



18 October 2018

Senate Standing Committee on Economics
Parliament House
Canberra ACT 2600

Dear Sir/Madam

Treasury Laws Amendment (Design and Distribution Obligations and Product Intervention Powers) Bill 2018

The Australian Banking Association (**ABA**) welcomes the opportunity to provide this submission to the Committee's review of the Treasury Laws Amendment (Design and Distribution Obligations and Product Intervention Power) Bill 2018.

With the active participation of member banks in Australia, the ABA provides analysis, advice and advocacy for the banking industry and contributes to the development of public policy on banking and other financial services. The ABA works with government, regulators and other stakeholders to improve public awareness and understanding of the industry's contribution to the economy and the community, to ensure Australia's banking consumers continue to benefit from a stable, competitive and accessible banking industry.

As noted in submissions on earlier drafts of this Bill, ABA members support the intent of the design and distribution obligations (DDO) to assist "consumers select appropriate financial products by requiring issuers and distributors to appropriately market and distribute financial products." In the context of complex financial products and/or products that carry investment risk, disclosure in isolation can be ineffective. We support the observation in the Financial Systems Inquiry Final Report that "these issues have contributed to consumer detriment from financial investment failures, such as Storm Financial, Opes Prime, Westpoint, agribusiness schemes and unlisted debentures."

We acknowledge efforts by the Treasury during the consultation process to address some of the matters raised in our and others' earlier submissions. The matters outlined below represent our residual concerns and suggestions.

Key points

- Requiring distributors to ask clients about their personal circumstances to determine whether they fall within a target market determination risks confusing consumers about the level of advice they are receiving, including as to whether it is 'personal advice'. The Explanatory Memorandum (EM) or at least guidance from ASIC should provide information on how the distribution obligations can be crafted and met while minimising the risk of confusing customers.
- The exemption of conduct associated with the DDO from the definition of 'personal advice' would be more effective if proposed subsection 766B(3A) were drafted in terms similar to the following:
"(3A) However, the acts of considering one or more of a person's objectives, financial situation and needs, and/or of communicating with a person about those matters for the purposes of compliance with Part 7.8A, do not constitute personal advice under subsection (3)."
- The Bill, EM, or, at least, ASIC guidance, should make clear that the scalability of the DDO means that when an issuer or distributor deals in a product by rolling it over or renewing for a customer, the DDO is satisfied where it has already been determined that a client fits within the



target market, unless the issuer or distributor has reason to believe that the client's circumstances has changed.

- The requirement to suspend the sale of a financial product 'as soon as practicable' after a trigger for a review of a target market determination has been identified, could lead businesses incurring costs unnecessarily. In our view this could be addressed by removal of the words "as soon as practicable" from the relevant subsections in section 994E, with the result that issuers would have 10 days to review the TMD before the obligation to withdraw the product from sale crystallises.
- Making contraventions of all of the provisions of the Bill criminal offences is inconsistent with longstanding Commonwealth policy on the framing of penalty provisions and should be reconsidered.
- If Regulations make basic deposit products subject to the DDO, they should exclude very simple deposit products— such as low-cost transaction accounts – that will likely be suitable for all.
- The EM refers to bringing debentures of authorised deposit-taking institutions into the scope of the DDO. It would be helpful if this were clarified to just refer to debentures issued to retail clients (rather than suggesting the DDO will apply to wholesale debentures).
- The regime should support digital consumer channels and not limit innovation – therefore early and detailed guidance be provided by ASIC on the record keeping obligations generally (and, specifically, in relation to digital channels).

Personal advice, general advice, and target market determinations

To comply with the DDO and determine whether a consumer falls within a target market, distributors will need to take steps to understand the consumer's circumstances. In taking these steps, there is a risk that consumers will come to believe that (or, at least, be confused as to whether) the supply of the financial product has been made as a result of the consideration of their individual circumstances, and is thus akin to receiving personal advice. They may believe that because they have been supplied the financial product, a conclusion has been reached that it is appropriate for their unique circumstances, rather than because their circumstances match those of the target market.

This requires consumers to be able to discern between supplies of financial product on the basis of the DDO and supplies that are based on personal advice. This point is illustrated by an example below:

A distributor's staff member completes a home loan application gathering a great deal of personal detail about the customer in order to comply with responsible lending obligations. The customer asks about insurance for the new house. This is a very common sales scenario.

Before the staff member starts the engagement process he or she delivers a general advice warning making it clear that any recommendation about insurance will not take into account any of the customer's personal circumstance, financial situation or needs.

At some point in the acquisition process, under the provisions of this Bill, the staff member would also need to comply with distribution conditions and establish whether the client fits within the target market determination set by the issuer. This may mean that the staff member must ask questions of the client about their personal circumstances, financial situation or needs or be in breach of section 994(3). However, the client may also be left believing that their personal circumstances have been taken account of for purposes other than simply determining whether they fit the relevant TMD.

To address this risk, the EM or at least ASIC guidance should provide more detailed information on how the distribution obligations can be met while minimising the risk of confusing customers. This is relevant to distributors but also to issuers who will require guidance on the distribution conditions they need to attach to target market determinations.



Exemption from personal advice provisions

Further to the preceding point, the process of taking reasonable steps to distribute a product in accordance with its target market determination, may require a distributor to 'ask a retail client for information to determine whether or not they are in a target market ... and, inform the client of the result of that determination.'[para. 1.101] The EM notes that this might otherwise constitute the giving of personal advice.

As this is clearly not an intended result, the Bill and the EM seek to make clear that that asking clients questions of their personal circumstances for the purposes of complying with the relevant obligations is not to be taken as personal advice. The proposed section in the Bill to address this is the addition of subsection 766B(3A):

"(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."

This proposed subsection would follow subsection 766B(3) which provides:

"(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."

While we acknowledge the Government's efforts to address our previous concerns about this issue, we have the following residual concerns:

- A reasonable consumer may conclude that because they are being offered a product for which a target market determination exists, the distributor must have considered their objectives, financial situation or needs.
- This would mean that the recommendation would come within paragraph 766B(3)(b).
- This would, in our view, be better addressed if subsection 766B(3A) was drafted in terms similar to the following:

"(3A) However, the acts of considering one or more of a person's objectives, financial situation and needs, and/or of communicating with a person about those matters for the purposes of compliance with Part 7.8A, do not constitute personal advice under subsection (3)."

Renewals and roll-overs

There is some doubt around the application of the DDO in respect of products which are issued through a renewal or a roll-over (such as a term deposit or insurance policy which renew automatically). If the DDO apply in full to such roll-overs or renewals, issuers and distributors will need to inquire whether the customer continues to fall into the target market upon each expiration and re-issuance of the financial product.

The potential application of the DDO regime to term deposits demonstrates the concerns we have in this regard. Currently, term deposit products can be set to roll-over at a customer's instruction, so that if there are no further instructions from the customer to do otherwise, a subsequent term will commence with the appropriate interest rate of the day applied. Under the new regime, it is unclear whether it will be necessary, upon the completion of each term, to ask the customer questions to determine whether they remain within the target market. This could lead to poor outcomes for customers. For example, what does the bank do if answers can't be obtained? The funds may revert to an account with a lower interest rate, to the detriment of the customer.



Similar concerns arise in relation to insurance policies. These can currently be renewed simply by issuing a renewal notice and payment of the premium. Will it be necessary under the new regime to ask the client questions to determine their target market status every time the policy is subject to renewal? There is a risk that an unintended consequence of this may be that policies lapse where customers are silent. As well as the obvious detriment this could have for the consumer's exposure to risk, we note that the maintenance of insurance is a condition of home loan agreements and this is important from a prudential perspective.

We ask the Committee to consider recommending that it be clarified in the Bill or EM that, to the extent that the DDO apply when products are subject to roll-over or renewal, the scalability of obligations in the regime extends to treating the DDO as being satisfied where it has already been determined that a client fits within the TMD, perhaps with the caveat of unless the distributor has reason to believe that the client's circumstances have changed.

Review of target market determinations

The Bill seeks to impose a prohibition on continued sale of a financial product after a trigger for a review of a TMD has been identified. In our view, a sensible approach to this would be to require sales of the product to cease if a review (and if necessary, reissue of a TMD) has not occurred within 10 days.

However, section 994C requires that the product must be removed from sale '*as soon as practicable*', but no later than 10 business days' after becoming aware of the review trigger.

Reading this provision, together with commentary in the EM (paragraph 1.89), it is possible that an obligation to interrupt the sale of a financial product could occur even where a review can be completed within 10 days of becoming aware of the review trigger.

Our concern with this is that in some cases it could require costly and cumbersome interruption to the sale of the product prior to completion of a review (even within 10 days) – for example requiring the deactivation of e-commerce sites, removal of PDS links, communications with distributors, retrieval of hard copy PDSs and more – only to have to unwind all that effort in the following day or two when the TMD is reviewed.

In our view this could be addressed by removal of the words "as soon as practicable" from the relevant subsections in section 994E, with the result that issuers would have 10 days to review the TMD before the obligation to withdraw the product from sale crystallises.

Penalties

The ABA supports a strong enforcement regime that provides appropriate sanctions for wrongdoing. However, we wish to make a general point around the policy behind the proposed penalties outlined in the Bill.

The application of criminal offence provisions for all contraventions in the Bill is inconsistent with longstanding Commonwealth policy on the framing of penalty provisions. The justification offered for this approach in the EM appears to be based on providing broad discretion for the regulator to take a 'proportional approach'.

While it is appropriate that there be a range of sanctions available to respond to contraventions, the basic principle has long been that contraventions should not attract criminal sanction unless their character justifies this approach. The Government's *Guide to Framing Commonwealth Offences, infringement notices and enforcement powers* (the Guide) notes:

"Ministers and agencies should consider the range of options for imposing liability under legislation and select the most appropriate penalty or sanction."

The Guide outlines the factors that should be considered in determining whether a provision should be a criminal offence (see page 13). These are consistent with the view expressed in the Australian Law Reform Commission's *Principled Regulation: Federal Civil and Administrative Penalties in Australia* (ALRC Report 95):



“the ALRC suggests that Parliament should exercise caution about extending the criminal law into regulatory areas unless the conduct being proscribed is clearly deserving of the moral censure and stigma that attaches to conduct deemed criminal...”

While it is arguable that the more serious contraventions in this package – such as failing to make a target market determination – could, due to their capacity to cause widespread harm, justify a criminal sanction, this is far less clear in relation to other provisions. For example, the addition of clause 994B(9) in the draft, requires that target market determinations be made available to the public free of charge. Treasury clarified, in consultation, that this requirement is to be enlivened only where a member of the public asks for the determination. It is difficult to conceive of how a contravention of this provision ‘so seriously contravenes fundamental values as to be harmful to society’. The imposition of a civil penalty alone for this provision would seem to be an appropriate and adequate sanction.

Scope of the Regime – basic deposit products

The DDO can be extended through regulation. The EM notes that the Government intends to make regulations to include basic deposit products. For the Committee’s information, we reiterate below some points we have previously made around this.

The policy intent of the DDO is to overcome the identified deficiencies of disclosure, such as “consumer disengagement, complexity of documents and products, behavioural biases, misaligned interests and low financial literacy.” It also intends to reduce the likelihood of failures such as Storm Financial or Opes Prime. It is not clear how including basic products furthers this objective, nor what the expected benefits for consumers will be.

The inclusion of all basic deposit products in the DDO regime does not further the stated policy intentions and complicates their provision without providing useful consumer protection.

Basic deposit products are currently excluded from the disclosure obligations.

In the most recent consultation round, Treasury noted that the intention of this regime is to make issuers consider which markets are appropriate for particular products. In relation to basic products, Treasury has argued that certain fee structures or product categories – such as term deposits – may not be suitable for all. Even if this point of view were accepted, there remain subcategories of basic deposit products that are likely to be suitable for all customers – an example is no or low-fee transaction accounts. Applying the regime’s obligations to these kinds of products is likely to needlessly increase costs for businesses and this is likely to affect the cost to consumers.

In addition, flexibility and convenience for consumers in matters such as opening new accounts will be reduced if complexity is added to the process in order to comply with DDOs. For example, in situations where vulnerable customers, and particularly in cases of family and domestic violence, it can be critical for customer outcomes, and even safety, to streamline the process of opening a basic banking product to ensure safe access to funds. Unnecessarily complicating such processes is undesirable.

In this regard we note the statement in the Royal Commission’s Interim Report that “given the existing breadth and complexity of the regulation of the financial services industry, adding any new layer of law or regulation will add a new layer of compliance cost and complexity. That should not be done unless there is a clearly identified advantage....”¹

If basic deposit products are to be brought under the DDO by regulation, very simple basic deposit products that will likely be suitable for all should be carved out. This would avoid unnecessary cost and complexity brought about by the application of the regime to these products.

Wholesale ADI debentures

The EM (paragraph 1.34) makes it clear that regulations will be made to ensure that debentures issued by ADIs are caught by the legislation. Most debentures issued by ADIs under their terms can only be

¹ Commonwealth of Australia 2018 *Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry*, p. 290



issued to wholesale investors. There is no reason not to make it very clear that debentures issued to wholesale investors are excluded from the DDO regime.

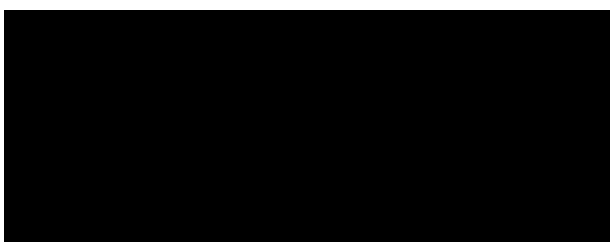
Digital services

Customers are increasingly using digital channels to help provide them with greater convenience and control over their finances. We consider that the DDO regime should support digital consumer channels and not limit innovation.

System changes may be required to member banks' digital channels that operate under a 'no advice' or 'general advice' model (in particular, to comply with the record keeping obligations and to ensure we satisfy our 'reasonable steps' obligations). For this reason, we think it is essential that early and detailed guidance be provided by ASIC on the record keeping obligations generally (and, specifically, in relation to digital channels).

Thank you again for the opportunity to contribute to this process.

Signoff



Jerome Davidson
Policy Director

