SUBMISSION TO THE TREASURY:

DESIGN AND DISTRIBUTION OBLIGATIONS AND PRODUCT INTERVENTION POWER

ANZ

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PART 2: RANGE OF PRODUCTS COVERED BY THE MEASURES

1. **Do you agree with all financial products except for ordinary shares being subject to both the design and distribution obligations and the product intervention power? Are there any financial products where the existing level of consumer protections means they should be excluded from the measures (for example, default (MySuper) or mass-customised (comprehensive income products for retirement) superannuation products)?**

   Response: It would seem appropriate to exclude highly standardised products that have been designed for a broad customer base or are well understood by customers who typically buy the product. Standardised products include those that have common features through either market convention or regulatory requirements. Issuers have relatively limited discretion over the terms of these products and distributors could safely distribute them to a wide range of customers. Further, there are products that are already subject to significant consumer protections – for example, certain basic deposit products are well understood by consumers and are covered by the Financial Claims Scheme.

   There is also the issue of listed products. These are cleared through the relevant market operator's listing rules and are thus approved for broad distribution to not only the primary issuance market but also the broad secondary market which is open to all investors. Investors with limited primary market access (due to the obligations) would still be able to purchase the products on the secondary market. Changing this would require a significant readjustment of Australia's trading markets.

   It may be useful if products could be exempted from the design and distribution obligations and the product intervention power through regulation. This would allow products to be carved out iteratively if Government or ASIC were to introduce measures that make the obligation and power unnecessary. As an initial step, we would suggest that 'basic banking products' as defined in section 961F and MySuper products would be appropriate for exclusion.

2. **Do you agree with the design and distribution obligations and the product intervention power only applying to products made available to retail clients? If not, please explain why with relevant examples.**

   Response: Yes, this is a suitable delimitation on the obligations and the power. It should also be clear that the obligations and the power do not apply to products made available to sophisticated clients. By definition, these clients are more capable of discerning the utility of a product for their needs.

   There is the issue of products that are distributed to retail clients and sophisticated/wholesale clients. In these cases, it should be made clear that the obligations and the power only apply to the products to the extent that they are made available to retail clients.

   Further, we note below in response to question 17 that there should be a mechanism of excluding investors from the obligations who, while not otherwise sophisticated investors, certify that they understand the product and its risks and are thus suitable to purchase it.

3. **Do you agree that regulated credit products should be subject to the product intervention power but not the design and distribution obligations? If not, please explain why with relevant examples.**

   Response: Yes, the responsible lending obligations coupled with in-train work on credit cards are adequate measures concerning credit products.

4. **Do you consider the product intervention power should be broader than regulated credit products? For example, 'credit facilities' covered by the unconscionable conduct provisions in the ASIC Act. If so, please explain why with relevant examples.**

   Response: The scope of the power is ultimately a matter for Government. However, we note that loans to small business are being addressed through both the *Small Business Loans Inquiry* conducted by the Australian Small Business and Family Enterprise Ombudsman and through revisions to the *Code of Banking Practice*.

PART 3: DESIGN AND DISTRIBUTION OBLIGATIONS

5. **Do you agree with defining issuers as the entity that is responsible for the obligations owed under the terms of the facility that is the product? If not, please explain why with relevant examples. Are there any entities that you consider should be excluded from the definition of issuer?**

   Response: Yes, we agree with defining 'issuer' for the purposes of the obligation as those entities captured by section 761E(4) of the *Corporations Act 2001* (Cth).

   We note that consideration may need to be given to providing a carve-out from the obligation for retail clients deemed to be issuers of derivatives under section 761E(5) of the *Corporations Act 2001* (Cth).

6. **Do you agree with defining distributors as entity that arranges for the issue of a product or that:**

   (i) **Advertise a product, publish a statement that is reasonable likely to induce people as retail clients to acquire the product or make available a product disclosure document for a product; and**

   (ii) **receive a benefit from the issuer of the product for engaging in the conduct referred to in (i) or for the issue of the product arising from that conduct (if the entity is not the issuer).**

   Response: The second limb of the proposed definition of 'distributor' appears quite broad.

   Although we note the commentary in the consultation paper that media companies would be excluded, the definition would capture entities that merely advertise financial products at the direction of others and which have no true involvement in questions of whether the audience is suitable for a particular financial product. For example, on the basis that such firms are not media companies, the definition could capture entities which offer advertising as part of a social media or internet search function.

   Such entities are not resellers of a product in that they do not control or directly influence whether a particular individual concludes a contract concerning the financial product with the issuer of the product. We note that the examples given in the consultation paper all concern situations where the distributor is actually selling the product, rather than merely advertising it.

   We also note that the definition could capture comparison services that receive a benefit for including a product in a list of compared products. If such services were 'distributors', then they could have issues complying with the distribution requirements of multiple issuers. This should be recognised in the form of the obligation.

We note below that the broader the definition of distributor is made, then the harder it will be for such entities to comply with the obligations intended for distributors. For example, an advertiser of a product is unlikely to be able to monitor who purchases a product. Similarly, entities like referrers merely suggest that customers speak with a product issuer (or arranger); they would have no information on whether such customers actually conclude a contract with the issuer. It will also be difficult for issuers to assess and monitor distributor controls where the issuer has no contractual relationship with the distributor.

7. **Are there any situations where an entity (other than the issuer) should be included in the definition of distributor if it engages in the conduct in limb (i) but does not receive a benefit from the issuer?**

   Response: If an entity does not receive a benefit from the issuer, then it will likely not have a contractual relationship with the issuer. In such case, it may be difficult for the issuer to be aware of the activities of the entity. This would mean that they would be unlikely to be able to refer to the entity to obtain information concerning their distribution activities. As such, there may be little utility in defining 'distributor' so broadly.

8. **Do you agree with excluding personal financial product advisers from the obligations placed on distributors? If not, please explain why with relevant examples. Are there any other entities that you consider should be excluded from the definition of distributor?**

   Response: Yes, this seems reasonable given the existing obligations placed on those who offer personal financial advice. We note that, in question 19, there is a proposal to effectively bring advisors back within the scope of the distribution obligation.

9. **Do you agree with the obligations applying to both licensed and unlicensed product issuers and distributors? If they do apply to unlicensed issuers and distributors, are there any unlicensed entities that should be excluded from the obligations (for example, entities covered by the regulatory sandbox exemption)? Who should be empowered to grant exemptions and in what circumstances?**

   Response: We do not have a view on this issue.

10. **Do you agree with the proposal that issuers should identify appropriate target and non-target markets for their products? What factors should issuers have regard to when determining target markets?**

    Response: Yes, this is appropriate for products subject to the obligation. We already identify target markets for products.

    The factors that would be appropriate for consideration should be those relevant to whether a product is suitable for class of purchasers/investors.

    These could include the class':

    - Financial objectives
    - Financial position
    - Level of financial literacy or experience
    - Risk appetite
    - For investment products, ability to bear losses

- Degree to which the financial service provided by the product is already provided by another financial product that the class holds or benefits from.

The key challenge with specifying these factors is that they should be identified at a level sufficiently granular to allow matching of product with appropriate class of investor/consumer but not so specific that identification of target market becomes equivalent to the steps involved in providing personal advice. Thus, there should be a clear distinction between class-appropriateness and individual-appropriateness.

For example, we note that the consultation paper states that identifying how a product fits into a broader portfolio could be relevant. It will be important that there is clarity within the legislated obligation on how detailed such processes should be. The appropriateness of a portfolio can vary with the investor's individual investment profile. If issuers need to specify with precision that profile, then identifying the target market could become akin to identifying appropriate individuals rather than appropriate classes of investors.

Consideration will also need to be given as to how individuals can be made aware that simply because they fall within a target market does not mean that the financial product is uniquely appropriate for them.

We also note that it is proposed that issuers should undertake testing to assess the ability of the target market to understand the key features of the product. The degree of testing that issuers need to perform should be carefully considered. Understanding the financial literacy and comprehensive capacity of large classes of the population is easier than understanding how very specific target markets will respond to disclosure material. Further, sound extrapolation of results concerning one target market to a similar target market may be appropriate.

To help provide clarity to the market on the steps that should be taken, it may be useful to set out a qualitative standard in the legislation that clarifies the extent of the obligation. For example, the legislation could, like section 961B of the *Corporations Act 2001* (Cth) concerning the best interests duty for financial advice, specify the steps that issuers could perform in order to demonstrate that they have identified the target market.

In addition, because the obligation to identify a target market could be a relatively open-ended exercise, the legislation could specify that issuers must attempt to identify target markets in good faith, or on a best endeavours basis.

Without such clarity, it may be possible for counterfactual arguments to be easily mounted that different steps could have been taken to arrive at different target markets. While it is important that regulators have the ability to opine on appropriate steps, regulated entities will need certainty in advance of what is expected of them and not have to defend against a standard imposed or contended on a post facto basis.

11. **For insurance products, do you agree the factors requiring consumers in the target market to benefit from the significant features of the product? What do you think are significant features for different product types (for example, general insurance versus life insurance)?**

    Response: Yes, these seem appropriate.

12. **Do you agree with the proposal that issuers should select distribution channels and marketing approaches for the product that are appropriate for the identified target market? If not, please explain why with relevant examples.**

Response: Yes, this seems appropriate. As noted above, if issuers have this obligation, then it may be worth exploring how much utility there is in subjecting advertisers and similar entities acting as ciphers for the issuer to the obligations.

13. **Do you agree that issuers must have regard to the customers a distribution channel will reach, the risks associated with a distribution channel, steps to mitigate those risks and the complexity of the product when determining an appropriate target market? Are there any other factors that issuers should have regard to when determining appropriate distribution channels and market approach?**

    Response: It would seem appropriate that issuers select distribution channels that are well adapted to ensuring the issuer's products reach the appropriate target market. Consideration of a distribution channel should include its reach and the controls it employs to ensure products are offered and sold to the appropriate customers.

    The question's reference to determining an appropriate target market based on the attributes of the distribution channel seems to offer the analytical steps in the inverse order. We would suggest that issuers would:

    - Identify a target market based on perceived need for or benefit from a financial product or service;
    - Design the product or service to fulfil that need, taking into account the market's other attributes, as discussed above in response to question 10; and
    - Select a distribution channel that aligns with that market.

    As noted in response to question 10, it may be useful to provide legislative clarity on the steps that issuers need to take to satisfy this element of the obligation. It will be important that issuers who carefully approach channel selection are not exposed to regulatory or civil action in the case that consumers outside the target market merely happen to receive advertising messages.

    For example, it would be worthwhile specifying that if issuers take reasonable steps (that are set out in legislation) to select appropriate distribution channels, then their obligations in respect of the distribution of the product are satisfied. Well-regulated and well-managed distributors should be able to adequately ensure the appropriate distribution of products without further oversight from or responsibility on issuers.

14. **Do you agree with the proposal that issuers must periodically review their products to ensure the identified target market and distribution channel continues to be appropriate and advise ASIC if the review identifies that a distributor is selling the product outside of the intended target market?**

    Response: Yes, it is appropriate that issuers should be periodically reviewing their products to ensure the target market and distribution channel remain appropriate.

    However, whether it is appropriate that issuers (or, indeed, distributors) should identify if any individual is outside the target market is a separate question. Reaching such a conclusion would involve considering the individual's personal circumstances: this may involve steps that are analogous to providing personal advice.

    We would also ask whether it is necessary for issuers to report to ASIC if distributors are selling products outside of the intended market. This seems to be introducing a new form of breach

reporting framework. We would suggest that the existing framework (recognising that it may be amended by Government due to the current review) is appropriate to provide ASIC with intelligence as to potential consumer harm arising from breaches of the law.

15. **In relation to all the proposed issuer obligations, what level of detail should be prescribed in legislation versus being specified in ASIC guidance?**

    Response: The obligations will be new to Australia's regulatory framework. Legislative certainty concerning the limits of the obligations will help issuers and relevant distributors to design their controls with confidence. This will be particularly important concerning which products are caught, who is considered a distributor and any limits on the obligations (see our responses to questions 10, 13 and 16).

    Allowing ASIC to use a legislative frame to fill in some detail through guidance would allow the flexible development of standards.

16. **Do you agree with the proposal that distributors must put in place reasonable controls to ensure that products are distributed in accordance with the issuer's expectations?**

    Response: It is important that distributors be able to distribute products to the target market identified by the issuer.

    When considering what controls would be reasonable, these should align with the steps that distributors are commercially expected to, or typically, perform. For example, distributors rarely prepare disclosure material (this is often performed by issuers) so it is perhaps unreasonable to expect them to exercise control over such material. That said, where distributors prepare material that is based on, or summarises, the issuer's disclosure, the distributor would be expected to have controls in place to ensure that it complies with the issuer's and its own disclosure obligations.

    Equally, as we noted above in response to question 10, well-regulated and well-managed distributors should be able to identify members of the class of investors for whom the product is appropriate. Issuers rely on distributors to appropriately sell their products.

    Further, we note that several of the proposed controls listed on page 24 would involve testing. For example, it is suggested that disclosure needs to be tested, as could how choices are presented to consumers. These supplement testing concerning the proposed scenario analysis of product performance and comprehension capacity of target markets.

    This again raises the question of how much and what type of testing is adequate. How would issuers or distributors be able to recognise that they have performed sufficient testing? Is the requirement to simply do testing of the disclosure or choice framing, or to iteratively test and adapt disclosure and choice frames to an optimal point? If the latter, how will issuers/distributors know when they have reached that point?

    If there is no clarity in the regulatory framework concerning these points, the requirement to understand the attributes of target markets, perform scenario analysis concerning products or empirically test disclosure could easily lead to counterfactual claims there is, for example, a more optimal form of disclosure or yet more permutations of scenario analysis. Empirical inquiries concerning attributes of target market, the anticipated performance of a product or the effectiveness of disclosure could be boundless.

As noted above in response to questions 10 and 13, to provide certainty concerning these obligations, it may be useful if the legislation provided that if distributors completed a set of steps, then they would be deemed to have satisfied their obligation. Similarly, recognising that it is sufficient if distributors impose those controls identified by them in good faith would help provide certainty concerning the obligations.

It will also be important to clarify how the testing requirements interact with the disclosure standards in sections 710/711 (concerning prospectuses) and 1013C/1013D (concerning product disclosure statements). These sections (and related guidance) set out formal tests for the content of disclosure. Introducing a requirement that disclosure be empirically tested for effectiveness will introduce a parallel set of more malleable and less certain content requirements. The interaction of the formal requirements in sections 710/711/1013C/1013D and the empirical requirements contemplated by the controls required by the obligations will need careful consideration.

17. **To what extent should consumer be able to access a product outside of the identified target market?**

Response: The target market is the issuer's *ex ante* estimation of who may understand and benefit from a product. Issuers may, however, in good faith misidentify the appropriate target market or fail to understand the circumstances of a class of consumers. Further, mandating that only consumers within the target market are able to purchase the product seems to be imposing a strict standard that goes beyond the apparent general intent of the obligation that, as stated on page 18 of the consultation, '…issuers should *seek* to match products with target markets…' (emphasis added).

If consumers who are outside of the target market decide for themselves that they may benefit from a product, then it would seem reasonable that there be a mechanism available for them to access the product. Thus, there could be a legislatively established path for consumers who are not otherwise sophisticated investors to be able to certify to issuers (or distributors) that they understand the product and its risks and are thus suitable to purchase it (without being provided with advice). This would allow consumers to opt into the benefits and risks of the product even if they are outside the target market.

18. **What protections should there be for consumers who are aware they are outside the target market but choose to access a product regardless?**

Response: These types of consumers should have recourse to the existing protections in Chapter 7 of the *Corporations Act 2001* (Cth) and in the *Australian Securities and Investments Commission Act* (Cth).

However, it would be reasonable that they be unable to take action against issuers and distributors in connection with the design and distribution obligations. This is because they would be accessing, at their own discretion, the products outside the controls implemented under those obligations.

19. **Do you agree with the proposal that distributors must comply with reasonable requests from the issuer related to the product review and put in place procedures to monitor the performance of products to support the review? Should an equivalent obligation also be imposed on advised distributors?**

    Response: It would seem reasonable that distributors which are closely involved in the sale of products be able to respond to requests from issuers concerning to whom the distributor is selling the product.

    However, as discussed above, the appropriateness of this proposal rests on which entities are defined as 'distributors'. If there is a broad definition, which captures advertisers for example, then it is questionable how much information they would have on the product, particularly 'the performance of products'.

    Indeed, it is difficult to imagine that any distributors would have better information than the issuer concerning the performance of the product. The issuer is the entity responsible for meeting and enforcing obligations under the product. They would have a close commercial interest in how the product is performing.

    At best, distributors would have records concerning to whom they have sold or recommended the product. This information concerns the performance of the distribution channel (not the product itself).

    With respect to whether an equivalent obligation should also be imposed on distributors which are advisors, this would seem to run contrary to the proposed scope of the obligation which excludes products distributed through advised channels.

20. **In relation to all the proposed distributor obligations, what level of detail should be prescribed in legislation versus being specified in ASIC guidance?**

    Response: Please see our response to question 15.

21. **Do you agree with the obligations applying 6 months after the reforms receive Royal Assent for products that have not previously been made available to consumers? If not, please explain why with relevant examples.**

    Response: It will be important that industry is given sufficient time to implement the obligations appropriately. Some of the controls contemplated involved significant and complex work; for example, leveraging data sets and performing empirical testing are operationally complex and will need careful consideration to ensure well-calibrated results.

    It may be more appropriate to consider sufficient implementation lead-times when there is clarity over the nature and extent of the obligations. At a minimum, we would request that Government allow a 12-month implementation lead-time for new products.

22. **Do you agree with the obligations applying to existing products in the market 2 years after the reforms receive Royal Assent? If not, please explain why with relevant examples and indicate what you consider to be a more appropriate transition period.**

    Response: Subject to the comments in response to the prior question, this seems reasonable.

PART 4: PRODUCT INTERVENTION POWER

23. **Do you agree that ASIC should be able to make interventions in relation to the product (or product feature), the types of consumers that can access a product or the circumstances in which a consumer can access the product If not, please explain why with relevant examples.**

    Response: Subject to our comments in response to question 1 concerning the products covered by the power, we support measures which allow ASIC to be a stronger regulator within the context of a well-functioning market for financial services.

24. **Are there any other types of interventions ASIC should be able to make (for example, remuneration)?**

    Response: We believe the proposed types of interventions are appropriate. There are reforms already underway concerning remuneration – see the Sedgwick Review commissioned by the Australian Bankers' Association.[1]

    It may also be useful to clarify that the interventions will not extent to matters concerning prices. While pricing is an important consumer matter, we note that there are significant initiatives concerning competition within financial services in-train or under contemplation (see recommendation 30 of the *Financial System Inquiry* and recommendation 3 of the *Review of the Four Major Banks: First Report*).

25. **Do you agree that the extent of a consumer detriment being determined by reference to the scale of the detriment in the market, the potential scale of the detriment to individual consumers and the class of consumers impacted? Are there any other factors that should be taken into consideration?**

    Response: These seem appropriate factors.

    We would suggest that the identified harm needs to be not merely hypothetical. Its existence or likelihood should be able to be substantiated and the chance of harm should not be merely remote.

    Like all regulatory measures, it may be also useful to consider the net economic benefit that would be expected to arise out of the use of the power. Cost-benefit analysis could take into account, for example, the potential of temporarily banning a product on the investment opportunities of other consumers or the functioning of other elements of the financial system, such as the availability of finance. Such analysis would help target the form of the intervention: for example, rather than banning a product outright, perhaps it may be more appropriate to restrict it to particular markets.

26. **Do you agree with ASIC being required to undertake consultation and consider the use of alternative powers before making an intervention? Are there any other steps that should be incorporated?**

    Response: Yes, the intervention power is a strong measure and the need for its use should be carefully established, including through robust evidence, prior to exercise.

    It will be important that affected parties have an opportunity to comment on the evidence and analysis that ASIC offers in support of the use of the power.

[1] http://www.bankers.asn.au/media/media-releases/media-release-2016/review-into-retail-banking-remuneration-begins

In particular, the exercise of the power could theoretically raise issues that are relevant for other regulatory objectives. For example, banks issue debt and hybrid instruments on terms prescribed by the Australian Prudential Regulatory Authority (**APRA**) to raise regulatory capital. While this is a matter for APRA, we would suggest that it will be important that any exercise of the power be carefully calibrated with APRA's objectives. If the intervention power were to attempt to shape the issuance of hybrid instruments, this could have an impact on the ability of banks to raise regulatory capital.

In this sense, we note section 915I of the *Corporations Act 2001* (Cth) which either requires ASIC to consult with APRA before taking licensing action against an APRA-regulated entity or, if the entity is an ADI, vests the ability to take action in the Minister. This schema recognises that a regulatory power vested in one agency could impact the regulatory objectives of another. There may be merit in similarly conditioning the use of the intervention power by ASIC when it could be relevant to the regulatory objectives of APRA (or other relevant agency).

27. **Do you agree with ASIC being required to publish information on intervention, the consumer detriment and its consideration of alternative powers? Is there any other information that should be made available?**

    Response: Yes, this seems reasonable. It would also be helpful that ASIC publish the analytical underpinnings of the use of the power.

28. **Do you agree with interventions applying for an initial duration of up to 18 months with no ability for extensions? Would a different time frame be more appropriate? Please explain why.**

    Response: Yes, this timeframe seems reasonable.

29. **What arrangements should apply if an ASIC intervention is subject to administrative or judicial appeal? Should an appeal extend the duration that the Government has to make an intervention permanent?**

    Response: Government should ensure it has adequate time to consider the merits of extending the intervention through its actions.

30. **What mechanism should the Government use to make interventions permanent and should be mechanism differ depending on whether it is an individual or market wide intervention? What (if any) appeal mechanisms should apply to a Government decision to make an intervention permanent?**

    Response: It would seem appropriate that market-wide interventions be implemented through regulation. This would mean that they are subject to Parliamentary review.

    An individual-specific intervention should be implemented through Ministerial order. This would allow the affected individual administrative law review rights.

31. **Are there any other mechanisms that could be implemented to provide certainty around the use of the product intervention power?**

    Response: To help industry understand when ASIC may consider use of the power appropriate, a regulatory guide that sets out these circumstances could be required by law to be published. Such a guide could act a roadmap to the employment of the power and also provide clarity to other stakeholders on various matters (eg that the power is not a pre-approval power and that

simply because an individual is able to buy a product is not conclusive evidence that the issuer considers them suitable for the product).

32. **Do you agree with the powers applying from the date of Royal Assent? If not, please explain why with relevant examples**

    Response: The design and distribution obligations and the power appear intended to operate in tandem, with the power giving the regulator recourse if an element of the industry fails to meet the obligations. It is proposed that the obligations have a staged implementation process of six months for new products and two years for existing products.

    If the power were to be available from the date of Royal Assent, it may be difficult to demonstrate that the use of the power is truly a last resort as industry has yet to be given an opportunity meet the design and distribution obligations.

    As such, it may make more sense if the power and the obligations were to have coordinated commencement dates.

PART 5: ENFORCEMENT AND CONSUMER REDRESS

33. **What enforcement arrangement should apply in relation to a breach of the design and distribution obligations or the requirements in an intervention?**

34. **What consumer rights and redress avenues should apply in relation to a breach of the design and distributions obligations or the requirements of an intervention?**

    Response: The ability of ASIC and aggrieved consumers to take action in the case of failure to meet the obligations or adhere to an intervention is clearly important.

    The main design consideration with respect to enforcement arrangement and consumer redress avenues concerns ensuring there is clarity about when an entity has met and conversely, not met, the obligations.

    A fair enforcement and consumer redress framework needs to rest on ex ante clarity about the standard that issuers and distributors need to meet. Allowing the content of the obligation to be filled in iteratively through regulatory action and case law would engender uncertainty concerning appropriate controls. See our response to questions 10, 13 and 16 in particular.

ENDS