

9 February 2018

By Email: productregulation@treasury.gov.au

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

Dear Sir/Madam,

Submission re Design & Distribution Obligations Draft Legislation

We are pleased to respond to your request for comment on the Design & Distribution Obligations Draft Legislation.

1. Practical difficulties for Issuers regarding Target Market Determinations for investment products for which there are a wide range of uses and investor types

(a) Difficulties in defining a Target Market (by Class of Investor)

While we recognise that there may be some investment products suitable for a narrowly defined target market, *there are also many investment products that have a very wide target market.*

Using the example of an investment product which offers exposure to Australian shares, there would be a very large number of reasons why an investor may legitimately acquire such a product, and a large variety of investor types. These may include:

- (i) investors wanting to hold a long term exposure to Australian shares;
- (ii) investors wanting to speculate on the short term outcomes of Australian shares;
- (iii) investors wanting to take exposures that combine well with various other asset classes or which offset liabilities
- (iv) investors concerned with the comparative prospects of other asset classes
- (v) retail and wholesale investors
- (vi) geared and ungeared investors
- (vii) affluent and less affluent investors
- (viii) corporate, individual and super fund investors

Because the potential uses of the investment product are so wide, and the potential investor characteristics and financial situations of those investors are so wide, *we contend that it is not possible to define the target market in terms of an investor class, it is only possible to define the target market in terms of the investment itself.*

That is, in this example, it would appear that the target market for an Australian share fund in many cases could only be "Investors seeking exposure to a managed portfolio of Australian shares".

Accordingly, we consider it vital that the legislation and legislative guidance accommodates the definition of target markets in terms other than (narrow) investor classes. That is, the Target Market must be able to be defined in a manner that is sensible, practical and appropriate for each particular investment product.

(b) Difficulties for issuers in complying with the requirement to consider the needs, objectives and financial situation of persons to determine the appropriateness of the target market

As noted above, there may be an exceptionally large number of potential investor types who may make valid use of certain common investment products. Clearly, it is only possible to consider the needs, objectives and financial situation (an action which is required by the proposed legislation) in a very generalised sense when there is such a large range of potential investor types.

In the example given above, a product providing exposure to Australian Shares, we have noted at 1(a) that the target market could only be defined as “Investors seeking exposure to a managed portfolio of Australian shares”. Following on from this, the need/objective of an investor for this product could only be assessed as “to hold exposure to a managed portfolio of Australian shares”.

It is not possible to identify the financial situation of investors in this target market.

It follows that the legislation and legislative guidance must allow issuers the flexibility to assess the needs, objectives and financial situation of investors in the target market in a manner (and to an extent) that is sensible, practical and appropriate for each particular investment product.

2. Difficulties for Issuers in ensuring a product is only distributed to Investors in the Target Market

(a) Issuers are Not Financial Advisors and Do Not Hold Personal Information on Investors

The proposed legislation requires Issuers to take reasonable steps to ensure that a product is distributed in accordance with its Target Market Determination. This obligation will most particularly apply where an Issuer distributes its own product (for example, where an investor makes a direct application for an investment).

Issuers are not financial advisors and they do not hold or have access to personal information as to the financial situation or needs of investors. Accordingly they have no means of independently assessing whether or not a direct applicant is within a target market.

Accordingly, we question whether the legislation should place such an obligation on issuers (knowing that they have no means of satisfying it)?

However should this obligation be placed on issuers, the only practical means for an issuer to satisfy the obligation is through investor self-certification. Using the example again of an investment product providing exposure to a managed portfolio of Australian shares, an issuer could require an investor applicant to make a declaration along the following lines: “In submitting this application I certify that I am an investor within the Target Market for this investment product”.

If this obligation is placed on issuers, we note that the legislation and legislative guidance must accommodate investor self-certification for investors applying directly to issuers.

(b) Identifying significant dealings that are inconsistent with the target market determination

The proposed legislation requires issuers to notify ASIC if they “become aware” of significant dealings that are not consistent with target market determinations.

Because issuers have no access to the personal financial information of investors, whether held directly by the investor or indirectly via a financial adviser, they have no means of identifying or assessing whether a dealing is consistent or inconsistent. This would be the case even if the issuer became aware of one or more pieces of information that suggested that a dealing may be worthy of investigation.

We question whether this obligation should be placed on issuers when they do not have access to the necessary information, do not have access to full information, and have no rights to request such information. Possibly the obligation on Issuers to advise ASIC on inconsistent dealings, should be limited to passing on notifications received under Paragraph 1.72 of the Explanatory Memorandum.

3. Added Complications for Listed Investment Products

(a) Transitional Allowance Required for Listed Investment Products

The proposed legislation (as drafted) applies to ASX listed investment products, such as shares/units in ETFs and listed investment companies and listed investment trusts. (The legislation requires Target Market Determinations to be in place for new issues or shares/units and prohibits market participants from dealing or advising on investment products unless they have a Target Market Determination in place).

A transitional allowance should be incorporated within the legislation so that existing listed investment products may prepare and release Target Market Determinations for their existing issued listed securities. This may need to be coordinated with ASX.

(b) Additional Difficulties in Defining and Ensuring Compliance with Target Markets

In this regard we note that:

- (i) The possible range of investors for closed ended listed investment products is even wider than for unlisted products, as it includes investors seeking to generate investment outcomes from differentials between asset backing and market prices in addition to those investing to obtain exposure to the underlying investments.

The result of this is that the target market definition must be even wider. This exacerbates the practical difficulties outlined in 1(a) and (b) above.

In the example of a closed-ended listed fund providing exposure to an Australian share portfolio, the target market could only be defined as "Investors seeking exposure to a managed portfolio of Australian shares through a closed-ended listed structure". Following on from this, the needs of an investor in this target market for this product could only be assessed as "Exposure to a managed portfolio of Australian shares through a closed-ended listed structure".

In this example it is certainly not feasible for the issuer to be any more specific in identifying possible investors who may have a legitimate use for the product.

- (ii) By the very nature of listed markets, the issuer of a listed product does not hold or have access to investor level information on needs, objectives and financial circumstances, and has no rights to request this information. The buying and selling of units/shares is undertaken entirely through licensed dealers in the ASX listed marketplace. This exacerbates the issues noted in 2(a) and (b) above.

(c) Listed Investment Entities Inclusion Questioned

For the reasons outlined in 3(b) above, we strongly question whether it is appropriate to place responsibilities on listed investment entities to assess or define the needs and circumstances of potential investors when they are not in the position to do so, and where all trade in the entity's securities occurs through licensed intermediaries, and where all direct issuance to investors would in practice rely on investor self-certification.

We note the extensive regulation of the ASX covering both listed entities and those dealing in securities on behalf of investors, and note that this extensive regulation is designed to ensure that investors in any listed security have adequate information, while ensuring that listed markets retain their important characteristic of transparency and efficiency.

While we thoroughly endorse the objectives of the legislation in protecting investors, we would contend that the primary obligation on listed issuers should logically be to identify the risks, benefits and key features of their product (an obligation which is already enshrined in legislation).

The obligations to ensure that the listed product suits the specific needs of an investor can in reality only be addressed by an advisor or intermediary acting for that investor or by the investor themselves.

On this basis, we question the rationale for including listed investment products within this legislation.

In the event that it is considered appropriate for the legislation to apply to listed issuers, then we would contend that the solutions and suggestions identified at 1 and 2 above, would most certainly need to be considered.

Yours Faithfully,



A.J. Gluskie, Director

Listed Investment Companies Association of Aust Ltd