributors. With basic deposit products held by almost all adult Australians, this could be a significant cost on the financial system for little benefit.

### *Retail clients only*

10. More generally, it would provide clarity to the market if the power under clause 993DB(7) were expressed subject to a limitation that it cannot extend the Obligations beyond products issued to retail clients that require disclosure. Alternatively, our comment in paragraph 2 could be adopted in a way that delimited this regulation making power.

## CLAUSE 993DB(10)

### *Listed products*

11. Clause 993DB(10) states that a determination will be appropriate when it would be reasonable to conclude that, if the product were issued or sold to persons in the target market in accordance with the distribution conditions, *it would generally meet the likely*

*objectives, financial situations and needs of the persons in the target market.* The last component of this clause could be interpreted as requiring the conditions to meet the likely objectives, financial situations and needs of all persons in the target market, regardless of whether they purchase the product upon issue (or in a sale situation prescribed by clause 993DB(11)) or on the secondary market. Thus, on this interpretation, while the conditions govern the way the product is issued, the test of whether a product is appropriate would extend through the life of the product and capture any secondary sales.

12. Obviously, it would be difficult for issuers to control who purchases a listed product on the secondary market through a condition on how the product is issued. We note that ASX Listing Rules prohibit transfer restrictions. If the intent is that clause 993DB(10) only applies to persons in the target market purchasing the product upon issue (or in a sale situation prescribed by clause 993DB(11)), then perhaps a change is required to the clause to clarify this.
13. This could be done through clarifying that clause 993DB(10) only applies at the point of primary issue of the financial product and/or through making clear that the advice and dealings covered by the Obligations are those that occur in connection with that issue. We have also suggested a change to clause 993DE to clarify that its obligations only apply upon issue.
14. That said, we acknowledge that it is clearly intended that the product remain appropriately distributed in accordance with the review obligations in clause 993DC.

#### *Interaction with personal advice*

15. The test articulated in clause 993DB(10) uses the concept of ‘...the likely objectives, financial situations and needs...’ of persons. This is also the concept that triggers whether a provider is providing personal advice (under section 766B). That is, a provider is taken to be providing personal advice when:
  - a. They have considered one or more of the person’s objectives, financial situation and needs (other than for compliance with the anti-money laundering laws); or
  - b. A reasonable person might expect the provider to have considered one or more of those matters.
16. We note that the Explanatory Memorandum states, at paragraph 1.39, that the use of the phrase ‘likely objectives, financial situation and needs’ in clause 993DB(10) ‘...does not reflect a requirement to take into account the personal circumstances of any particular person or to provide personal advice’. While there may be no requirement to always take these circumstances into account, it is possible that to meet clause 993DE, a distributor

will need to consider if the person's specific objectives, financial situation and/or needs are aligned with those of the class of persons who comprise the target market.

17. Whether this occurs would depend on the granularity and nature of the description of the class that is included in the target market determination pursuant to clause 993DB(9)(a). Thus, if the class is described in very generic terms, then it is conceivable that a conclusion could be reached as to whether a person fell within it without considering their objectives, financial situation and needs. However, if the class were described with more specificity, or by reference to the class's objectives, financial situation or needs, then it would be difficult to reach that conclusion without that consideration.
18. If the regulated person does this in an attempt to comply with the distribution obligations, it would be easy to conclude that the regulated person is providing personal advice. This would enliven significant advice-related obligations on the regulated person. If Treasury wishes to avoid this, it could add to the current carve-out in section 766B(3)(a) (relating to compliance with AML laws) so that a provider in complying with the Obligations is not taken, without more, to have considered one or more of the individual's objectives, financial situations or needs.

## CLAUSE 993DC(3)(B)

19. Clause 993DC(3)(b) works to apply clauses 993DC(4) and (5) by reference to either:
  - (i) An event or circumstances occurring that would reasonably suggest that the target market determination is no longer appropriate; or
  - (ii) A review trigger occurring.

A review trigger is defined by clause 993DB(12) as events and circumstances that would reasonably suggest that the target market determination is no longer appropriate.

20. As clause 993DC(3)(b)(i) effectively restates the definition of 'review trigger', we wondered if it could be deleted.

## CLAUSE 993DE

*Only upon issue*

21. Clauses 993DE(1) and (2) require that dealings and advice provided in relation to a product are consistent with target market determination. Under clause 993DB(10), such determinations concern how products are issued or sold (within the meaning of clause 993DB(11)). Thus, it may be important to clarify that clauses 993DE(1) and (2) do not cover *all* dealings and advice but, rather, only those dealings and advice that occur in connection with an issue (or sale) of a product.

### *Best interests duty*

22. We note that there may be a two-part issue with how the Obligations interact with the best interests duty under Part 7.7A of the Corporations.
23. First, clause 993DE(2) requires a regulated person to take reasonable steps to ensure that advice is consistent with a target market determination. It is possible that this injunction may cut across the advice provider's ability to provide optimal advice to her or his client. Thus, if the advice provider reaches a conclusion (consistent with sections 961B and 961G of the Corporations Act) that a particular product will best meet the client's objectives, financial situation and/or needs, they may be unable to recommend that product if the client does not fit within the issuer's target market. In this case, the issuer's abstract conceptualisation of who may benefit from the product would trump the adviser's applied consideration of the client's situation.
24. We do not think that the definition of 'reasonable steps' in clause 993DE(3) provides permission to override a target market determination. This is because that clause provides a test of the reasonableness of measures taken to ensure dealing or advice is in accordance with the target market determination. Thus, clause 993DE(3) explains clauses 993DE(1) and (2) but does not derogate from them; it cannot be read as allowing the deliberate deviation from the target market determination.
25. Second, and conversely, an advisor may conclude that merely because a client falls within the issuer's abstractly defined target market, then recommending the product is in the client's best interests. We are not sure that this is the policy intent of the Obligations.
26. In these cases, the abstract target market definition could supersede the specific circumstances of a client, potentially to their detriment. We wondered whether there needs to be clarity in the Bill concerning how the Obligations interact with the best interests duty.

### *Client's unilateral decision*

27. This issue is also relevant when a client unilaterally decides they would like to acquire a financial product despite not being in the target market. Clause 993DE may work to discourage the issue of the product to the person.
28. We appreciate that the intent of the Obligations is to aid clients make better decisions through a class appropriateness mechanism. However, if clients cannot access products that they genuinely believe are in their best interests, issuers and distributors would be



forced to have difficult conversations with clients about why they are unable to buy a product. This could contribute to a poor customer experience, particularly for those clients who believe, with good reason, that they are sufficiently financially literate to make their own decisions.

29. To avoid this, it may be helpful if there were some statutory mechanism that allows competent retail clients to exercise their informed discretion concerning products. We appreciate that this should be designed in a way that does not derogate from the overall policy intent of the Obligations.

#### *Safe harbour for advised situations*

30. It may further be appropriate that an issuer's responsibility under clause 993DE is deemed discharged if the product is distributed under personal advice. Thus, if the product is sold through personal advice, we wondered what additional steps an issuer would need to demonstrate to ensure that the product was sold in accordance with the distribution conditions. It would provide certainty if this was made clear in the statute.

#### *Reasonable steps*

31. We would also ask Treasury (or ASIC) to consider what may constitute reasonable steps for an issuer, particularly where there is no contractual relationship between the issuer and entity which is dealing in or advising on the financial product. If an issuer has no existing relationship with the distributing entity, are issuers expected to create a contractual nexus so that they may influence the entity's behaviour? If so, then the challenge and cost of implementing the Obligations will increase significantly. The hurdle of meeting such a requirement should be taken into account when designating an appropriate implementation period.

## CLAUSE 993DF(2)

#### *Feasibility of collecting distribution information*

32. Clause 993DF(2)(e) requires that the proportion of the number of issues and sales that the person makes which are consistent with the determination be recorded. As only those entities that prepare target market determinations will 'issue' (or 'sell' in the specific meaning of clause 993DF(3)) a financial product, this obligation will fall on issuers, not distributors (ie regulated persons) more generally.
33. This arrangement, where issuers need to assess the compliance of all issues of a financial product with the distribution conditions, could be very onerous. As written, the clause would require the issuer to look through distribution chains and identify non-compliance with distribution conditions for each product issued. This could be difficult, particularly

where the issuer has no direct relationship with the distributor (a continuation of the concern raised in paragraph 31 above).

34. While we agree that information concerning compliance with the distribution conditions would be useful to assess the effectiveness of the conditions and to help ASIC's regulatory oversight, we would ask Treasury to reconsider the calibration of this obligation. In particular, it would be helpful if Treasury considered the potential for any duplication of reporting that might occur through a distribution chain and which entities would be best placed to collect and report particular data.

*Clarity on who must collect distribution information concerning issues and sales*

35. We note that clause 993DF(2) imposes a series of obligations on both those who must prepare a target market determination and 'regulated persons'. As we noted above in connection with clause 993DF(2)(e), the obligations in clauses 993DF(2)(c)-(e) will fall on those who must prepare target market determinations rather than all regulated persons (as only such preparers will 'issue' or 'sell' the products).
36. To help with its interpretation, the drafting of clause 993DF(2) could be bifurcated into two distinct clauses concerning preparers of target market determinations and regulated persons separately. Less violently, the language in clauses 993DF(2)(c)-(e) could refer to *persons who must prepare target market determinations* rather than just *persons*.

*What constitutes a unique issue or sale*

37. Separately, as clause 993DF(2)(c) requires records of the number of 'issues' and 'sales' to be kept, it may be useful to clarify what constitutes a unique 'issue' and a 'sale'. For example, is the issue of 10 financial products to one client, 10 issues or one?

*What is meant by 'way'*

38. We also wondered if further clarity could be provided on what is meant by 'ways' in clause 993DF(2)(f).

*Typographical error*

39. More mundanely, we note that the reference to 'section 933DE' (emphasis added) in clause 993DF(2)(g) appears erroneous and should be to 'section 993DE'.

## CLAUSE 993DI

40. We note that 'section 993D' is currently part of Division 2 and, as clause 993DI(1) cross refers to that Division, the separate cross-reference to the section appears redundant.

## CLAUSES 993DM(4)/993DN(1)

41. These clauses concern actions commenced under clause 993DM. We wondered whether the references to clause 993DM(2) in these clauses should be to clause 993DM(3). Clause 993DM(2) does not, of itself, provide for a cause of action (it modifies the cause of action created by clause 993DM(1)) while clause 993DM(3) does so provide.

## CLAUSE 1022CC/301C

### *Meaning of 'significant detriment'*

42. We appreciate that the Explanatory Memorandum notes that both 'significant' and 'detriment' will take their ordinary meaning within the context in which they are used. It may be useful if Treasury or ASIC were to provide further clarity on the terms' meaning to help industry and the public understand when ASIC may be minded to exercise the power.

### *Purpose of exercise of power*

43. Clauses 1022CC(1)(c)-(e) and 1022CC(3)(c)-(e) (and the equivalent proposed provisions of the *National Consumer Credit Protection Act 2009* (Cth)) set out the content of the product intervention orders that ASIC can give. We note that, 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).
44. 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).<sup>1</sup> 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.
45. It may be helpful if the Powers were similarly directed to addressing the concern that gives rise to their availability to ASIC.

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<sup>1</sup> *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.

## CLAUSE 1022CE/301E

46. We wondered whether the obligation on ASIC to consult before making a product intervention order should also apply to proposals to amend an order. While consultations on amendments are contemplated by clauses 1022CJ(2)(d) and 301K(2)(c) (which requires ASIC to publish a description of the consultation it has undertaken on an amendment), we could not see a clear obligation on ASIC to undertake them.
47. We also note that clauses 1022CE and 301E do not stipulate a minimum time period for a consultation. If the lack of a minimum time period is to assist ASIC in issuing orders expeditiously, perhaps an alternative would be for a minimum time period to be specified but then allow ASIC to follow a truncated process in matters of urgency provided a subsequent, fuller, consultative process were followed.

**ENDS**