



AUSTRALIAN
SENATE

Senate Standing Committee for the
Scrutiny of Delegated Legislation

Parliament House, Canberra ACT 2600
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www.aph.gov.au/senate_sdsc

18 March 2021

The Hon Josh Frydenberg MP
Treasurer
Parliament House
CANBERRA ACT 2600

Via email: tsrdlos@treasury.gov.au
CC: committeescrutiny@treasury.gov.au

Dear Treasurer,

ASIC Corporations (Design and Distribution Obligations—Exchange Traded Products) Instrument 2020/1090 [F2020L01600]

The Senate Standing Committee for the Scrutiny of Delegated Legislation (the committee) assesses all disallowable legislative instruments against scrutiny principles outlined in Senate standing order 23. The committee has identified scrutiny concerns in relation to the above instrument, and the committee seeks your advice in relation to this matter.

***Modification of primary legislation
Parliamentary oversight***

Senate standing order 23(3)(j) requires the committee to consider whether an instrument contains matters more appropriate for parliamentary enactment (that is, matters that should be enacted via primary rather than delegated legislation). This may include instruments which provide exemptions and modifications to primary legislation. Senate standing order 23(3)(k) requires the committee to examine each legislative instrument as to whether it complies with any ground relating to the technical scrutiny of delegated legislation. This include whether any instrument may exclude or limit parliamentary oversight.

The instrument modifies the application of the design and distribution obligations under Part 7.8A of the *Corporations Act 2001* (the Corporations Act) to issuers and distributors of exchange traded products. The instrument does this by modifying the operation of, omitting, and substituting a range of sections, subsections and paragraphs in Part 7.8A of the Corporations Act.

The committee notes that the *Treasury Laws Amendment (Design and Distribution Obligations and Product Intervention Powers) Act 2019* (the 2019 Act) will insert Part 7.8A, sections 994A-994Q, into the Corporations Act from 5 April 2021. Of these provisions, the instrument modifies the operation of sections 994B, 994C, 994D, 994E and 994F in relation to exchange traded products. The committee also notes that, as a result of the ASIC Corporations (Deferral of Design and Distribution Obligations) Instrument 2020/486 [F2020L00618], all regulated persons, and any other person who is required to make a target market determination, are exempt from all provisions of Part 7.8A until the end of 4 October 2021.

The committee has long been concerned with provisions in delegated legislation which modify the operation of primary legislation, particularly where those modifications appear to substantially depart from the original provision. The committee therefore expects the explanatory statement to any modification instrument to comprehensively justify the nature and scope of the relevant modifications. In this instance, the explanatory statement generally explains that Parliament provided ASIC with the power to modify the operation of the Act as it applies to a specified class of financial product. However, the explanatory statement does not explicitly address why this is necessary in the context of this instrument, nor does it address why it is necessary to modify the operation of these provisions prior to their commencement.

The committee has significant concerns that ASIC is modifying the operation of provisions of primary legislation via delegated legislation prior to the commencement of those provisions. The 2019 Act was considered and passed recently by Parliament, and it is the committee's strong view that the modifications set out in the instrument should have been included on the face of the bill as it was being considered by the Parliament.

The committee's scrutiny concerns are heightened noting that standard sunseting applies to the instrument, meaning that it may remain in force for 10 years. The explanatory statement explains that this is required as early sunseting may create uncertainty about compliance and burden the industry, and that ASIC will monitor the operation of the instrument. The committee's longstanding view is that provisions which modify or exempt persons or entities from the operation of primary legislation should cease to operate no more than three years after they commence. This is to ensure a minimum degree of regular parliamentary oversight.

The committee's views in this regard, including in relation to ASIC instruments, are set out in its final report of its inquiry into the exemption of delegated legislation from parliamentary oversight.¹ In the report the committee notes that it considers that a three year timeframe for such instruments is appropriate as it allows ASIC to rapidly address issues in relation to the operation of primary legislation, while providing a significant period of time while the instrument is in force to consider whether the modification or exemption provided by the instrument will be required for a longer period. If it is determined that a modification or exemption is required for a longer period, the committee considers that certainty for industry and the market can be best provided by incorporating the modification or exemption onto the face of the primary legislation.

In light of this, and as per the committee's guidelines, the committee considers that the explanatory statement should indicate whether there is any intention to conduct a review of the relevant provisions to determine if they remain necessary and appropriate, including whether it is appropriate to include the provisions in delegated legislation.

The committee welcomes your commitment to addressing the committee's significant scrutiny concerns about ASIC instruments which provide for modifications to and exemptions from primary legislation. This systemic issue is of deep concern to the committee, and the committee considers that this ongoing engagement is integral to the committee's role in providing oversight of delegated legislation on behalf of the Senate.

¹ Senate Standing Committee for the Scrutiny of Delegated Legislation, Final report: Exemption of delegated legislation from parliamentary oversight, March 2021
<https://www.aph.gov.au/Parliamentary_Business/Committees/Senate/Scrutiny_of_Delegated_Legislation/Exemptfromoversight/Final_report>.

The committee therefore requests your advice as to:

- why it is considered necessary and appropriate to use delegated legislation, rather than primary legislation, to modify the design and distribution obligations of issuers and distributors of exchange traded products under the *Corporations Act 2001*, including why it is necessary and appropriate to do so prior to the commencement of the modified provisions;
- whether the instrument can be amended to provide that the measures cease within three years after they practically commence for those affected by the instrument; and
- whether there is any intention to conduct a review of the relevant provisions to determine if they remain necessary and appropriate, including whether it is appropriate to include the provisions in delegated legislation.

The committee also notes your ongoing engagement in relation to the committee's scrutiny concerns about parliamentary oversight of ASIC instruments and anticipates that this instrument will be further considered as part of this ongoing engagement.

The committee's expectation is to receive a response in time for it to consider and report on the instrument while it is still subject to disallowance. If the committee has not concluded its consideration of an instrument before the expiry of the 15th sitting day after the instrument has been tabled in the Senate, the committee may give notice of a motion to disallow the instrument as a precautionary measure to allow additional time for the committee to consider information received.

Noting this, and to facilitate the committee's consideration of the matters above, the committee would appreciate your response by **1 April 2021**.

Finally, please note that, in the interests of transparency, this correspondence and your response will be published on the committee's website.

If you have any questions or concerns, please contact the committee's secretariat on (02) 6277 3066, or by email to sdlc.sen@aph.gov.au.

Thank you for your assistance with this matter.

Yours sincerely,

Senator  the Hon Concetta Fierravanti-Wells
Chair
Senate Standing Committee for the Scrutiny of Delegated Legislation



THE HON JOSH FRYDENBERG MP
TREASURER

Ref: MS20-000658

Senator the Hon Concetta Fierravanti-Wells
Chair
Senate Standing Committee for the Scrutiny of Delegated Legislation
Parliament House
CANBERRA ACT 2600

Dear Senator Fierravanti-Wells

Thank you for your letter on behalf of the Senate Standing Committee for the Scrutiny of Delegated Legislation (the Committee) regarding the *ASIC Corporations (Design and Distribution Obligations—Exchange Traded Products) Instrument 2020* (the Instrument).

In that letter, the Committee requested my advice about:

- why it is considered necessary and appropriate to use delegated legislation, rather than primary legislation, to modify the design and distribution obligations of issuers and distributors of exchange traded products under the *Corporations Act 2001*, including why it is necessary and appropriate to do so prior to the commencement of the modified provisions;
- whether the Instrument can be amended to provide that the measures cease within three years after they commence; and
- whether there is any intention to conduct a review of the relevant provisions to determine if they remain necessary and appropriate, including whether it is appropriate to include the provisions in delegated legislation.

Use of delegated legislation

Exchange traded products (ETPs) are open-end investment products that are traded on a financial market. Issuers of ETPs continuously issue new products that are quoted and an ETP's open-ended structure allows the issuer of an ETP to issue and redeem units on a daily basis resulting in the number of units on issue fluctuating depending on investor demand. Issuers of these products use different market making structures to provide liquidity. This affects how these products are distributed to consumers through financial markets.

The primary legislation provides ASIC with the power to make exemptions and modifications to the new regime in Pt 7.8A of the *Corporations Act 2001*. These powers are intended to support the effective operation of the regime, by allowing ASIC to, for example, tailor the operation of the regime to avoid any unintended consequences that may arise with respect to a particular person or product.

These powers are necessary because the design and distribution obligations apply broadly to most financial products across all sectors that ASIC regulates. In particular, the products are issued and distributed by financial product firms that have a diverse array of operational structures and employ an extensive variety of distribution methods. As a result, it is difficult for the primary legislation to deal with every business model and distribution structure.

The modifications made by the Instrument support the operation of the primary legislation by addressing unintended consequences resulting from the application of the disclosure rules to ETPs.

Without the modifications made by the Instrument, the design and distribution obligations would apply in an inconsistent and anomalous way to issuers and distributors of ETPs. For example:

- Design and distribution obligations would apply in full for ETP issuers utilising internal market making (IMM) structures, and distributors engaging in retail product distribution conduct in relation to these products, while certain obligations would not apply for issuers of ETPs utilising external market making (EMM) structures. Additionally, distributors engaging in retail product distribution conduct in relation to these products would not be subject to any obligations.
- Issuers of ETPs would face practical difficulties in complying with certain obligations where a product is continually issued and traded on a financial market, including the obligation to cease retail product distribution conduct where a review trigger has occurred. Issuers would also face practical difficulties in complying with review obligations in circumstances where distributors were not required to provide them with information regarding consumer outcomes.

Following the passage of the primary legislation and the making of the regulations, ASIC engaged with industry on its implementation of the design and distribution obligations, and released its draft regulatory guide for consultation on 19 December 2019.

A number of interested stakeholders raised queries about how the obligations would apply to ETP issuers, as well as intermediaries involved in distribution, such as brokers, authorised participants and trading agents appointed by the issuer. As a result of feedback from the Financial Services Council, fund managers, ASX and Chi-X that requested ASIC provide certainty in this area to ensure the regime operated effectively, ASIC carried out further targeted consultation in relation to the application of the regime to ETPs in August 2020.

Therefore, ASIC considered it necessary and appropriate to use its modification powers prior to commencement to provide certainty and consistency in relation to the application of the obligations to issuers and distributors of these products, in circumstances where industry is in the process of planning, systems development and training to implement these reforms. The DDO are systems and processes driven obligations. They require industry to implement robust and effective product governance arrangements ahead of commencement, in order to ensure they are delivering products to consumers that meet their needs.

Without the certainty provided by ASIC's modification ahead of commencement, the ETP sector may not have been in a position to implement effective arrangements and comply with the obligations when they commence. ASIC's broader consultation on guidance and its targeted consultation on this issue indicated considerable demand for this certainty to be provided as soon as possible so that implementation could occur prior to commencement.

Modifying the primary legislation with ASIC's modification powers also meant that ASIC could provide guidance to industry in a timely manner and specifically provide guidance on the application of the obligations to ETPs: see Appendix to Regulatory Guide 274 *Product design and*

Distribution Obligations. There was considerable demand for guidance in this area, and more generally demand for guidance to be provided as soon as possible to support implementation of these reforms prior to commencement.

While the primary legislation intended to apply to products that require a PDS and are issued or on-sold to retail clients, ETPs (by virtue of their distribution structure through financial markets) do not fit strictly into the proper operation of the obligations – and this resulted in anomalous and inconsistent outcomes. As noted above, the DDOs cover most products across all sectors of the financial system, making it difficult for primary legislation to deal with every business model and distribution structure. Through the Instrument, ASIC provided clarity regarding the application and addressed inconsistencies to support the practical application of the primary legislation.

Sunsetting period

As I have noted in my previous correspondence to the Committee, the Government shares the Committee's objective that the period of operation of legislative instruments should be consistent with maintaining appropriate Parliamentary oversight, while also considering the underlying policy intent of the relevant primary law and the regulatory burden imposed on individuals and entities.

I consider that the 10 year sunseting period remains appropriate given that issuers and distributors of ETPs will structure their business, systems and processes in accordance with the modified provisions. An earlier sunseting period of the Instrument will likely create significant uncertainty around compliance and lead to undue burden for industry.

This is consistent with the principles I have previously provided to the Committee about when the default sunseting period will generally be appropriate.

I look forward to discussing this issue further with the Committee, in a meeting to be arranged between my Office and the Committee.

Review of the relevant provisions

As set out in the explanatory statement to the Instrument, ASIC will monitor the operation of the Instrument, including whether the provisions remain necessary and appropriate, and respond as needed.

I trust this information will be of assistance to the Committee.

Yours sincerely

THE HON JOSH FRYDENBERG MP

9 / 4 /2021



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13 May 2021

The Hon Josh Frydenberg MP
Treasurer
Parliament House
CANBERRA ACT 2600

Via email: tsrdlos@treasury.gov.au

CC: committeescrutiny@treasury.gov.au; Chris.Reside@treasury.gov.au

Josh

Dear Treasurer,

ASIC Corporations (Design and Distribution Obligations—Exchange Traded Products) Instrument 2020/1090 [F2020L01600]

Thank you for your response of 9 April 2021 to the Senate Standing Committee for the Scrutiny of Delegated Legislation in relation to the above instrument.

The committee considered your response at its private meeting on 12 May 2021. On the basis of your ongoing, good faith engagement with the committee in relation to Treasury portfolio instruments which modify or exempt persons or entities from the operation of primary legislation, the committee has resolved to conclude its examination of the instrument as part of its regular scrutiny process.

However, as you are aware, the committee continues to have significant systemic scrutiny concerns relating to instruments which modify the operation of primary legislation, and the operation of these instruments for a ten year period. The committee will therefore consider this instrument as part of this ongoing engagement. In light of these ongoing discussions, the committee has resolved to withdraw the notice of motion to disallow the instrument.

While the committee has resolved to withdraw the disallowance notice in place on this instrument, I advise that the committee will give disallowance notices on similar Treasury portfolio instruments which raise these concerns in the future if the committee's systemic scrutiny concerns are not satisfactorily resolved through the current ongoing discussions.

In the interests of transparency, I note that this correspondence will be published on the committee's website and recorded in the *Delegated Legislation Monitor*.

If you have any questions or concerns, please contact the committee's secretariat on (02) 6277 3066, or by email to sdlc.sen@aph.gov.au.

Thank you for your assistance with this matter.

Yours sincerely,

Senator the Hon Concetta Fierravanti-Wells
Chair
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