



15 August 2018

Manager  
Financial Services Unit  
Financial System Division  
The Treasury  
Langton Crescent  
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**By email (Word and PDF formats)**

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Dear Colleagues

**Consultation on draft Treasury Laws Amendment (Design and Distribution Obligations and Product Intervention Power) Bill 2018 released 20 July 2018**

## 1 Introduction

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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 *Treasury Laws Amendment (Design and Distribution Obligations and Product Intervention Power) Bill 2018* released on 20 July 2018 (**Bill**) and explanatory memorandum for the Bill (**EM**) also released on 20 July 2018 for consultation in relation to the proposed:

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

This letter sets out the FSC's submissions in relation to the Bill 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 Bill 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. However, we note that the principles that we raise may be of general application, where appropriate, to the proposed amendments to the *National Consumer Credit Protection Act* 2009.

## Executive summary

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### 1.1 Transitional timing for DDO

Industry is now working through the detail of the Bill and assessing the DDO compliance changes that they will need to implement to their systems and processes. In light of the fact that:

- (a) ASIC regulatory guidance for the DDO, which will need to be taken into account in designing these system and process changes, will not be released for consultation until after Royal Assent; and
- (b) the transitional period for the European (MiFID II) equivalent of the DDO had an implementation period of over 3½ years,

we request that the DDO transition period is extended from 2 to 3 years (or alternatively that it is re-framed so that the 2 year transitional period commences on the publication of the finalised ASIC regulatory guidance).

A longer transitional period is warranted given the significant impact that the Bill is likely to have across the financial services industry.

### 1.2 Personal advice

Thank you for proposing an exception to the definition of personal advice to address DDO compliance activities.

We would like to propose some alternative exemption language which we submit would achieve the regulatory intention while providing a more workable exemption. Our alternative drafting is designed to reflect the language of the personal advice definition and ensure that there are no unintended gaps in the exemption, or unintended consequences where issuers or distributors take steps to comply with their DDO obligations.

### 1.3 Reasonable steps and excluded dealing

We welcome the approach to exclude 'excluded conduct' from certain DDO obligations.

However we consider that some small amendments are needed to section 994E(4) and the definition of 'excluded dealing' to:

- (a) make those provisions more workable and appropriate for the Australian market where a large proportion of retail products are distributed via platforms and intermediaries, usually in

situations where the platform operator does not know the end client, who receives personal advice from a third party adviser; and

- (b) confirm that where consumers already receive significant protection through the regulation of personal advice, all dealings (including issues and related sales) in relation to retail clients following personal advice will also be eligible for the 'excluded conduct' exemption. Currently the exemption is only available to persons 'arranging' the issue or regulated sale.

#### **1.4 PIP consultation**

We continue to be of the view that an opportunity for private consultation, and a reasonable minimum period of consultation, in relation to the use of the PIP is essential to provide due process and procedural fairness and for the consultation to be meaningful and effective.

## **2 Design and distribution obligations (DDO)**

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### **2.1 Transitional timing**

- (a) Thank you for amending the commencement day provisions in the Bill so that the DDO commences, in relation to new products, 24 months (rather than 12 months) after Royal Assent.
- (b) As the earlier draft of the Bill provided (in part 10) for the DDO to apply 24 months from Royal Assent in relation to existing products, the new draft of the Bill does not provide any additional transitional timing in relation to existing products. The process and operational challenges in relation to implementing the DDO are arguably more extensive for existing products, whose systems are already in place and require amendment.
- (c) Our members have been working through the detail of the revisions to the Bill and the disclosure, information flow and record keeping changes needed to give effect to, and be compliant under, the DDO including:
  - (1) designing and executing IT system and related process/procedure changes, including the flow of information between issuers and various distributors; and
  - (2) rolling out those process changes and implementing new training programs.
- (d) Our members are concerned that the new section 994F record keeping and notification obligations are onerous for both product issuers and distributors and will place a heavy burden and responsibility on issuers to obtain and record a range of information, including that collected by distributors. These

new obligations will require new systems to be built to transmit, analyse and record the indicated information which is particularly of concern for issuers who will be exposed to regulatory risk if distributors fail to give issuers the required information in the prescribed period.

- (e) Our members have also been working through and assessing the DDO compliance changes that they will need to implement to their systems and distribution channels, all of which have significant lead times.
  - (1) By way of illustration we attach a strawman timeline which has been prepared to provide a possible example of the time that it may take to prepare for the DDO.
  - (2) As you can see from this timeline, two years is a tight timeline which does not have a buffer for delays or implementing any changes in direction, industry practice or regulatory guidance.
  - (3) We also anticipate that not all issuers and distributors will be in a position to immediately implement system and process changes when the ASIC regulatory guidance is finalised, particularly if the whole industry is looking to implement system and process changes at the same time and the number of IT consultants and system service providers available to work on these changes is limited.
- (f) In light of all of the above, we are concerned that expediting the establishment and implementation of these systems could create significant issues down the track, should industry not be provided with sufficient time to design effective and functional systems before their implementation.
- (g) We understand that the ASIC regulatory guides will contain significant details that will determine, to a large extent, the systems that issuers and distributors implement with a view to complying with the new DDO regime. We also understand that, although ASIC is well progressed with finalising draft regulatory guides in relation to the DDO, they cannot be released for consultation until the Bill has been finalised and passed.
  - (1) This means that it will not be practically possible for issuers and distributors to finalise and start to implement their system and process changes until these regulatory guides have been finalised. As much of the DDO is principles based regulation which will need to be supplemented by ASIC regulatory guidance, it is critical that industry has sufficient time between their finalisation and the DDO commencement to absorb and implement them.
  - (2) Realistically this means that system and process changes will be 'on hold' or unable to be finalised or materially progressed until the finalisation of the regulatory guidance.

- (3) The practical effect of the timing of the finalisation of the regulatory guidance is therefore that the transitional time available for industry to adapt and finalise their processes and systems will be less than 2 years. For example it would be 18 months if it takes 6 months to finalise the ASIC regulatory guidance, assuming that consultation commences immediately after Royal Assent.
- (4) Given the uncertainty of the timing of the finalisation of the ASIC regulatory guidance, we request that Treasury:
  - (A) increases the transitional period beyond two years. Given that the European (MiFID II) equivalent of the DDO had an implementation period of over 3½ years<sup>1</sup>, (and that industry participants were challenged to comply even with this length of transition), the FSC considers that an extension to the DDO implementation period for Australia is reasonable and sensible. We request that the period is extended from 2 to 3 years; or
  - (B) re-frames the 2 year transitional period so that it commences on the publication of the finalised regulatory guidance.
- (h) We would also be interested to know if ASIC is considering a period of 12 months facilitative compliance, commencing after the end of the transition period, similar to the facilitative compliance period that applied following the introduction of FOFA, where ASIC takes a facilitative approach and does not take regulatory action if an issuer or distributor is making a genuine effort to comply with the DDO. A period of facilitative compliance:
  - (1) would be consistent with the 12 months of regulatory forbearance currently being applied in Europe in relation to the MiFID II reforms; and
  - (2) would in effect recognise this is a new, detailed and somewhat complex regime in its practical application and that it will take some time for industry to familiarise itself with it as well as to design, operationalise and implement systems.

## **2.2 Prospective effect and legacy products**

- (a) In amending the transitional provisions in Part 10 in the previous draft of the Bill, some of the earlier drafting in the Bill which clarified the operation of the DDO with respect to legacy or existing products has been lost.

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<sup>1</sup> Articles 16(3) and 24(2) of Directive 2014/65/EU took effect on 3 January 2018. The second consultation paper providing the detail of the new laws was released on 22 May 2014.

- (b) Our members would be grateful if it could be confirmed in the EM that the DDO applies prospectively from its commencement date and does not apply to legacy products which are not offered for issue or sale after the commencement date.
- (c) In confirming that the DDO applies prospectively it would also be helpful for the EM to confirm that the target market determination (**TMD**) applies at the 'point of issue' or 'point of sale'.
  - (1) We request that the EM confirms that once a product has been issued (or sold in a regulated sale situation), if no further issues (or regulated sales) occur in relation to the product which require a prospectus or product disclosure document (**PDS**) to be given to a retail client, the issuer is not required to review the TMD or assess on an ongoing basis whether the holders of the product continue to be suitable for it and in the target market.
  - (2) We understand that this is the regulatory intention based on sections 994B(8) and 994C and request that the EM puts this beyond doubt.

### 2.3 Personal advice

- (a) Thank you for proposing an amendment to the definition of personal advice and for listening to our submissions in relation to concerns that performing obligations under the DDO will in practice require issuers and distributors to make enquiries as to the personal objectives, financial situation and needs of the end consumers and so may result in them giving personal advice in order to discharge their DDO obligations.
- (b) You have proposed the following (marked up) amendments to effect changes to the definition of personal advice:

Section 761A "personal advice" has the meaning given by subsections 766B(3) and (3A)".

766(B)(3) For the purposes of this Chapter, personal advice is financial product advice that is given or directed to a person (including by electronic means) in circumstances where:

- (a) the provider of the advice has considered one or more of the person's objectives, financial situation and needs (otherwise than for the purposes of compliance with the Anti-Money Laundering and Counter-Terrorism Financing Act 2006 or with regulations, or AML/CTF Rules, under that Act); or
- (b) a reasonable person might expect the provider to have considered one or more of those matters.

766(B)(3A) However, the acts of 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.

(c) While we welcome your proposal to amend the definition of personal advice, we would like to raise with you some concerns that our members have in relation to the application of the proposed new section 766(B)(3A).

(1) As a practical matter, there will be circumstances where issuers or distributors interact with investors in relation to a range of matters, where enquiries may be more than 'solely' to determine if the person is in a target market. They may be asking for feedback on the product or its disclosure, or for information in connection with other DDO obligations for example in reviewing a TMD and assessing if the TMD is still suitable.

(2) Also, the actions of issuers and distributors after having asked for information, may require them to then 'consider' information they receive in relation to the personal situation, objectives and needs of the investor, and that 'consideration' activity is not exempted under the proposed section 766(B)(3A).

(3) This is because the proposed exemption applies in relation to acts of 'asking for information' but does not exempt a person's 'consideration' of the information provided in response, because the language used in the proposed section 766(B)(3A) does not reflect the 'consideration' language used in the current definition of 'personal advice' in section 766B(3), (extracted above for your ease of reference).

(4) This leaves open the possibility that the act of asking for information solely for the purpose of determining whether the person is in the target market would not constitute the provision of personal advice, but that acting on the information provided in response and considering it would still constitute personal advice.

(5) We understand that such an outcome is not Treasury's intention and that the intention was to provide some certainty that taking steps to comply with DDO obligations could not of itself amount to personal advice.

(d) We propose the following alternative section 766(B)(3A) which we submit would be appropriate to give effect to our understanding of the regulatory policy intention:

(3A) However, personal advice is not given or directed to a person (including by electronic means) to the extent that the provider of the advice has

considered one or more of the person's objectives, financial situation or needs in performing, or seeking to perform, one or more obligations imposed on the provider pursuant to Part 7.8A.

(e) Mindful of the serious consequences of being taken to have provided personal advice through the loss of an exemption from that definition, which could arise:

- (1) unexpectedly when personal advice was not intended to be provided but the exemption ceases to be available; or
- (2) where a person is in the process of complying with their DDO obligations but has not yet completed that process and so has not (yet) fully complied with their DDO obligations,

we have proposed that section 766(B)(3A) applies where a person performs "or seeks to perform" their DDO obligations.

- (3) If a person seeks to perform fully their DDO obligations but fails, for example by inadvertently missing a reporting obligation under section 994F(4) by one day (reporting 11 business days, rather than 10 business days, after the end of the reporting period), we submit that the consideration of a retail client's objectives, financial situation and needs in relation to that obligation, (for example to identify what information may reasonably suggest that the TMD is not appropriate and may need to be reported under section 994F(4)) should continue to be excluded from the meaning of personal advice under subsection (3A).
- (4) In this way, issuers and distributors would be responsible for, and liable for, a failure to meet their DDO obligations in that circumstance but would not bear the risk and uncertainty of being taken to have provided personal advice where:
  - (A) they had not intended to provide personal advice or to assume the regulatory burden associated with personal advice;
  - (B) they would not have met the regulatory requirements associated with providing personal advice (eg providing a statement of advice and observing the best interests duty); and
  - (C) they would inadvertently be in breach of the Act and their Australian financial services licence (**AFSL**) conditions if the exemption ceased to apply to their activity and they were not authorised to provide personal advice under their AFSL.
- (5) We would like to suggest that once the DDO has been in operation for a reasonable period, retail client feedback is sought in relation to:



- (A) the extent to which they have valued and utilised the TMD information; and
- (B) whether there was any confusion or misunderstanding in relation to the nature of enquiries made in connection with the TMD and assessing if the retail client was in the target market. For example, whether the retail client had, notwithstanding the general advice warning and other disclaimers, incorrectly concluded or perceived that personal advice was being given to them, due to the personal nature of the enquiries being made.

## **2.4 Excluded conduct and excluded dealing**

- (a) We thank Treasury for its proposal to introduce a definition of 'excluded conduct' and to provide that certain DDO obligations do not apply where there is excluded conduct. We understand that given the significant standards in place under the regulation of personal advice, imposing DDO obligations in situations where consumers already receive significant protection through the regulation of personal advice would have amounted to unnecessary duplication, inefficiency and cost.
- (b) We would like to request two small amendments to the definition of 'excluded dealing', to clarify that the definition also applies to all dealings in relation to the provision of personal advice to retail clients.
- (c) We seek clarification that the definition applies to:
  - (1) issues and regulated sales to retail clients pursuant to personal advice; and
  - (2) arranging by another distributor (such as a platform operator) for a retail client who has received personal advice in relation to buying a product from a third party adviser. As you would appreciate, a large proportion of retail financial products are held via platforms where advice is provided by a third party entity, not an associate of the platform provider. Similarly, dealer groups and financial advisory intermediaries are a common channel of distribution for financial products directly to retail clients.
- (d) In relation to the first requested amendment, we understand that the regulatory intention is that, where consumers already receive significant protection through the regulation of personal advice, certain of the DDO restrictions in relation to undertaking retail product distribution conduct will not apply in relation to 'excluded conduct' (sections 994C(3)-(7), 994D(d), 994E(1) and 994E(3)).
  - (1) The definitions of 'retail product distribution conduct' and 'regulated person' are wide and capture both:

- (A) issues of products and regulated sales of products under section 994A; and
  - (B) issuers and sellers of products under sections 1011B(a) and (b).
- (2) Unless issues and regulated sales of products to retail clients pursuant to personal advice are expressly included in the definition of 'excluded dealing', they will be regulated as 'retail product distribution conduct' and will not be subject to the 'excluded conduct' exemptions in sections 994C(3)-(7), 994D(d), 994E(1) and 994E(3).
- (3) Under the current definition of 'excluded dealing', by contrast, a person 'arranging' for an issue or a regulated sale of a product to a retail client pursuant to personal advice is expressly subject to the 'excluded conduct' exemptions in sections 994C(3)-(7), 994D(d), 994E(1) and 994E(3).
- (4) We assume that this divergence in approach is an unintended consequence of the definition of 'excluded dealing' because there appears to be no policy reason to exempt 'arranging' dealings (but not the dealings themselves) in a personal advice scenario, given that the significant protection afforded through the regulation of personal advice applies to 'arranging' dealings and to the dealings themselves.
- (e) In relation to the second requested amendment, consider, for example, a situation where:
  - (1) a retail client pays a fee to a licensed financial adviser to provide them with financial product advice, including personal advice;
  - (2) as part of the personal advice, the licensed financial adviser recommends that a proposed portfolio of investments (e.g. certain recommended managed funds, SMAs and listed securities) are accessed via a platform and then held in custody on that platform so that the client will receive ongoing administration and reporting services in relation to the investments on the platform;
  - (3) the licensed financial adviser would then arrange for the investments (the subject of the personal advice) to be acquired by the platform operator and accessed via the platform; and
  - (4) this process would be repeated each time that further personal advice is received by the client, and the licensed financial adviser, as a result, arranges for additional investments to be acquired by the platform operator and accessed via the platform.
- (f) In this example all the dealings undertaken by the platform operator in order to give effect to the personal advice should,

we submit, be regarded as 'excluded dealings' but under the current definition they would not be.

- (g) Consequently, please consider the following suggested (marked up) amendments to the definition:

**'excluded dealing'** means a dealing in a financial product that consists of an issue or regulated sale of a product to a retail client or arranging for a retail client to apply for or acquire the product, where the issue, regulated sale or arranging is undertaken:

(a) by a person, or by an associate of a person or by another regulated person; and

(b) for the sole purpose of implementing personal advice that the person or another regulated person has given to the retail client.

## 2.5 Reasonable steps

- (a) The reformulated section 994E(3) places distribution obligations on regulated persons subject to an exception for excluded conduct which, as the Treasury's Information Note explained, is designed to clarify that personal advisers do not have design or distribution obligations, except with respect to record-keeping.
- (b) While we understand and support the approach to exclude 'excluded conduct' from certain DDO obligations, uncertainty remains under the Bill for regulated persons in relation to the extent to which reasonable steps must be undertaken, particularly when they are aware of the acquisition of a financial product by a person who has received personal advice.
- (c) This uncertainty is not fully addressed by the new section 994E(4) because that provision only deals with circumstances where a client acquires a product where they are not in the target market.
- (d) We submit that, for a range of regulated persons, if, after making reasonable inquiries, they are aware that a client has received personal advice, this should provide sufficient consumer protection and not warrant any further steps to be taken.
- (e) This will be particularly relevant for platform operators, who:
- (1) distribute a wide choice of products to a wide range of clients who are often advised by other, third party, regulated persons and whose personal circumstances, situation and needs are not known to the platform operator; and
  - (2) have limited opportunity to adapt reasonable steps in respect of each product on a given menu.
- (f) Providing for a limited extension to the new section 994E(4) would also deliver the benefit of avoiding unnecessary duplication (and so inefficiency and wasted costs) in

regulatory obligations as between regulated persons and personal advice providers.

- (g) For these reasons we submit that the following (marked up) amendments should be made to section 994E(4):

"994(E)(4) A regulated person is not taken to have failed to take reasonable steps for the purpose of paragraph (3)(~~de~~):

(a) merely because a retail client who is not in the target market for the product acquires the product; or

(b) if the regulated person made all inquiries (if any) that were reasonable in the circumstances and believed on reasonable grounds that the acquisition of the relevant financial product was made in reliance on the provision of personal advice by another regulated person.

- (h) Some practical illustrations of the utility of this amendment are:

- (1) where a platform operator relies on representations or certifications from an authorised financial adviser that an on-platform investment by their client is being undertaken on the basis of personal advice provided to the client;
- (2) that platform operators would not be deterred from accepting applications for products from an advised client due to concerns as to what further reasonable steps would need to be taken by the platform operator as distributor in relation to its DDO obligations in relation to the retail product distribution conduct by a third party regulated person; and
- (3) where there is no relationship between the issuer of the product and the regulated person advising the end client in relation to a range of products on a platform menu, the issuer's attempts to regulate the retail product distribution conduct would be ineffective and inefficient.

## **2.6 Target market determination**

- (a) The Bill and EM have proposed more extensive content requirements for the TMD than in the earlier exposure draft. It is proposed now that issuers need to include the following in the TMD:

- (1) events and circumstances that would reasonably suggest the determination is no longer appropriate (review triggers);
- (2) maximum review periods (review periods);

- (3) reporting periods for when complaints about the product should be provided from the distributor to the issuer; and
  - (4) the kinds of information needed to promptly determine that a determination may no longer be appropriate, along with:
    - (A) which distributors should provide those kinds of information; and
    - (B) reporting periods for when that information should be provided by the distributors to the issuer.
- (b) Our members understand the policy requiring the determination of these additional matters when making the TMD but would like to ask Treasury to revisit whether all of these items of information must be included in the TMD.
- (c) Our members are concerned that including a large amount of information in a TMD would:
  - (1) reduce its effectiveness, by making it harder for consumers to digest and work through additional information;
  - (2) where the TMD is included in a PDS or prospectus, make it harder to satisfy the 'clear, concise and effective' test for those documents; and
  - (3) increase the administrative burden and costs of updating the TMD (and updating any PDS or prospectus it is contained in).
- (d) We suggest that the regulatory policy could be achieved by requiring these matters to be:
  - (1) determined when making the TMD;
  - (2) recorded in writing and subject to record keeping obligations; and
  - (3) made available on request,while allowing issuers the flexibility to:
  - (4) include this information in their TMD if they wish; or
  - (5) not include this information in their TMD, in order to keep the TMD brief and easier for consumers to understand.
- (e) For example, a popular type of financial product for Australian retail clients is a separately managed account (**SMA**) which is structured as a registered scheme and offered under a PDS.
  - (1) A typical SMA might offer as many as 50 model portfolios and its PDS would include information in relation to all the model portfolios offered.
  - (2) A TMD will not be suitable for all model portfolios in a SMA and we would expect that the SMA may have different TMDs for different model portfolios (or groups of model portfolios).

- (3) If the SMA PDS were to include all the applicable TMD information (as proposed) in relation to all these model portfolios that would significantly increase the content of the PDS (by a substantial number of pages) and make it harder for consumers to find the relevant information and for the PDS to satisfy the 'clear, concise and effective' test.
- (4) Allowing some flexibility to limit the TMD information that needs to be provided to retail clients would facilitate more effective disclosure.

## **2.7 Industry templates and participation**

- (a) The FSC considers that it is important for the proper and efficient operation of the DDO that industry participants should use broadly consistent terminology and categories when making and applying TMDs.
- (b) If industry is able to implement the DDO reforms with a degree of consistency, that would promote operational certainty and efficiency which will ultimately facilitate better consumer outcomes and comparability. Our members consider that having standardised industry templates for the movement of data will be key to a successful adoption of the DDO.
- (c) We request that you take into account potential competition law issues with a view to facilitating the FSC being able to:
  - (1) provide TMD framework and category suggestions and information flow templates to Treasury, or ASIC, or both of them, and to work with them to develop practical and useful guidance and templates for industry; and
  - (2) create a working group to commence the proposed information flow templates and target market criteria templates.

## **2.8 DDO stop orders**

- (a) ASIC can issue a stop order if ASIC is satisfied that a provision of Division 2, or section 994E, has been contravened in relation to a financial product.
- (b) Given the serious consequences of a stop order, we request that section 994J(6) is extended to give the person who made or was required to make the TMD:
  - (1) a draft of the order, a reasonable period before, and not less than two business days before it is finalised and served on them under section 994J(6); and
  - (2) an opportunity to correct any misunderstanding in relation to the draft order. This approach would give affected parties an opportunity to identify any errors or unintended consequences of the order.

## **2.9 Employer-sponsors**

- (a) In our submission in February 2018, we noted that the scope of the DDO caught employers who provide superannuation information to their employees.
  - (1) Employers nominate employees to join their default superannuation plan and product issuers are then required to provide disclosure documents (e.g. the PDS) to those employees with a welcome letter when they join the plan. Such employers are mere conduits of information related to the employees' superannuation (in some cases, providing disclosure documents).
  - (2) The definition of regulated person in s994A is wide, including the definition of regulated person in s1011B, and so extends to employer-sponsors arranging for the issue of a superannuation product to employees.<sup>2</sup>
- (b) As Treasury did not take on our suggestion to amend the definition of regulated person to exclude employer-sponsors by excluding the persons described in Corporations Regulation 7.6.01(1)(hc), we assume that, as a matter of policy, Treasury intends that employer-sponsors are subject to the DDO.
- (c) If our assumption is correct, we request that the EM specifically notes this policy intention, to put all employer-sponsors on notice that they will be subject to DDO obligations in connection with giving effect to the superannuation benefits provided to employees as an incident of the employment relationship.
- (d) While there is a degree of awareness of the DDO in the financial services sector, not all employer-sponsors in the financial services sector will be aware that the DDO applies to them in this way and we anticipate that employer-sponsors in other sectors will generally be unaware that they need to comply with the DDO and will not be preparing for it.

## **2.10 Record keeping obligations**

- (a) We understand the policy driver for additional record keeping obligations under the DDO regime but query whether these obligations could be made more scalable and standardised, so that record keeping is more efficient.
- (b) We request that consideration is given to standardising reporting timeframes (which are currently proposed to be set by issuers on a case by case basis, which does not allow economies of scale or reporting synergies across the industry).
- (c) We would welcome a more standardised approach to reporting timeframes which we consider would deliver greater

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<sup>2</sup> Employer-sponsors fall within para (f)(ii) of the definition of regulated person in s1011B by virtue of their Australian financial service licence exemption under s911A(2)(k) and Corporations Regulation 7.6.01(1)(hc).

efficiencies for the industry and facilitate making DDO process and system changes.

### 3 Product intervention power (**PIP**)

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#### 3.1 Implementation timing

- (a) It is proposed that the PIP will apply to services and products specified in regulations under section 764A(3) which are not otherwise caught in the definition of financial product.
- (b) Issuers of products which are not currently identified in the Bill or EM as being subject to the PIP, but which in the future will be subject to the PIP by regulation, will need a reasonable amount of time to prepare for the impact on them of this legislative change.
- (c) We understand that there will be public consultation (including regulatory impact analysis and a reasonable period of consultation, consistent with the Government's regulatory policy framework which is available at <https://www.pmc.gov.au/regulation>) in relation to any new regulations to bring new categories of services and products under the PIP. If our understanding is not correct, we request that the EM records that there will be a reasonable period of consultation in relation to any such new regulations.

#### 3.2 Consultation

- (a) Our members continue to be of the view that an opportunity for private consultation, and a reasonable minimum period of consultation, in relation to the use of the PIP is essential to provide due process and procedural fairness and for the consultation to be meaningful and effective.
- (b) We request that a new section 1023F(5) is added to the Bill to require ASIC to not make a product intervention order until ASIC has undertaken a reasonable minimum period of consultation (of at least 5 business days) with the affected persons.
  - (1) An issuer's reputation could be seriously damaged, in circumstances where the consumer detriment might have been dealt with by a voluntary modification of the offering or distribution following a minimum period of consultation.
  - (2) We ask that this amendment is not made to section 1023F(1) because section 1023F(4) provides that a failure to comply with section 1023F(1) does not invalidate the order.
- (c) We remain concerned that the absence of a right to consult privately, creates a risk that:
  - (1) unnecessary reputational damage may arise and that innovation may be stifled;



- (2) publication of a proposed intervention order could cause concerned consumers to seek to exit the investment immediately, crystallising a loss which would otherwise not arise; and
- (3) consumer detriment may be exacerbated where:
  - (A) the investment itself falls in value simply as a result of an order being made public; and
  - (B) a large number of sales or exits result from the publicity which in turn creates a reduction in the market value of the product.
- (d) An opportunity to consider ASIC's concerns in private and volunteer to modify or withdraw the product, or potentially demonstrate why the order should not be made is potentially beneficial to investors, ASIC and product issuers and distributors alike, with the potential to deliver the regulatory outcome that ASIC is seeking in a more time and cost efficient manner, without adversely affecting consumer protection.
- (e) A minimum period of private consultation would deliver a fair outcome to an issuer who has invested substantial resources in designing and launching the product and, in attaching their brand to it, would suffer the greatest loss from an intervention.

## 4 Submissions common to the DDO and PIP

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### 4.1 Additional guidance

- (a) Consistent with the FSI report, the DDO and PIP take a principles-based (less prescriptive) approach. Industry understands this approach, but it inevitably results in reduced regulatory certainty and potential ambiguity.
- (b) Our members are concerned that reduced regulatory certainty and potential ambiguity may lead to wasted costs, inefficiencies in the design and distribution of products, inability for consumers to compare products effectively, a stifling of innovation or a reduction in the investment in and growth in the financial services industry in Australia.
- (c) In order to deliver more certainty to industry, to help industry prepare for these reforms and implement them in an efficient and broadly consistent manner, we request that:
  - (1) paragraphs 1.74 and 1.75 in the EM are expanded to provide more information and some examples in relation to 'significant dealings'. It will be important to have clarity in relation to what are and are not significant dealings in order to be able to notify ASIC of any significant dealings in a product that are not consistent with the product's TMD. A few examples in the EM of what are, and what are not, significant dealings for this purpose would be very helpful;

- (2) paragraphs 1.54 to 1.55 in the EM are expanded to provide more detail on what may be, or may not be, regarded as 'relevant matters' to be taken into account for the purposes of determining reasonable steps under section 994E(5) under the 'risk management approach'.
    - (A) Ideally these examples would illustrate what may be relevant steps for a platform operator to take in practice, recognising that a platform operator will generally not know the end investor (who will usually be advised by another regulated person).
    - (B) On a commercial and pragmatic level, we submit that costs are not an unreasonable factor to be considered as one of the relevant matters for the purpose of determining what are reasonable steps;
  - (3) paragraphs 1.88 to 1.92 in the EM and section 994E(5) are expanded to provide some examples of what may, or may not, be regarded as 'reasonable steps' under section 994E; and
  - (4) paragraphs 2.31 to 2.35 in the EM and section 1023E are expanded to provide more information and some more examples in relation to what 'significant' means in relation to detriment for the purposes of the PIP.
    - (A) Again, some examples of what is, and is not, significant for this purpose would be very helpful.
    - (B) As we noted in our February 2018 submission, we request that the EM expressly specifies (possibly by including an example) that a fall in the value of the product as a result of market movements is not a matter that constitutes a 'significant detriment' for this purpose.
- (d) We request that this clarification and guidance is included in the EM and is not left to ASIC policy. When interpreting and applying a statutory provision, a court may have regard to information in the EM, which is intended to provide an explanation of the legislature's intent. A court is more likely to have regard to the EM than ASIC policy (which is a statement of ASIC's interpretation of the law and how ASIC will administer it).
- (e) If Treasury is not minded to provide this guidance in the EM then we request that ASIC provides guidance in the new regulatory guides, although for the statutory interpretation reason noted above, our preference would be for additional explanation to be included in the EM.

## 4.2 Litigation risk

- (a) The proposed section 994M provides investors with a right to recover loss or damage because of a failure of an issuer or distributor to take the reasonable steps required under the DDO and proposed section 1023Q provides investors with a right to recover loss or damage because of a contravention of a product intervention order in each case "whether or not":
  - (1) a person has been convicted in relation to the contravention;
  - (2) a court has declared a contravention of a civil penalty provision under section 1317E; or
  - (3) a court has ordered a person to pay a pecuniary penalty under section 1317G.
- (b) We continue to be concerned that these provisions could:
  - (1) allow investors to seek compensation for a downturn in investment markets, or for losses resulting from risks which were clearly disclosed to them and which they willingly undertook in order to seek a higher return on investments;
  - (2) lead to a proliferation of class actions, initiated by litigation funders and without the involvement of ASIC; and
  - (3) lead to a reduction in the viability and solvency of issuers and distributors of financial products, which could adversely affect the stability of the financial system and deter financial services providers from entering the market or continuing to provide products and services to Australian investors.
- (c) We understand that the laws of the United Kingdom and the United States include equivalent provisions. On one view, Australia's existing civil liability regime for financial products is already more onerous than the American or British comparators, given the absence of requirements for intent or knowledge under a wide range of statutory provisions and Australia's unique class action system.
- (d) We submit that in order to strike an appropriate balance between protecting the rights of consumers and providing issuers with reasonable certainty in relation to litigation risk and investment risk being passed back to issuers, that the section 994M and 1023Q remedies apply "if" (rather than "whether or not") so that the remedies remain, but can only be exercised with the involvement of ASIC or a pre-existing declaration by the court:
  - (1) a person has been convicted in relation to the contravention;
  - (2) a court has declared a contravention of a civil penalty provision under section 1317E; or

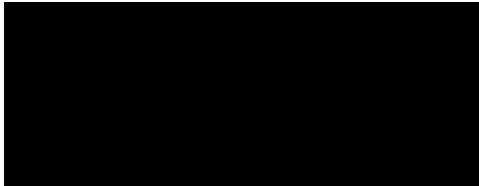
- (3) a court has ordered a person to pay a pecuniary penalty under section 1317G.

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Should you have any questions in relation to our comments, please contact us on [REDACTED]

We look forward to discussing this matter further in due course.

Yours faithfully

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**Paul Callaghan**  
**General Counsel**