FSC FINANCIAL SERVICES COUNCIL

ASIC CP 325: Draft regulatory guide on product Design and Distribution Obligations

FSC Submission

March 2020

Contents

1. About the Financial Services Council

The FSC is a leading peak body which sets mandatory Standards and develops policy for more than 100 member companies in one of Australia's largest industry sectors, 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 $3 trillion on behalf of more than 15.6 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.

2. Introduction

The FSC welcomes the opportunity to provide comment on the Consultation Paper (**CP**) 325, Product Design and Distribution Obligations (**DDO**), released by the Australian Securities and Investments Commission (**ASIC**).

As an initial point, we note the impact of COVID-19 on financial services and the whole economy is serious. We note commitments from Government, ASIC and other financial regulators to provide regulatory relief in this current period, including the following statement from the Council of Financial Regulators on 16 March 2020:

> *Council members are examining how the timing of regulatory initiatives might be adjusted to allow financial institutions to concentrate on their businesses and assist their customers…*
>
> *[APRA and ASIC] stand ready to deal with problems firms may encounter in complying with the law due to the impact of COVID-19 through a facilitative and constructive approach. In particular, each agency will, where warranted, provide relief or waivers from regulatory requirements.*

In addition, this press release from ASIC of 23 March 2020:

> *ASIC is committed to working constructively and pragmatically with the firms we regulate, mindful they may encounter difficulties in complying with their regulatory obligations due to the impact of COVID-19.*

With this in mind, the key DDO issues for FSC members, as highlighted in this submission, are as follows:

- A request for facilitative compliance once the DDO regime commences, particularly with the difficulties and changing priorities financial services firms are facing in the context of the COVID-19 pandemic.
- The DDO regime will mean a substantial increase in information required of consumers, particularly for products issued direct to consumers.
  - Further clarity is needed on how to collect this information so that individuals are not left with the impression their personal situation has been considered and hence that personal advice has been given.
  - Further clarity is also requested on how to design consumer interactions to ensure distribution is consistent with Target Market Determinations (**TMDs**), for example whether, and when, knockout questions should be used.
- Issues with how a TMD should be approached for superannuation products, particularly how changes in superannuation interests, such as insurance arrangements and investment choices, should be treated.
- Requesting exemptions from the DDO regime for:
  - Issues of superannuation interests that are not chosen by the member (eg successor fund transfers, reversionary benefits, and family law splits); and
  - superannuation trustees relating to employer default products, in addition to the existing MySuper exemption.

- The need to extend the DDO exemption relating to personal advice to also cover dealings (particularly by platforms) following financial advice from a non-associated adviser.
- The need for clarity about how DDO applies to exchange traded products.
- A request that ASIC remove requirements for issuers to supervise and monitor distributors.
- Can ASIC's support for a consumer-centric approach by issuers and distributors extend to the DDO regime avoiding approaches that produce poor customer outcomes?

The FSC has not provided a response to every question asked in ASIC's CP. This should not be taken as providing tacit support for the approach in the draft Regulatory Guide (**RG**).

3. Response to consultation paper

B1: Product governance framework

We propose to give guidance that a robust product governance framework that fulfils the objectives of the design and distribution regime should:

(a) focus on the identified target market across the lifecycle of the financial product;

(b) be designed to reduce the risk of products being sold to consumers that are not consistent with their likely objectives, financial situation and needs; and

(c) be documented, fully implemented, monitored and reported on, and regularly reviewed to ensure that it is up to date.

See draft RG 000 at RG 000.30–RG 000.43.

ASIC question B1Q1

Is our guidance on a robust product governance framework useful? What additional matters, if any, do you think are important in ensuring that a product governance framework will be effective and support compliance with the design and distribution obligations?

FSC response

The FSC agrees in principle with the requirement for issuers and distributors to develop a robust product governance framework. Most FSC members already have in place such frameworks which will need to be reviewed to ensure alignment with DDO where necessary. However, we have some concerns with some elements of the guidance in this section of the draft RG.

Role of issuers in supervising and monitoring distributors

We note ASIC envisages issuers engaging in monitoring and supervision of distributors (see RG 000.120). We note early drafts of the DDO legislation contained such requirements but they were removed from the final legislation and are not envisaged in the explanatory memorandum. The rationale for this revised approach is that distributors should be responsible for taking reasonable steps to ensure the distribution is consistent with the TMD, having in place robust product governance frameworks to do so.

We envisage that the DDO record keeping and reporting obligations will generally provide product issuers with sufficient insights into how their products are being sold and distributed, without having to enforce additional monitoring and supervision requirements on issuers.

In demonstrating reasonable steps, in our view an issuer would review, synthesise, and make appropriate decisions based on the information provided to issuers by distributors as set out in the law. Any further obligation on issuers to monitor and supervise distributors does not appear consistent with the policy intention of the legislation and is not supported by the legislation. In any event, these terms (‘monitor’ and ‘supervise’) do not clearly set out ASIC’s expectations to issuers as to the steps issuers would be required to take.

The difficulties with requiring issuers to monitor and/or supervise distributors are best demonstrated by considering the diverse ways that products can be distributed. For example, a product might be distributed directly to consumers, through advisers in the same corporate group, through unaligned advisers, through a platform owned in the same corporate group, and through an unaligned platform. Further, the distribution through a platform might be to unadvised consumers, consumers with advisers in the same corporate group, or to consumers with unaligned advisers. It would be problematic for issuers to have a responsibility to 'monitor' or 'supervise' distribution using many or all of these distribution methods.

With many wealth management businesses exiting the financial advice business, more distribution will occur through unaligned advisers, platforms and/or other channels. In many cases, issuers will not have any current contractual or monitoring relationship with these distributors; and in some cases, issuers will only be aware of who is a distributor of their product after the distributor has sold a product to a final consumer – particularly where the PDS is freely available to all on the issuer's website.

It is open to any financial adviser, including those that an issuer has no formal or informal relationship with, to access a PDS online and recommend that product. For example, a client may request the adviser to consider a particular product which is not included on the adviser's Approved Product List (**APL**). After considering the client's personal circumstance and if it is in the best interest of the client, the adviser could recommend this product via the non-approved product process. In this scenario, the issuer would have no distribution arrangement with the adviser or their licensee. The issuer is entirely reliant on the adviser recognising their reporting obligations under the DDO and providing appropriate reporting to the issuer for the issuer to be able to undertake any form of (post-facto) monitoring. It would not be appropriate or practical to expect an issuer to monitor or supervise this type of distribution arrangement.

Further, some fund managers in the industry will have upward of 200 products that are in-scope of the DDO regime. Each of these products will have distribution arrangements in place across numerous distribution channels – platforms, IDPS, exchanges, direct advice, direct sales. Some of these channels will be formalised via written agreements, many will not. While we recognise that the obligations under the legislation require issuers to receive reporting and to assess, synthesise and make meaningful decisions based on this information, issuers should not be ordinarily required to undertake additional monitoring and supervision activity. Further, issuers should have clarity as to expectations with respect to monitoring and supervision of distributors so as to not unnecessarily increase red tape and compliance burden across the industry.

It is unclear in the circumstances outlined above how issuers could undertake any significant monitoring or supervision of distributors.

Recommendation: The FSC recommends the removal of the terms "monitor" and "supervise" from the RG or alternatively clarify that these terms in the RG relate only to the review and decision making based on the information provided to issuers by distributors, as set out in the legislation.

Concept of benefit

ASIC has also extended the scope of DDO beyond merely considering the likely objectives, financial situation and needs of consumers to a concept of **benefit**. The RG notes in RG 000.12 that issuers should target products to those consumers who would *benefit* from them, rather than merely be in the target market. Similarly, in RG 000.70 ASIC states "we expect product design to be driven by features that benefit the consumer." This is also ASIC's approach in RG 000.81(c).

The FSC agrees that issuers must design and distribute products that are likely to be consistent with the likely objectives, financial situation and needs of consumers; and that issuers should assess the information they receive from distributors for the purposes of review triggers. The FSC also acknowledges that by defining a TMD for a product and carrying out distribution that is consistent with the TMD, those who acquire the product are more likely to benefit from the product as it is more likely that the product will be consistent with their likely objectives and financial situation.

However, the concept of benefit should not be extended as an additional legal requirement, given that benefit is subjective and cannot be determined without clear insight into each individual's personal circumstances beyond what is required for a TMD. Rather, benefit should be determined by considering the product features required to meet the likely objectives of the types of people within the TMD with consideration to their likely financial situation.

Interaction with other obligations

The FSC requests ASIC provide further guidance on how DDO aligns with trustee and distributor best interests duties and related obligations contained in legislation and Prudential Guides.

B2: Consumer outcomes

We propose to give guidance that issuers and distributors should not take advantage of behavioural biases or factors that can impede consumer outcomes. In addition, issuers and distributors should consider consumer vulnerabilities and how these vulnerabilities may increase the risk that products sold to consumers do not meet their needs and lead to poor consumer outcomes.

See draft RG 000 at RG 000.52–RG 000.56.

ASIC question B2Q1

Is our guidance on the consumer-centric approach issuers and distributors should take to deliver good consumer outcomes useful?

FSC response

The FSC agrees that issuers and distributors should have a consumer-centric approach to product design and distribution. However, we consider there should be a requirement to only take reasonable steps in looking at behavioural biases and consumer vulnerabilities likely to

apply to consumers generally, or to a class of consumers, but not based on a consumer's individual circumstances.

For most fund manager issuers that do not have a distribution channel direct to the customer (or have a limited one), their knowledge and expertise in understanding behavioural biases and consumer vulnerabilities will be limited. In addition, their requirement to gain such knowledge is also limited since their products are generally distributed through third parties.

Specifically, the RG 000.54 suggests that issuers are required to consider how consumer vulnerabilities may increase the risk that products sold to consumers do not meet their needs. RG 000.54 notes that this may include a consumer's personal circumstances and the specific influence or impact of features in a product's choice architecture. We accept that issuers ought to take reasonable steps to look at behavioural biases and consumer vulnerabilities that may be generally relevant to a class of consumer. However, the language of RG 000.54 implies that issuers are required to look at these factors at the individual customer level (rather than at a cohort or class level), which we do not believe is appropriate or achievable. In particular, considering a consumer's personal circumstances would likely be classified as personal advice or give rise to a perception by the consumer that they are being provided with personal advice.

It is also important that ASIC recognises the role of advisers in considering the personal circumstances of consumers including behavioural bias and consumer vulnerabilities. In an advised product environment, it is unnecessary, inefficient and duplicative for the product issuer to duplicate the adviser's work by identifying and considering consumer vulnerabilities at the individual customer level.

Recommendation: The FSC recommends removing "personal" and "specific" from the draft RG at RG 000.54 as both suggest the issuer needs to consider an individual consumer's circumstances rather than circumstances for a group, cohort or type of customer.

In the context of promoting a customer-centric approach, we note that some potential/proposed approaches to implementing DDO would produce poor customer outcomes – see the FSC response to C1Q1, D1Q2, D3Q4, and C9Q1, and in the section of this submission recommended exemption for dealings involving third party advice. These issues should be addressed to enable the DDO regime to provide customer-centric outcomes.

ASIC question B2Q2

What additional matters, if any, do you consider to be relevant?

FSC response

It is clear how ASIC proposes issuers should consider the choice architecture of products that are distributed through very specific (narrow) channels. It is less clear, however, how an issuer is expected to consider, or modify, choice architecture for products widely distributed through multiple channels or exchange traded products. To the extent ASIC believes that the choice architecture of these types of widely distributed products is likely to influence

consumer decisions, it would be advantageous to provide examples in the RG to illustrate this.

Apart from this, the FSC does not consider it necessary for ASIC to provide additional guidance in an RG on these issues, particularly as commercial negotiations can be more adaptable to changing technology and circumstances compared to regulatory guidance.

However, we would be happy to work together with ASIC on how this could be implemented in a practical way, outside the more formalised context of an RG.

C1: Making a Target Market Determination

We propose to provide guidance that what amounts to an appropriate target market determination can differ, depending on the type and particular characteristics of the financial product to be issued, the intended distribution approach and the issuer's product governance framework.

See draft RG 000 at RG 000.64–RG 000.65.

ASIC Question C1Q1

Do you agree with our approach to guidance on the form and content of a target market determination? If not, why not?

FSC response

The TMD is the centrepiece of the DDO regime. It will describe the class of consumers for whom the product is likely to be suitable, and set the distribution conditions, the review triggers and the timing and details of information that must be supplied by distributors to issuers. The content and level of granularity of each TMD will also determine the data capture and reporting points distributors will need to record and provide to issuers.

The TMDs for each of the hundreds or thousands of products available on a platform, IDPS, mFunds or securities exchange will need to be collected, collated and reviewed. That means the stakeholders for a TMD are numerous and it will be crucial that the TMD meets the needs of all stakeholders and are consistent both within, and across industries. FSC members have been working on industry TMD templates for approximately a year.

The FSC's industry members are also considering drafting standard definitions for terms like "significant dealing" and developing template review triggers for various product types to help support common understanding and approach. For the TMDs to be workable on this scale, it involves a large number of participants coming together to develop industry standards.

Progress has been made by industry where practicable, however it is important for ASIC to recognise there has been much uncertainty about the level of detail and prescription that would be contained within the RG. This has meant that progress has not been able to be made on all fronts. For example, it would not have been efficient for industry to invest significant financial resources toward developing IT solutions without regulatory certainty.

Once this certainty is provided, work can then commence on IT solutions to automate the process, enhancing product governance frameworks and updating numerous legal agreements to implement the regime within and across firms.

To give some idea of the magnitude of the implementation, taking Schroders, an average sized funds manager, as an example, Schroders has 1,208 dealer groups and 5,360 adviser practices distributing Schroders products. Many of these are small in nature, with 3,800 of those 5,360 adviser practices having balances under $1 million.

There is an alternative view that the industry has adequate time to implement the DDO regime. However, significant parts of the work have been contingent on the finalisation of the ASIC regulatory guide and decisions about the use of the ASIC modification powers. This submission raises a number of areas where industry considers changes to (or at least further clarification of) the RG are required in order for the DDO to operate; and in some cases this submission raises situations where DDO will be very difficult to implement without the use of the modification powers. These problems highlight how the industry has in many cases not been able to take key steps to implement DDO at this stage.

See also the discussion in the 'ASIC compliance approach' section of this submission.

Detail in TMDs

To assist in the implementation of the DDO regime, the FSC has established a number of working groups across investments, superannuation, managed funds and life insurance. One of the tasks underway is drafting sample/template TMDs. As work has begun to draft template TMDs for each product type, a number of practical issues are being considered as detailed below:

- In general, there is a trade-off between detail, likelihood of meeting consumer needs and consumer experience. We encourage ASIC to provide more guidance on this trade-off and the consequences of that trade-off.
- The more detailed the TMD (in describing the target market in more granular detail and any exceptions), the more likely it is that the acquisition of the product by a consumer in that target market will be consistent with the likely objectives, financial situation and needs of the individual consumers in the product (s994B(8)).
- The more detailed the TMD, the more detailed the reasonable steps filtering is likely to need to be – eg the issuer will need to ask more questions to address the detail of the target market determination. Consequently, the consumer experience of acquiring the product is likely to be poorer.

Section 994B(8) contemplates that a TMD must be such that it would be reasonable to conclude that it would be *likely* that the retail client is in the target market. We request ASIC acknowledge that the length and detail of a TMD must be directed to whether it is *likely* the retail client is in the target market and that this is different from a requirement to *ensure every* retail client is in the target market.

Accordingly, we request ASIC guidance around the level of detail it expects in the TMD (which flows into the reasonable steps expected) and specifically, ASIC's acceptance of the

consequences of that level of detail – i.e. acknowledgement of the higher/lower likelihood of the product meeting the needs of a specific individual in the class of consumers described in the TMD who acquire the product balanced against the consumer acquisition experience.

TMDs for superannuation and retirement income products

Issues specific to TMDs for superannuation and retirement income stream products are considered in the FSC response to C7Q1 and in 'Special issues for superannuation' in Section 4 of this submission.

C2: Identifying and describing a target market

We propose to provide guidance that, generally speaking:

(a) for new products—issuers should identify the target market and design financial products that are likely to be consistent with the likely objectives, financial situation and needs of consumers in that target market; and

(b) for continuing products—issuers should still critically assess the product (and its features) and identify the target market under the design and distribution obligations by reference to the likely objectives, financial situation and needs of consumers for whom the product would likely be consistent. If issuers already have processes directed towards these purposes, they should check that the processes meet the detailed requirements of the legislation.

See draft RG 000 at RG 000.62–RG 000.65.

ASIC Question C2Q1

Is our guidance on the approach to identifying the target market for new products and continuing products useful?

FSC Response

The FSC believes the approach in RG 000.62–65 needs more information as to ASIC's expectations on TMD content, because TMDs are a new obligation.

The FSC agrees with the objective of improving product design to ensure products deliver good consumer outcomes.

Fund managers, and trustees of superannuation products, understand fund characteristics, such as objective, volatility, liquidity and other characteristics. These characteristics can be generalised as to what type of investor (or person with certain financial needs and objectives) may find these products suitable. These issuers often have minimal direct contact with customers, given the nature of distribution typically via platforms, IDPS, advisers and superannuation options.

The expectations as they stand in the draft RG are a material step change in terms of data collection for issuers of managed funds and superannuation products where the issuer is not integrated with distributors. For these issuers, the only information the issuers collect to date from existing consumers is that required to satisfy anti-money laundering (**AML**) and know

your customer (**KYC**) requirements, making a determination as to the likely objectives, financial situation and needs of individual consumers difficult. Further, in some situations not even this is provided, for example Exchange Traded Products (**ETPs**) traded on a secondary market. Therefore, the only way in which this information could ordinarily be sourced would be to ask consumers questions. Asking detailed questions of consumers may mean consumers are left with the impression that personal advice is being provided – further discussed in section D3 below.

Hence it is important that reasonable steps dictate the methodology used and this may differ depending on the circumstances of each product issuer.

Existing (on sale) products

The DDO regime raises several issues for existing (on sale) products, including the proposal in the draft RG that the development of TMDs should have regard to historical sales; and how the DDO regime applies to reinvestments/auto investment plans in existing products (see response to C3Q3).

The FSC requests more guidance, potentially including an example, around what is expected for these products. In most instances, issuers of investment and superannuation products will have inadequate information to determine if existing investors form part of the target market (see earlier part of response to C2Q1). There would be substantial difficulties in issuers needing to obtain this information, including the potential for this information to appear to be personal advice (see section D3), and the sheer volume of information that would be required to be collected from consumers by April 2021.

Additionally, there could be substantial differences between the data collected for (a) historical sales and (b) new sales after the DDO regime commences. Any expectation to consider the typical historical cohort of consumers in developing a TMD should be completed only to the extent the issuer already has that historical information.

In relation to RG 000.69, we request ASIC reword this so that an issuer is required to "consider" modifying the design of a product (final sentence). The historical purchasing cohort of the product (to the extent that is known in a pre-DDO regime) is a relevant consideration in the development of a product's TMD. However, it does not follow that the fact that a product has been historically sold to a certain consumer group requires a product to be redesigned. It may mean that the TMD needs to be revised, but we do not believe this to be the same as redesigning a product where the product remains appropriate for retail consumers.

ASIC Question: C2Q2

What additional matters, if any, do you consider to be relevant?

FSC response

As a broader comment, the draft regulatory guide frequently uses all or part of this phrase, or something similar: "An appropriate target market for a financial product is one where the product is likely to be consistent with the likely objectives, financial situation and needs of a

consumer in a given target market" (see paragraphs 45, 66, 68, 69, 71, 72, 75, 79, 80, 81, 87, 88, 89, 91, and examples 3, 5, 7). There is a risk that this repetition is not providing any particular guidance to issuers or distributors, as it is just restating the legislation.

C3 ASIC examples

While we do not propose to give any definitive formulation of how a target market should be described in a target market determination, we propose to give guidance that explains the process and key considerations for identifying and describing the target market by reference to examples across different product sectors.

See draft RG 000 at RG 000.66–RG 000.89.

ASIC Question: C3Q1

Do you have any comments on our approach to guidance on identifying and describing the target market?

FSC comment

The FSC's views on RG 000.76-77 are consistent with those provided in C2Q1, in that given the limited information issuers collect from consumers, it would be more appropriate for issuers of investments products to consider broad characteristics such as capital growth and/or income generation alongside the potential risks when determining a target market. This will allow issuers to design and issue products with regard to the likely objectives, financial situation and needs of that class of consumer as opposed to determining this on an individual basis, which is difficult, and runs the risk of giving the consumer the impression that their individual objectives, financial situation and needs have been considered.

As noted in response to D3Q4, FSC requests guidance on how issuers can address the objectives, financial situation and needs of a class of consumers without giving consumers the impression that their individual objectives, financial situation and needs have been considered.

ASIC Question: C3Q2

Do you have any comments on the following examples, which we have used in our guidance to illustrate key principles set out in RG 000.66–RG 000.89:

(a) Example 1: Credit cards;

(b) Example 2: Reverse mortgages;

(c) Example 3: Cash options in superannuation;

(d) Example 4: Consumer credit insurance;

(e) Example 5: Low-value products; and

(f) Example 6: Basic banking products?

FSC Comment

Example 3 – cash option in superannuation

This example could be interpreted as stating that a TMD is required for each investment option offered by a superannuation fund, whereas the DDO regime only applies to the financial product level (see further discussion in Section 4 headed 'Special issues for superannuation').

The example refers to 'preparing' the TMD for the choice product and it might be better stated that the issuer should 'review' the TMD to ensure it remains appropriate. The example also seems to imply that the cash option must be suitable for the existing target market of the product. While this is the most likely approach, the issuer could instead decide to adjust the target market as a result of adding new options or features to a product.

More broadly, this example is fairly critical of cash options. However:

- A cash option might have very low returns after fees in a bull market but could be the best returning option in a bear market – the insurance value of cash options should not be understated as this example appears to do. Recent market events in response to the global implications of COVID-19 have demonstrated the benefit of cash options as part of an individual's total super investments. This also demonstrates the value in offering investment choices to individuals whose circumstances typically change over the duration of their membership in a super fund including in response to broader market trends.
- Cash can form a small part of a much larger portfolio that is riskier and therefore has much higher expected returns. While this does not justify introducing a cash option that is likely to produce negative return in its first year of operation, as described in example 3, it should be a consideration in relation to cash options generally.
- If the fees discussed in the example are investment fees alone, then the point about negative net returns is valid. However, the example does not make it clear that it is considering investment fees only.
- Example 3 implies that a cash option is only used for capital protection. However, cash options have other benefits particularly high levels of liquidity which is important in the retirement phase or in transition to retirement.

ASIC Question: C3Q3

What additional matters, if any, do you consider to be relevant?

FSC Comment

Legacy products

Legacy products are generally outside the scope of the DDO regime (RG 000.16). However, it appears that DDO could apply to legacy superannuation products where an interest in the product is acquired due to the death of a member, where the beneficiary takes the benefit as a death benefit pension, or as a result of a family law payment split (see details in discussion headed 'Special issues for superannuation' in Section 4 of this submission). In such cases a

fund is required to give a PDS to the individual acquiring the new superannuation interest. It would be ideal if these particular scenarios were excluded from the distribution requirements of the DDO regime as super funds are usually legally obliged to provide an interest in these products for example in these examples interests may be acquired as part of a member's beneficiary nomination or a court order.

It is also unclear how the DDO would apply in relation to investment products in relation to additional contributions to the products, dividend reinvestment plans and auto investment plans where consumers have elected into these programs prior to the commencement of the DDO regime. For both on sale and legacy investment products, the issuer may have inadequate information to know whether the customer is in the target market for the additional investments, and collecting this information by April 2021 is problematic (see response to C2Q1). Further ASIC guidance on these situations would be helpful.

It is also not clear how the DDO regime is intended to apply to legacy superannuation products which are closed to new employer plans but open to new members within the existing employer plans (see s994B(2). RG 000.15(b) states that DDO applies to "existing products that continue to be issued to consumers after commencement of the regime (continuing products)". Does this mean these legacy products are caught, and is this ASIC's interpretation of the DDO legislation? We request further guidance on this situation.

C4: Diversification

We propose to give guidance that when an issuer considers it appropriate to contemplate consumers in the target market acquiring the financial product as part of a diversified portfolio, the reasonable steps obligation will require the issuer to manage the risk of the product being sold to consumers who do not have a diversified portfolio.

See draft RG 000 at RG 000.78–RG 000.79.

ASIC Question: C4Q1

Do you have any comments on our proposed guidance for issuers considering the role of diversification as it relates to their identification of the target market?

FSC comment

We note the intent of the guidance in RG 000.79; however, the use of an inherently flawed product as an example is not instructive to product issuers, as ASIC appropriately notes that such a product would not be suitable in any circumstances, even in a diversified portfolio. Issuers should not offer inherently flawed products in any event, given their Australian Financial Services Licence (**AFSL**) and other financial services obligations.

It would be useful for ASIC to clarify or reframe this to provide clarity using examples of products that are not inherently flawed but ASIC considers the products would still not be suitable even as part of a diversified portfolio, if that is the intention of the guidance. Otherwise we believe it would be preferable to remove RG 000.79.

In the examples in both RG 000.76 and RG 000.79, assuming the examples are modified so that the products used are not inherently flawed, it is possible that the distribution of products could be consistent with the DDO requirements if the product formed a small part of a much larger portfolio.

In this context, we recommend the guidance should clarify the meaning of a 'diversified portfolio' plus having the examples aligned with the definition in the guidance.

We also note that if the reasonable steps obligation requires issuers to manage the risk of the product being sold to consumers who do not have a diversified portfolio, in the long run, there will be a convergence of the product to a portfolio that might in fact be less diversified – only consisting of investments of the specified risk. For example, a defensive investor could end up investing in only defensive products which would create a skewed portfolio that will be overweight in cash and fixed income. Based on the proposed guidance, the target market assessment is focused on the individual product sold. Therefore, the TMD cannot consider the personal features of each potential investor and the general situation of their personal investment portfolio.

Dealing with diversification of consumer portfolios

It is difficult to see how an issuer could manage the risk of an investment product being acquired by consumers who do not have a diversified portfolio without the issuer relying on substantial consumer understanding, personal advice, or some form of disclosure and attestation. Issuers, or distributors such as platform operators, are very unlikely to know the full financial portfolio for potential consumers of a product, so they will not know for example if the purchase is a small or large part of the investor's overall portfolio.

To ascertain whether a client is within the target market for a product that is only likely to be suitable if acquired as part of a diversified portfolio, it appears issuers and distributors will need to rely on investor self-certification in order to reduce the risk of appearing to provide personal advice. This form of self-certification would relate to factual information that could potentially be verified and provides an alternative way to consider diversification without appearing to provide personal advice. Self-certification is also discussed in response to D3Q4.

If ASIC has another approach in mind we would be keen to discuss this further.

See also the comments in D3 about asking questions of consumers.

C5 Consumer understanding

We propose to give guidance that we do not consider a target market for a product should be predominantly based on consumer understanding of a product.

See draft RG 000 at RG 000.80

ASIC question C5Q1

Do you agree that consumer understanding of a product does not necessarily equate to the product being likely to be consistent with the likely objectives, financial situation and needs of consumers in the target market? If not, why not?

FSC comment

While a product issuer may create a TMD around a class of consumers, someone who has prior experience could be more likely to understand how the product will meet their objectives, financial situation and needs better than the product issuer. This is particularly the case for investment and superannuation products issued directly to retail investors, where the amount of information currently held by issuers can be limited (see comments in section D3). As a result, personal experience can be a relevant way to determine if a product is suitable.

While consumer understanding can be a valid factor in deciding on who is inside a target market, it should not be the only factor in making this decision. We note there are situations where consumers hold products that may not be suitable to them, despite having prior experience with those products, so the fact they have previously held the product does not of itself, necessarily mean they fall within the target market for similar products in the future.

C6: Negative target market

We propose to provide guidance that in making a target market determination, it will also be useful for the issuer to consider, in addition to the target market, those for whom the financial product is clearly unsuitable (the 'negative target market').

See draft RG 000 at RG 000.90–RG 000.92.

ASIC question C6Q1

Do you agree that it may also be useful for an issuer to describe the negative target market for its financial product? If not, why not?

FSC Comment

In principle, the FSC can see the value of issuers describing the negative target market when appropriate to do so, but not as a general rule. The FSC requests more guidance on the circumstances of when ASIC considers that the additional disclosure in relation to a negative target market would add value beyond what may already be defined in the positive target market and improve the decision-making of the consumer. The negative target market should not be identified by simply taking the opposing characteristics of the positive target market but rather an effort to identify the group of consumers for which their likely needs and objectives of a product is specifically incompatible. Following on from this, it would be helpful for the RG to explicitly note that a negative target market will not be appropriate or necessary for many products.

As per the discussion in diversification above, a wide range of investments can be suitable as small parts of larger portfolios – this makes it hard to define any clear 'negative target market' for these products.

Consistent with our observations on diversification, we question whether it is correct to argue "a negative target market for a high-risk investment product might include consumers with a low risk tolerance who do not have the ability to bear loss." (RG 000.90). This product might be suitable for the consumer as a small part of a much larger portfolio.

FSC Recommendation: in RG 000.90 amend "…it will also be useful for the issuer to consider…" to "it may also be useful for the issuer to consider".

Reconsider the position that "a negative target market for a high-risk investment product might include consumers with a low risk tolerance who do not have the ability to bear loss." – at least as it pertains to a product that is a small part of a portfolio.

ASIC Question C6Q2

Is our guidance on the role of describing a negative target market adequate and useful? If not, please explain why, giving examples.

FSC Comment

The FSC considers it is a good discipline to consider the potential for a negative target market for a product; however, the outcome may be that no such negative target market exists or does not add any value to the consumer, such as for a mass retail type investment product.

FSC Recommendation: in RG 000.90, change "to consider, in addition to the target market, those for whom the product is clearly unsuitable", to "to consider, in addition to the target market, if there exists a class of consumers for whom the product is clearly unsuitable"

C7 Product-specific issues

We propose to give guidance on how the target market determination applies for certain products when the application of the obligation is not straightforward, including:

(a) to superannuation and investor directed portfolio services (also known as 'platforms' or 'IDPS');

(b) when products are offered and acquired as a 'package' or 'bundle'; and

(c) when products are customisable by the consumer at point-of-sale, including through choices or options (e.g. selecting a waiting period for an income protection insurance product).

See draft RG 000 at RG 000.98–RG 000.106 and Examples 7–8.

ASIC question C7Q1 – superannuation

In relation to our guidance on how a target market determination should be approached for superannuation products, as set out in Example 7:

(a) Do you agree with our proposed guidance that if investment options are suitable for different groups of members, then the trustee should account for this in undertaking its target market determination for the Choice superannuation product? If not, why not?

(b) What factors do you consider relevant to the grouping of investment options in making a target market determination? Why?

(c) Do you agree with our proposed guidance to consider insurance as part of the target market determination for a Choice product? If not, why not?

(d) How should a trustee take into account insurance in making a target market determination for a Choice product?

FSC comment

Most superannuation and retirement income stream products now offer investment choice to members. The guidance provided by ASIC (see Example 3 at RG 000.86 and Example 7 at RG 000.101), could be read as suggesting either that a TMD is required for each investment option or that the TMD for the superannuation product requires consideration of which consumers are likely to be suitable for each investment option. This is despite the fact that an investment option within a super product is not itself a financial product. The legislation does not require a separate TMD for each investment option. This also applies to insurance options offered within a product.

In addition, the DDO regime applies to retail superannuation product distribution in relation to initial acquisition of a financial product. It does not apply to subsequent variations or disposal of the product, such as choosing or changing insurance or changing investment options (see discussion headed 'Special issues for superannuation' in Section 4 of this submission). However, the ASIC guidance seems to suggest that reasonable steps be taken where a member switches between investment options or takes out additional insurance cover within super, which does not appear to be consistent with the legislation. There would be value in clarifying how this should work consistent with the legislation.

Strictly, whether a member is within the target market is only required to be tested at the time that the member first acquires an interest in that superannuation plan and not tested each time the member makes a choice of insurance or investment within that plan (after that initial acquisition). Therefore, we suggest that the TMD for a superannuation product which offers investment choice could identify a class of consumers who intend to make investment choices (either on their own or with the assistance of a financial adviser), while for the individual options the issuer considers whether there are options (and/or combinations of options) that are likely to be consistent with the likely objectives, financial situation and needs of the class of consumers in the target market but not be required to consider whether all possible combination of choices would be suitable.

Similarly, individual circumstances typically change over time, demonstrating the importance of providing members with choice in how their money is invested, rather than restricting them to an investment or insurance option based on the information captured at the time the product was originally acquired.

Considerable complexity arises if TMDs were required to be defined at the investment and insurance option levels within a superannuation product. Some superannuation products offer up to 150 investment options. Having a product with the same number of target market classifications in addition to insurance options may be lengthy and confusing. Further, in the case where multiple investment and insurance options are offered within a product there are very large number of combinations consumers can choose and it would not be feasible for a distributor to adequately consider which combination of choices would be suitable for a consumer without taking into consideration their personal circumstances – which would then be likely to be personal advice.

For example, as part of applying for a new superannuation product through the super fund's website, an individual chooses five investment options to which any future rollovers or contributions will be allocated. According to information gathered from the individual as part (or after) the application process, it is determined that three of the options are likely to be suitable for the individual and two options are not. While it may be relatively simple to arrive at this determination on a stand alone basis examining each investment option individually, it is much more complex for the distributor to determine the appropriateness of these options when options are combined within an individual's preferred diversified portfolio. As noted earlier, in some cases there are a significant number of combinations that individuals may choose and it becomes inherently complex for a distributor to adequately consider what is suitable for a class of customers in this instance.

The situation is even more complicated where a superannuation product offers all four of these choices: investment, TPD insurance cover, death cover, and IP insurance cover.

Recommendation: ASIC revisit Example 7 and consider whether it could be taken to be misunderstood (in relation to requiring a separate TMD for each investment option) and to contradict the comments in RG 000.104.

See also our response to C7Q4.

ASIC Question C7Q2 – IDPS

Do you agree with our guidance on the application of the target market determination obligation to IDPS?

FSC response

For an IDPS operator, the TMD is expected to consider the "types of products available on the platform". Practically, an operator would be determining a TMD based on the platform, and then when admitting new products/types of products into the investment menu, considering whether those new products are consistent with the platform's TMD. If the issuer wants to admit new products which are not consistent with the platform TMD, this is likely to

constitute a review trigger requiring the platform operator to consider whether the TMD for the platform remains appropriate. Would that meet ASIC's expectation?

For an issuer of products available on a platform, Example 8 states that the TMD should "include consideration of whether the selected platform is an appropriate distribution channel". We assume that this can be done generally as to the types of platforms – for example, there is not a requirement to make a specific TMD for the product for each platform. Otherwise it would become difficult to administer and manage both for the underlying issuers as well as platforms.

We assume ASIC intends that the approach for determining a TMD for an IDPS platform would also apply to the issuer of a superannuation wrap platform product, and would appreciate this being clarified.

We note there are specific issues relating to platforms and non-aligned advisers, considered in this submission in response to D3Q1.

Insurance offered on platforms – potential duplication on AFSL licensees record-keeping and reporting to both the platform and insurer

Where a retail advised insurance (inside superannuation) product is provided to a retail client under a custodial arrangement under s1012IA of the Corporations Act, it appears that the trustee will need to make a TMD for the superannuation interest and the insurer will need to make a TMD for the insurance product (*where the insurance is not issued as a group policy*).

Example 7 (Superannuation Products) in RG 000.101 does not appear to be relevant to this particular scenario as Example 7 relates only to group insurance policies offered to trustees. The draft Guide relevantly states "there is no obligation on the insurer who issues the **group policy** to the trustee to make a target market determination" (emphasis added).

Example 8 (Investor Directed Portfolio Services) in RG 000.102 seems to be the closest analogy on this scenario – namely, insurance offered on platforms.

To the extent that there is an obligation on the platform issuer, and the insurer, to issue a TMD, there is also therefore an obligation on distributors (of the platform, which includes the insurance on the platform) to maintain record-keeping and meet reporting obligations to both the platform issuer and the insurer. The FSC submits that this will significantly increase the record-keeping and reporting obligations on AFS advice licensees and advisers (who may need to report the same information to both the insurer and trustee, in respect of the insurance held through the platform). If so, this is a significant compliance burden which could contribute to underinsurance in Australia. As the FSC finalises its analysis on this scenario, the FSC may approach ASIC in future with a view to seeking modification or relief, designed to ensure there is no unnecessary duplication in record-keeping or reporting requirements for distributors (advice licensees) in respect of insurance offered through an IDPS or superannuation platform; and potentially in relation to TMD obligations of the platform issuer, to the extent there may be duplication in the TMD content of the insurer and platform. Given the complexity and timing, we wish at this stage just to note we are working through the analysis for which we may subsequently approach ASIC.

Also see our response in D7 *Provision of information to issuers* which raises similar points in relation to duplication of information (to issuers) between platforms and financial advisers.

ASIC Question C7Q3 – bundled products

Do you agree with our guidance on how a target market determination should be approached for a bundled product? If not, why not?

FSC Comment

Where separate products must be acquired together as a 'bundle', the consumer will need to be within the target market for all products that form part of the bundle. If separate TMDs must be made, these may include significant cross-referencing and may result in duplication to ensure the consumer is within the target market for all products in the bundle. This may increase complexity and cost, reduce efficiency and be a less helpful consumer experience. Perhaps a better approach would be to provide issuers with flexibility to determine whether separate TMDs or a single TMD would be more suitable based on the particular bundle of products, the distribution channel and so on.

ASIC Question C7Q4 – customisation

Do you agree with our proposed approach to the application of the design and distribution obligations to products that can be customised at point-of-sale? If not, why not?

FSC response

For a single product that has multiple elements that are offered as a package or bundled, issuers should make a TMD that considers the entire product as a package. However, in our view, this does not necessarily mean separate target markets and TMDs for each element or bundled feature of the product.

Having multiple critical assessments, and multiple target markets, for customisable products is likely to be duplicative, impractical, and is unclear, particularly when there are a large number of product features available at the point of sale. We think a more appropriate approach in light of the policy of the DDO regime is to design TMDs based on the likely need (or objectives) of customers.

The draft RG specifically mentions waiting periods as one of the options that are customisable at point-of-sale, where the issuer must consider whether selecting this option changes the target market. We understand ASIC is not using this example to address any specific regulatory concerns.

This waiting period example calls into question whether the following life insurance options, amongst other things, also affect the target market, and therefore the number of TMDs (and target markets):

- standalone versus linked cover;
- superannuation versus non-superannuation ownership (including split cover across both environments);
- level versus stepped premiums;

- agreed value versus indemnity contracts (noting APRA's actions on agreed value products); and
- additional benefits, for example, accident benefit, superannuation contribution option, buy-back, double buy-back.

FSC members do not consider that options or features (choices to be made) within life insurance products should necessarily constitute separate target markets. Instead, issues relating to bundling and customisation are associated with how products are marketed, to address the likely objectives and needs of consumers that acquire these products, whether or not assisted by intermediaries. For this reason, we consider that generally there is a separate target market for different life insurance **product types**, for example:

- Life insurance (death cover)
- Income protection
- Critical illness/trauma
- Total and Permanent Disablement.

We think the product type approach, set out above, for life insurance, more clearly articulates how different product objectives (eg death cover pays a lump sum on death; income protection has the objective of replacing income) may constitute the product as a separate target market.

We request the RG be amended to remove the *waiting period* example (in RG 000.104) as we consider it concerning that the reference to waiting periods implies a different waiting period (eg 14 day, 28 day, 90 day) creates separate target markets with separate TMDs.

We therefore suggest that the RG should provide principles-based guidance, where the focus is on the consumer's objectives and needs, rather than individual benefits.

Where a completely different consumer objective/need is being addressed, this should result in a separate TMD (see the life insurance product types example above), even if some of the same benefits are being offered. For example, even though one of the benefits offered from a *business expenses policy* is a total disability benefit, it is distinct from an Income Protection (**IP**) policy, because the objective of a *business expenses* policy is to cover costs associated with running the business, rather than covering personal income (as is the case for an IP policy) – thus, a separate TMD is warranted for a *business expense policy* versus an *IP policy*.

Other comments

In RG 000.104, ASIC seems to expect a different TMD based on choices or options for when a product is customisable by the consumer at point-of-sale, including through choices or options; however this seems to be inconsistent with Example 7 Superannuation Product in relation to a single TMD for the Choice superannuation product that describes multiple target markets for each investment option or group of investment options offered as part of the product.

We therefore request ASIC revisit Example 7 and RG 000.104 and their consistency in relation to separate TMDs for each investment choice or option.

C8 Reasonable steps for issuers

We propose to give guidance on the reasonable steps obligation for issuers, and set out our view on the factors that may be relevant to the obligation. These factors include:

(a) the distribution conditions that are specified in the target market determination;

(b) the issuer's marketing and promotional materials;

(c) the selection of distributors;

(d) the supervision and monitoring of distributors;

(e) the issuer's ability to eliminate or appropriately manage conflicts of interest; and

(f) whether issuers have provided distributors with sufficient information to help them ensure that distribution is consistent with the target market determination.

See draft RG 000 at RG 000.107–RG 000.120, Examples 9–11 and Table 3.

ASIC Question C8Q1 – examples

Do you have any comments on the following examples, which we have used in our guidance to illustrate key principles set out in RG 000.107–RG 000.120:

(a) Example 7: Superannuation products;

(b) Example 8: Investor directed portfolio services;

(c) Example 9: Superannuation;

(d) Example 10: Mortgage fund; and

(e) Example 11: Listed investment companies?

FSC Comment

Example 7: Superannuation products

This example in the Draft RG guide provides that when assessing the insurance component included in a choice superannuation product, this may result in the target market for the choice superannuation product being different from a superannuation product without that insurance component.

Clarity is needed on whether an insurance component offered on an optional basis permanently alters the TMD for the super product regardless of whether it is chosen or not.

The preferred view is that an optional feature (like insurance) should not narrow the target market however the TMD should identify if certain groups of retail clients are not within the

target market for certain options within the product at the time the retail customer acquires the superannuation product.

Taking the approach in Example 7 would unnecessarily exclude persons who have no intention of choosing the insurance component, and for whom the product would otherwise be suitable.

A person with pre-existing medical conditions might want to invest in a super product which has investment options or benefit payment features that are suitable for them. However, the optional insurance has an exclusion for pre-existing conditions and so is not suitable. The person should be entitled to choose the super product but the insurance choice could be restricted.

Example 9: Superannuation – General comments

We query the observation in this example "The superannuation trustee assesses that the potential risk of harm from the high growth investment option if distributed to members who are outside of the target market is high." Consistent with our comments about diversification earlier in this submission, it could easily be the case that a proportion of the total superannuation interest be invested in a high growth investment option, with the proportion invested in the option dependent on the risk appetite of the member and their investment time horizon.

With respect to the following text:

> *"[The superannuation trustee] also commences an internal regular report to obtain information about the types of members choosing the option and the distribution channel by which the option is acquired to check that its controls are working."*

Can ASIC provide specific examples around the type of data it expects to be used to classify members into different "types", noting in some cases a fund may have limited information about fund members (see response to D3Q1)?

Example 9: Superannuation – restricting options

This example suggests that customising/restricting options available to members based on member characteristic information the trustee holds is an appropriate reasonable step to take in mitigating the risk of distribution to members outside the target market. RG 000.169 and 000.177, however, indicate that a distributor should not frame its processes in a way that leaves the consumer with the impression that their personal circumstances have been considered.

See also discussion in section D3 below on customising/restricting options available to members, and interaction with the personal advice exemption.

With respect to the following text:

> *"The fund website requires members to log in and they are then presented with potential investment options. To restrict the possibility of members selecting an*

investment option inappropriate for them, the trustee customises the options presented to members after they log in based on member characteristics information the trustee holds."

As per our response to C1Q1, we do not believe the DDO obligations apply to existing members in a superannuation product in terms of subsequent variations or disposals of that product.

Nevertheless, supposing this situation were to apply upon acquisition of the product it is unlikely that the information the trustee holds is sufficient to assess what is appropriate for a member or to customise investment options that are presented to the member. Is it ASIC's intention that a trustee obtains sufficient information about members to assess what is appropriate for them? If so, this raises the concerns about questions asked of members, particularly the concern that it creates the impression for the customer that personal advice is being given – see section D3.

In addition, we seek ASIC's confirmation that this approach does not mean the potential investment options cannot be presented in full on the trustee's website at all. Otherwise, this might be a total shift in what information about options is publicly available on the superannuation trustee's website. It might also result in reduced competition and worse consumer outcomes as comparisons between superannuation products would be made much harder.

The legislation at section 994E (2)(b) acknowledges that there are circumstances where it is appropriate for retail investors outside the target market to acquire the product. For this to occur in practice distributors cannot hide or restrict products from a consumer nor do some issuers believe doing so would be a good consumer outcome. Therefore, it would also be beneficial for ASIC to provide an example of reasonable steps where a consumer wishes to purchase a product from outside the target market.

Further, the TMD is in relation to a specific product, thus any assessment about being inside or outside a target market can only be made in relation to a specific product. That is, while a consumer may have overall 'needs, objectives and financial situation', they may have a specific (and slightly different) need, objective and financial situation for a particular product. Accordingly, the initial data collection from consumers should not necessarily restrict their ability to access/view products that don't quite fall within the overall needs, objectives and financial situation as they may have a need, objective or financial situation that had not been captured that would make the otherwise blocked products suitable to the consumer. It will be very difficult for a distributor or issuer, having just received information about the needs, objectives and financial situation of an individual consumer to make any attempt to redirect or restrict their investment without leaving the consumer with the opinion or impression that their personal needs, objectives and financial situation have been considered.

See also the FSC's comments in response to D3Q4.

Example 10: Mortgage fund

See FSC response to B1Q1 in relation to 'supervision' of distributors.

Example 11: Listed investment companies

In this example, ASIC sets out how issuers of closed-ended listed products may meet their obligations to take reasonable steps in relation to distribution. ASIC identifies the range of intermediaries who may act as distributors of products on their initial offering and the considerations issuers may have in relation to this distribution network.

We submit it would be helpful for issuers of listed products if ASIC confirmed in Example 11 that, once the products are quoted on the exchange, on-market trading of the products is outside the scope of the design and distribution obligations. We submit this is consistent with the secondary sale exemption referred to in RG 000.17 that issuers and distributors do not have to comply with the design and distribution obligations for secondary sales of products and the explanatory material which indicates that the obligations do not apply to secondary market trading.

Without this addition, Example 11 has very little commentary that demonstrates how the obligations apply to listed managed funds as compared with unlisted managed funds. ASIC provides no other relevant guidance on the treatment of exchange-traded products (**ETPs**) or the scope of the secondary sale exemption.

For open-ended listed products (i.e. ETFs), retail investors typically buy and sell products on the exchange and do not transact directly with the issuer or any intermediaries (see ASIC REP 583). Industry understands that, consistent with Treasury's intention, applicable market participants who facilitate trading of exchange-traded products would not be considered to be engaging in retail product distribution conduct or regulated sales (in the ordinary course of their activities) and would therefore not be 'distributors' in the same way as the intermediaries identified by ASIC in Example 11.

Notwithstanding, if ASIC's approach differs, then industry seeks relevant guidance that acknowledges the extremely limited steps (if any) that an issuer or 'distributor' of an ETP can take to ensure that their distribution is consistent with the TMD. In the event ASIC considers such activities to be within scope of the regime and fails to provide relevant and practical guidance, industry raises significant concerns in relation to the different regulatory treatment for closed- and open-ended products, practical implementation issues and other adverse impacts on the exchange-traded market (and, in turn, the potential for significant detriment to consumer outcomes).

In addition, the example says, "An issuer of LICs should provide the distribution network with sufficient information to assist distributors with meeting their obligations **to ensure** that distribution (including marketing and sale) is consistent with the target market determination." (emphasis added). It is unclear why the word "ensure" is used here when elsewhere the standard is conduct that is 'reasonably likely' to be consistent with the TMD.

For more detailed submissions on exchange traded products, please refer to discussion headed 'Secondary sales and exchange traded products' in Section 4 of this submission.

ASIC Question C8Q3 – factors relevant to issuer reasonable steps

What additional factors, if any, do you consider should be included in Table 3 of draft RG 000?

FSC Comment

The FSC is not proposing any additional factors should be included in Table 3. We do not consider further prescription on this issue is needed at this stage.

As a general point, we question the phrasing of paragraphs 118, 120 and Table 3 as factors that ***ASIC*** will take into account – would it be better to phrase this as factors that ***issuers*** should take into account when determining their DDO obligations. A change to this language would acknowledge that ASIC does not approve reasonable steps obligations, and parties other than ASIC (in particular the courts) can determine whether issuers are complying with the DDO regime. A similar point is made about Table 5 below.

C9 Review triggers

We do not propose to set out in guidance standard review triggers and maximum review periods for issuers to adopt. Instead, our draft guidance sets out examples to illustrate what review triggers may be appropriate for certain types of financial products.

See draft RG 000 at RG 000.127–RG 000.134 and Examples 12–13.

ASIC Question C9Q1

Do you have any comments on our guidance on setting appropriate review triggers and maximum review periods?

FSC Comment

The drafting of RG 000.126 does not reflect sections 994C(3)–(5) which requires a product issuer to cease issuing the product, not later than 10 business days after the person first knew the occurrence of the review trigger. When a review trigger occurs, sections 994C(3)–(5) requires a product issuer to either (a) review the TMD and, if it is no longer appropriate, make a new TMD within 10 business days or (b) cease issuing the product within 10 business days.

We understand the intention of RG 000.126 however we suggest that the current proposed drafting may create ambiguity as to the expectations for ceasing offering the product once a trigger occurs. RG 000.126 implies that an issuer must immediately cease issuing which would not be practical nor does it provide any avenue for an issuer to review its TMD as a consequence of a review trigger occurring, and coming to a conclusion that the TMD remains appropriate. We would recommend RG 000.126 be aligned to the obligations contained within s994C(3)–(5) which provides a practical mechanism for the ceasing of distribution if a TMD cannot be reviewed (and a determination made as to its appropriateness) within 10 business days.

The FSC considers issuers should be able to consider a review trigger to see if it impacts the TMD before looking to stop ongoing distribution, and such period of consideration (being not

longer than 10 business days) before looking to stop distribution would be considered "as soon as practicable" for the purposes of section 994C(5). We request clarification from ASIC that this is indeed permitted.

Ceasing to issue a product that is still suitable for many consumers generates a poor consumer outcome, for example where the unit price increases during the review period. Stopping distribution of a product during a TMD review appears to be a somewhat excessive measure, particularly if a TMD review leads to no changes. Ceasing to offer products takes time – and necessarily involves disclosure updates, system updates, change management with distributors, and the need to deal with inflight applications etc. This is particularly inefficient if the review reveals that minimal or no changes are required.

However, if an issuer considers a TMD to be no longer appropriate (for any reason, including a review trigger), then it is arguable the issuer should stop distribution immediately. We note the draft RG does not indicate which situations (other than a review trigger) would result in a TMD being no longer appropriate. We request clarification from ASIC on these situations.

We also consider that RG 000.126 should acknowledge that distribution that is excluded conduct may continue while a TMD review is being undertaken.

In addition, RG 000.126 states that "If the issuer becomes aware that an event or circumstance has occurred that would reasonably suggest that the target market determination is no longer appropriate" and then states "eg if a review trigger has occurred". However, the implied equivalence of these two situations is not correct, for example a review trigger may occur with no clear indication that the TMD is inappropriate, such as a regular TMD review.

Recommendation: The regulatory guide should be amended in the following ways:

- the comments on ceasing distribution during a review period be aligned to the obligations contained within s994C(3)–(5). In particular, issuers should be able to consider a review trigger to see if it impacts the TMD before looking to stop ongoing distribution, and such period of consideration (being not longer than 10 business days), before looking to stop distribution.
- to acknowledge that distribution that is excluded conduct may continue while a TMD review is being undertaken.

ASIC Question C9Q2

Do you have any comments on the following examples, which we have used in our guidance to illustrate key principles set out in RG 000.127–RG 000.130:

(a) Example 12: Insurance; and

(b) Example 13: Managed fund?

FSC Comment

Example 13: Managed fund

We have concerns with the approach proposed in this example that significant changes in market conditions, or losses suffered by holders, might be *per se* appropriate trigger points for review. For example, in time of economic downturn, if every issuer needs to stop issuing their products, this will become a much larger problem in the market. Whether market conditions would cause a review trigger to occur will depend on how market behaviour was considered in designing the product – in particular, a market movement is more likely to require a review for an investment product with a short term horizon than one with a very long horizon.

The FSC submits that stating issuers of a managed fund could consider "the taxation implications of the product compared to similar products" is too onerous in its current form. The tax implications are not only dependent on the product, but also the consumer's personal circumstances which an issuer is unlikely to know (as discussed elsewhere in this submission). However, we can see the case for a review relating to very material tax changes that would make a certain type of investment vehicle completely uncommercial or unlikely to meet any of its objectives – but this is much narrower than the cases used in the example.

C10 Required information from distributors

We propose to give guidance on the issuer's obligation to specify in the target market determination:

(a) any information that it considers is necessary to require from its distributors in order to promptly decide that a target market determination may no longer be appropriate; and

(b) the reporting period for the information the distributor must provide to the issuer about the number of complaints about the financial product.

See draft RG 000 at RG 000.135–RG 000.142.

ASIC Question C10Q1

Do you have any comments on our guidance on the issuer's obligation to specify information it requires from its distributors?

FSC Comment

Vertically integrated organisations that distribute their own products are likely to be able to specify information they require from distributors as there should be linkages between the product governance framework and distribution side of the business, which also allows for more frequent bilateral feedback.

However, monitoring of distributors, particularly third-party distributors, is likely to be very difficult, especially given that distributors will end up having all their material reviewed by

every issuer for which they distribute products. See also the comments on supervision of distributors in response to B1Q1.

The FSC is recommending a period of facilitative compliance after the legislation comes into effect, which would greatly assist issuers working towards specifying the information required from distributors and to implement standard distribution agreements, where needed. This is covered in more detail in a section called 'ASIC compliance approach' later in this submission.

See also answer to C10Q2.

Where distribution of products is done via third parties not associated or aligned with the product issuer, for example via a financial adviser or a platform, these distributors will not know what data they need to start collecting for each product until they are provided with the relevant TMD. Ideally distributors will need this information at least 6 months prior to the commencement of the DDO regime to be able to update their internal systems and processes to collect and report on the required data. We suspect that many product issuers will not have finalised their TMDs by six months before the start date (ie September 2020). In this event it would be useful for ASIC to clarify its expectations of distributors if systems for this collection of information are not in place by Day 1. In these instances, there may be an opportunity for distributors to collect this data after the product has been distributed where there is a low risk of consumer harm.

ASIC Question C10Q2 – existing information

What existing information collected by distributors would be relevant to an issuer's consideration of the ongoing appropriateness of its target market determination?

FSC Comment

It is difficult to answer this question as the data collected to date from distributors by issuers (whether it be transactional, consumer or fund level) has not been as extensive or frequent as the collection of data from issuers by distributors (which is generally collected in order to satisfy their compliance requirements for distributing the product and more specifically having the product named in the PDS). Data collected currently is ordinarily limited to those required under KYC and AML obligations. Issuers generally do not currently have a high level of visibility of the data collected by distributors. See response to C2Q1.

Until TMD criteria are established, issuers may not know what information is required to allow them to continue to assess the appropriateness of the TMD. It will be difficult for distributors to be able to collect data from the commencement of the DDO requirements as they will need to consider the TMD for each product being distributed. This collection may work better in practice where the issuer and distributor are one and the same, or a related party, however it will be quite difficult in the situation where the distributor is a third party, including financial advisers.

This is one reason why the FSC is recommending a period of facilitative compliance after the DDO regime starts, see response to C10Q1 and the separate section 'ASIC compliance approach' in this submission.

ASIC Question C10Q3

In addition to the information set out at RG 000.139, are there other types of information an issuer should collect from distributors? If so, please describe the type of information you think would be relevant.

FSC Comment

We do not consider it necessary for ASIC to provide additional guidance in an RG on this issue, particularly as commercial negotiations can be more adaptable to changing technology and circumstances compared to regulatory guidance. However, we would be happy to work together with ASIC on practical implementation issues outside the more formalised context of an RG.

ASIC Question C10Q4 – information & competition

What potential effects on competition may occur as a result of the issuer's right to set the information the distributor must provide?

FSC Comment

Competitive tensions may arise where an organisation distributes products on behalf of a third party, where that party is also a competitor in the market. In these instances, information sought from a distributor may be commercially sensitive. However, the information flows under the DDO regime are generally needed to ensure the regime works as it is intended.

These and similar issues may have adverse impacts on competition. We suggest that ASIC provides guidance as to how organisations should consider the data exchange requirements in conjunction with their existing requirements under competition law.

As a result of DDO, distributors, including financial advisers, may be inclined to consider a smaller selection of products when making a product recommendation to reduce the cost and effort of distributor reporting. This could result in worse outcomes for consumers as potentially better products may be overlooked.

There is also the potential for the number of issuers that distributors use to decrease or become more concentrated. Given that distributors will have the obligation to report back to issuers on the product they are distributing this may create a barrier to entry for new issuers of products.

ASIC Question C10Q5 – reporting period

Do you have any comments on our guidance on the issuer's obligation to specify the reporting period in relation to the number of complaints?

FSC Comment

We note ASIC is reviewing and updating RG 165, with further consultations planned in respect of collecting and reporting of internal dispute resolution complaints data. There is benefit in aligning the reporting requirements to be finalised under RG 165 with reporting of complaints under DDO, where appropriate, given the differences of the objectives of

reporting in the DDO regime. However, this will be dependent on these requirements being finalised and implemented before the start of the DDO regime. This does not appear likely at the moment given the further consultations required and the proposed timeframes in the original consultation.

We would appreciate ASIC's comments on this and appropriate interim steps distributors should be taking to ensure standardisation of complaints reporting under DDO across industry.

C11 Review of target market determinations

We propose to give guidance that, in reviewing a target market determination, we expect the issuer will take into account all available information on its financial product, using multiple data sources.

See draft RG 000 at RG 000.143–RG 000.145.

ASIC Question C11Q1

Do you consider our guidance on the types of information issuers should have regard to (described at RG 000.143) to be useful? If not, why not?

FSC Comment

The FSC submits the requirement to use 'all available information' may be unintentionally broad. We suggest removing the word 'all'. For example, newspaper articles, blog articles and TV stories are 'available' but it would be unreasonable to expect issuers to take all of these into account.

FSC recommendation: in RG 000.143, change "take into account all available information" to "take into account relevant available information".

ASIC Question C11Q2 – other data sources

In addition to the data sources described in draft RG 000 at RG 000.143(a)–RG 000.143(d), are there other sources of information that you think an issuer should take into account in reviewing a target market determination?

FSC response

The FSC's members have been working together for some time on the data used to review a TMD. We do not consider it necessary for ASIC to provide additional guidance in an RG on the data used for reviewing TMDs, particularly as commercial negotiations can be more adaptable to changing technology and circumstances compared to regulatory guidance. However, we would be happy to work together with ASIC on practical implementation outside the more formalised context of an RG.

ASIC Question C11Q3

Do you have any other comments on our guidance on conducting a review of a target market determination?

FSC response

As a general comment, the heading above RG 000.131, “Specifying reasonable maximum review periods”, could be read as discussing a maximum limit on the time taken for TMD reviews; a better phrasing of this might be “Specifying reasonable maximum periods between reviews”.

In RG 000.144, ASIC states that the issuer should check whether the product’s performance is significantly different from what the issuer originally expected and communicated to the distributor or consumer at the time of sale. From an investment perspective this is difficult to assess in a timely manner as performance objectives and timeframes are different per investment option. It may also not provide an accurate view of performance especially for superannuation which is a long term investment, or where there has been a significant market correction in a particular year.

C12 Notifying ASIC of significant dealings

We propose to provide guidance that the factors an issuer should consider when determining whether there has been a significant dealing in a financial product that is not consistent with the product’s target market determination include:

(a) the proportion of consumers who are not in the target market acquiring the financial product;

(b) the actual or potential harm to consumers; and

(c) the nature and extent of the inconsistency of distribution with the target market determination.

See draft RG 000 at RG 000.147–RG 000.148.

ASIC Question C12Q1

Are there any additional factors that issuers should consider? If yes, please provide details.

FSC Comment

Significant dealings – high-level comments

We are concerned that the proposed form of the significant dealings notice (in Table 4 at RG 000.149) goes significantly further than the obligation to ‘notify of significant dealings’ under section 994G. The legislative intention of that section is for issuers to notify of significant dealings and section 994G does not expressly suggest or imply that issuers must at the same time notify ASIC of:

a) The date that the issuer became aware of the significant dealing;

b) Why the dealing is considered to be significant;

c) How the significant dealing was identified;

d) What steps have been taken in relation to persons affected by the significant dealing; or

e) What steps have been taken to 'ensure' that the significant dealing does not occur again.

If the intention is to require this additional disclosure then we suggest that the appropriate method to achieve that is by amendment to section 994G.

We also note that issuers are not required to 'ensure' that significant dealings do not occur. The final row of Table 4 (in relation to what steps have been taken to 'ensure' that the significant dealing does not occur again):

- represents a significant departure from, and step up from, the actual obligation of issuers in section 994E(1) to 'take reasonable steps' that will, or are reasonably likely to, result in retail product distribution conduct in relation to the product (other than excluded conduct) being consistent with the determination; and

- is inconsistent with the statement in RG 000.78 that in some circumstances an issuer may deem it appropriate to consider consumers in the target market acquiring the product as part of a diversified portfolio. Table 4 indicates that ASIC's view is that no significant dealings are permitted even where a number of consumers are seeking diversification of their portfolio.

As a practical matter, given that this notice has to be made as soon as practicable and no later than 10 business days after becoming aware of the significant dealing, we submit that it is not practicable to expect the level of detail required by Table 4 to be provided in that period. It could take the whole 10 business days to investigate the dealing, make enquires of all relevant persons, receive and verify the information provided and make a determination that the dealing is significant and is not an excluded dealing. In very few cases will the issuer be also able to determine what steps need to be taken next, and have been taken, in that 10 business day period. Implementing changes to distribution channels in such a short period is not a realistic expectation.

While the opening words of RG 000.149 state that the notification 'can include' the information in Table 4, we are concerned that the inclusion of this table will cause industry to feel that they must 'opt in' to this higher level of obligation to meet ASIC's expectations. We consider that the level of prescription in Table 4, which contains much more detail than the legislation, is not appropriate for ASIC to raise in an RG and we submit that Table 4 should be removed from the regulatory guide.

Significant dealings – comments on details

In RG 000.146 we recommend that the opening words are amended to align with the words of section 994G(b) by adding "in relation to a retail client" so that it reads "An issuer must notify ASIC of a significant dealing <u>in relation to a retail client</u> (except excluded dealings) ….". This is a small but important change because issuers are not required to report significant dealings in relation to wholesale clients to ASIC. In the absence of this

amendment, issuers could conclude that ASIC's expectation is that significant dealings with wholesale clients should be reported.

We note that RG 000.148 (b) would be preferably worded as "as a result of consumers" (rather than "from consumers") as we understand ASIC's intention to be referring to the harm to the consumers outside the target market that acquired the product, rather than impacts to other members (within the target market) holding the product being impacted by consumers outside the target market acquiring it.

As a more general comment, in RG 000.150, in relation to ASIC taking "further action" it would be useful to insert a cross reference to section E of the RG which outlines the types of 'further action' that ASIC might take.

Significant dealings and personal advice

We request the RG provides clarity around situations where a financial adviser advises a client to acquire a product and the consumer is outside the target market. Under section 994F, significant dealings where the consumer has been given personal advice need to be reported (as there is no carve out for "excluding dealings") but these dealings do not need to be reported to ASIC under section 994G. It would be helpful for the RG to clarify these issues.

D1 Reasonable steps for distributors

We propose to give high-level guidance on the reasonable steps obligation for distributors of financial products by setting out our view on factors that may be relevant to this obligation, including:

(a) the distribution method(s) used;

(b) compliance with distribution conditions;

(c) the marketing and promotional materials circulated by the distributor;

(d) the effectiveness of the distributor's product governance framework;

(e) the steps taken to eliminate or appropriately manage the risk that incentives for staff or contractors may influence behaviours that could result in distribution being inconsistent with the target market determination;

(f) whether reliance on existing information about the consumer is appropriate;

(g) whether the distributor has given staff involved in distribution operations sufficient training; and

(h) how the distributor forms a reasonable view that a consumer is reasonably likely to be in the target market.

See draft RG 000 at RG 000.154–RG 000.163 and Table 5.

ASIC question D1Q1

Do you agree with the factors listed in Table 5 of draft RG 000 that we will take into account when considering whether a distributor has met the reasonable steps obligation? If not, why not?

FSC Comment

Under the item “Reliance on existing information about the consumer”:

- we request clarification of “the likelihood of circumstances changing…” The DDO regime’s focus is on point of sale, and this and the last paragraph suggest ongoing monitoring of consumers. This appears to be outside the remit of the DDO regime.
- This item suggests that broad assumptions about consumers (eg consumers who share a post code) can be implied or assumed. It will be helpful if the guidance could make it clear that assumptions should not be made based on grounds such as sex, post code, race, social class etc. It will be reasonable and fair to rely on unbiased information, such as financial objective, risk profile.
- In the situation where an existing consumer acquires a new financial product, we request clarification in the RG that the age of the information, and the likelihood the information is out of date, be considered. The use of out of date information could be quite problematic.

As a more general point, we question Table 5 listing factors that ***ASIC*** will take into account – it would be better to phrase this as factors that ***issuers*** should take into account when determining their DDO obligations. A change to this language would acknowledge that ASIC does not approve reasonable steps obligations, and parties other than ASIC (in particular the courts) can determine whether issuers are complying with the DDO regime. A similar point is made about Table 3 above.

ASIC Question D1Q2

What additional factors, if any, do you consider should be included in Table 5 of draft RG 000?

FSC response

We do not consider it necessary for ASIC to provide further content for Table 5. However, we would be happy to work together with ASIC on this table, outside the more formalised context of an RG.

Note other sections of this submission raise areas where the FSC is requesting additional guidance on how the reasonable steps obligation works in specific circumstances. However, to the extent these requests are specific to a particular class of products, they do not necessarily warrant a change to Table 5 which should apply across all financial products.

General observations on reasonable steps for distributors

IDPS Example (RG 000.155)

We recommend that platforms that are subject to third party personal advice should be covered by the personal advice exemption, see section on FSC recommended exemptions under section E1 (**Error! Bookmark not defined.**).

Given this, we recommend RG 000.155 be amended as follows (adding underlined text):

> *(b) the distributor's reasonable steps obligation under s994E(3) in relation to the underlying financial products offered on the platform unless there is excluded conduct on the part of the downstream distributor who provided compliant personal advice to the consumer.*

Example 14 & anti-hawking and personal advice

Example 14 about general insurance includes this text: "informing the relevant consumers that the information held indicates the consumer may no longer be in the target market for the product and ***offering alternative products*** whose target markets the consumer would likely be in." (bold and italics added).

We note this approach could be in breach of the 'no hawking' recommendation of the Royal Commission (which is yet to be legislated, but has bipartisan support). If this is true, then alternative products cannot be *offered* if a consumer is no longer in the target market. This could result in particularly poor consumer outcomes – the consumer would not be able to find out about products that are likely to be more suitable. This should be clarified including – if ASIC has a view – what statement or approach would ***not*** constitute hawking where a client has been determined as being outside the target market of another product.

There is a proposed carve-out from the hawking rules in relation to investments:

> "an offer for the issue, transfer or sale of an interest in a managed investment scheme that is made to a client by a financial services licensee through whom the client has acquired or disposed of an interest in a managed investment scheme in the last 12 months" (proposed s992A(2)(d)).[1]

Despite this, it is arguable that the approach in Example 14 would still be in breach of the anti-hawking provisions in relation to an interest in an investment product acquired through a platform – only the platform could offer an alternate product, the issuer of the underlying product itself would not be able to. Further, the narrow exemption is limited to managed investments only.

[1] See: Exposure draft of *Financial Sector Reform (Hayne Royal Commission Response—Protecting Consumers (2020 Measures)) Bill 2020*: Hawking of financial products https://treasury.gov.au/sites/default/files/2020-01/c2020-48919i-exposure-db.pdf

We also note that offering a consumer alternative products may also be (or appear to be) personal advice – this also needs clarification.

FSC recommendation: ASIC to clarify that if a consumer is outside the target market for a product it is not a breach of the anti-hawking rules if the consumer is offered another product where the consumer is likely to be inside the target market, and in addition making this offer is not considered personal advice.

Example 16 – direct life insurance

This example states ASIC *Report 587 The sale of direct life insurance* (**Rep 587**) found that direct life insurance leads to poor consumer outcomes.

However, the findings in Rep 587, which was released in August 2018, are based on data from 2010 to 2017 and do not relate to current industry practice. Importantly, Rep 587 focussed on direct life insurance sold through outbound telemarketing. This is not reflective of current practices, as from 13 January 2020 there has been a ban on unsolicited telephone sales of direct life insurance and CCI. We also note outbound telemarketing is not mentioned in Example 16.

FSC recommendation: In Example 16, remove the references to Rep 587 and findings within. If however, this reference (and findings within) were to be included, these findings should be both relevant and appropriately nuanced to reflect the substantial changes in industry practice since Rep 587.

D3 Asking questions of consumers

We propose to provide guidance:

(a) that, in most cases, a distributor should have sufficient information about a consumer through its existing sales processes to form a reasonable view on whether the consumer is reasonably likely to be in the target market for a financial product;

(b) that the ways a distributor's processes could assist it to form a reasonable view that a consumer is reasonably likely to be in the target market for a financial product include:

(i) the inclusion of 'knockout questions' within application processes;

(ii) analysis of data held on the consumer or a class of consumers; and

(iii) in some cases, asking the consumer direct questions to determine whether they are reasonably likely to be in the target market (see draft RG 000 at RG 000.168(a)–RG 000.168(c)); and

(c) on the steps that a distributor can take to reduce the likelihood that a consumer will be left with the impression that their personal circumstances have been considered, including:

(i) not having a relevant provider (i.e. an individual authorised to give personal advice to consumers on relevant financial products) involved in the distribution process to ask specific questions of a consumer and communicate the view that the consumer is in the target market to the consumer; and

(ii) only asking specific questions of a consumer (when required) in the later stages of the sales process after the consumer has already made the decision to acquire the financial product (see draft RG 000 at RG 000.169(a)–RG 000.169(b)).

ASIC Question D3Q1 – distributor existing information

Do you agree that, in most cases, a distributor would have sufficient information about a consumer through its existing sales processes to form a reasonable view on whether the consumer is reasonably likely to be in the target market for a financial product?

FSC response

Sales of wealth products direct to consumers

The FSC considers this view is incorrect for most investment, superannuation and platform products issued direct to consumers, so where the issuer is also the distributor. In many cases, issuers of these products would only collect information to satisfy AML/KYC requirements (see response to C2Q1).

As a result, an issuer of these products distributed direct to consumers would be unlikely to have sufficient information about diversification of the consumer's portfolio, their risk preferences, or the desired objective of the consumer in acquiring the product (such as growth, capital protection, income stream etc).

Issuers of these investment, superannuation and platform products direct to consumers currently do not need to ask detailed questions about the customer such as questions about:

- the other assets owned by a consumer;
- the consumer's risk appetite; or
- the need, objective or financial situation the consumer is looking to address in acquiring the particular product.

Asking detailed questions such as these could risk the perception that the issuer is providing personal advice (see response to D3Q3 below), and could risk an increase in internal/external complaints. However, consumer attestation could be useful in some cases – see response to D3Q4 and D4Q2 below.

In addition, in some cases investment products may be used to formulate structured portfolios (or managed portfolios) without the involvement of the product issuer. The issuer of the managed portfolio will usually have their own PDSs. This demonstrates the limited control issuers of investment products have on the distribution of their products.

A similar argument could apply to distributors that are aware of some, but not all, of a consumer's full financial position (for example, a non-super platform provider where the consumer also has significant superannuation savings, a home, and a home loan).

The FSC has significant concerns about the proposal to ask questions at the later stages of a sale process – see response to D3Q3.

Platforms

In relation to platforms as distributors, we note that platforms where the consumer is subject to third party advice would have limited information about the consumer (see response to C2Q1). In this case, we also consider the view in the draft RG that a distributor would have sufficient information about a consumer to be incorrect as well.

A platform might have substantial information about a consumer would be when the platform is integrated with the consumer's financial adviser, and the consumer received personal advice. However, in this case the product issuer is usually required to interact with the advice licensee on an 'arms-length' basis and would not be privy to any data or information that the advice licensee possesses.

Regardless, for many platforms it is more common for the platform to be covered by unaligned advice than aligned advice.

General advice

In addition, when the distributor is represented by an adviser providing general advice, there may be insufficient information available to assess against the TMD.

ASIC Question D3Q2 – information useful for target market assessment

What data do you consider would help distributors reasonably conclude that a consumer is reasonably likely to be in the target market for a financial product?

FSC response

If ASIC's guidance implies issuers and distributors need to know about the risk profile of a consumer's existing financial position to determine if a consumer is reasonably likely to be in the target market for a financial product, this would cause significant problems – this would be suggesting that the issuer or distributor would need to determine what is an acceptable level of risk for the consumer (moving into personal advice).

The FSC considers ASIC should provide an example of hypothetical questions that a consumer would need to be asked to determine their alignment with a TMD, particularly for online/direct distribution or when applying for an IDPS.

ASIC Question D3Q3 – other processes

Do you consider our guidance should identify (in draft RG 000 at RG 000.168) other ways that a distributor's sales processes can assist it to form a reasonable view that a consumer is reasonably likely to be in the target market for a financial product? What other approaches can be taken?

FSC response

Reasonable steps to ensure product is only distributed to persons likely to be in the target market versus not providing personal advice

The FSC has considered the issues with both:

1. meeting the obligation of ensuring that reasonable steps are taken to align distribution with the target market; and
2. doing this without providing personal advice (unless licenced).

The DDO regime provides an exception from any personal advice obligations where the distributor has made enquiries for the sole purpose of determining if the customer is within the target market.

In the FSC's view both matters above could be satisfied where it is made clear to the customer that the questions are only being asked to assess DDO obligations. We think one realistic means to do this is to tell the customer that questions are being asked to ascertain if they are likely to be in the target market, and that the distributor in asking those questions, is not providing any advice (general or personal). We consider that the RG should recognise that one means of meeting both these obligations (DDO and not providing personal advice unless licenced) is that the distributor clearly informs the customer that the purpose of the enquires are solely to ascertain if they are in the target market.

FSC recommendation: the RG acknowledges that a means of meeting an issuer's/distributor's reasonable steps obligations without providing personal advice may be met by the distributor clearly informing the customer that the purpose of inquiries is solely to assess whether the client is in the target market.

ASIC Question D3Q4 – personal circumstances

Do you have any comments on our proposed guidance (in draft RG 000 at RG 000.169) on how a distributor could reduce the likelihood of leaving a consumer with the impression that their personal circumstances have been considered?

FSC Comment

We understand ASIC's concern (noted in RG 000.169) that a consumer should not be left with the impression that their personal circumstances have been considered when they have not. We agree and consider that it will be important for both consumers and issuers/distributors to be clear about when personal advice is given and when it is not. This is particularly important in view of the recent reforms increasing the regulation applying to the provision of personal advice and recent judicial consideration of the personal advice test.

We would welcome some more guidance from ASIC in the draft regulatory guide in this respect, in relation to the situations noted below.

RG 000.176 notes that the Corporations Act provides a limited exception to the personal advice definition in section 766B(3A). This exception provides that: the acts of asking for information solely to determine whether a person is in a target market for a financial product,

and of informing the person of the result of that determination, do not, of themselves, constitute personal advice. Importantly this exemption uses the word ‘solely’ and is directed to questions testing solely whether a particular person is (or is not) in the target market for a particular product.

We would welcome any guidance ASIC can provide in relation to the ability of issuers and distributors to ask more general knockout questions, not phrased for example with respect to a particular product, while remaining within this important exemption.

It seems to us that issuers and distributors could deliver a better consumer experience and be more consumer–centric if they could use qualifying questions at the outset of the engagement with a consumer, to filter the long list of financial products or investment options available into a shorter list of financial products in relation to which the consumer could be in the target market.

These knockout questions could be in relation to risk level preferences, liquidity preferences and fee preferences for example, but would not be directed to any particular products. For example, a responsible entity may have a range of say 40 managed investment schemes available for investment on its website and it could use qualifying questions to ‘grey out’ the managed investment schemes whose features do not match the preferences indicated by the consumer in their responses to the knockout questions and reduce the ‘available’ options on the website to say 4 managed investment schemes.

- From the consumer’s perspective, they would have the option to look at the PDSs and TMDs for those 4 schemes, which is helpful for them and makes for a more efficient investment process and they should not (reasonably) form the impression that the responsible entity has given them personal advice.
- However, from the responsible entity’s perspective, there is a risk that this filtering activity amounts to personal advice and does not fit into the personal advice exemption. If ASIC has a different view or considers that this kind of activity is within the intention of the section 766B(3A) exemption, we would be grateful if this could be noted in the regulatory guide to provide more certainty for issuers and distributors that they can use knock out questions and filtering in this way to deliver a more consumer–centric experience.

We also request ASIC revisits RG 000.169(b) which suggests that in order for knockout questions to fall within the personal advice exemption and to not give the consumer the impression that they are receiving personal advice, the distributor should be asking specific questions of a consumer (when required) in the later stages of the sales process, after the consumer has already made the decision to acquire the product.

- We are concerned that if issuers and distributors adopt that approach, testing for whether a consumer is in the target market after they have made an investment decision (and potentially read the disclosure document and completed an application form), it may be an irritating or frustrating experience for the consumer if they are found to not be in the target market and if their application is rejected for that reason.

- We think that a better and more efficient consumer experience could be achieved by asking knockout questions earlier.
- We would be interested to know if ASIC would consider amending RG 000.169 (b) to give issuers and distributors comfort that they can ask knockout questions before an investment decision is made, within the personal advice exemption and by giving clear disclosure that no personal advice is being given.

If ASIC considers that knockout questions should be asked after an investment decision has been made, to improve the potential consumer experience at that point in time, we would welcome ASIC's guidance in relation to asking knockout questions:

- to not only determine whether the consumer is in the target market for the particular product they had made an investment decision about; but
- if the consumer is not in the target market, to also determine what other financial products the distributor may be distributing and in relation to which the consumer could be in the target market.

For example if a responsible entity has a range of say 40 managed investment schemes available for investment, and the consumer is found to not be in the target market for the scheme that they had applied for, when rejecting their application, could the responsible entity use knockout questions to identify other managed investment schemes in relation to which the investor could be in the target market and inform the consumer of that short list? That would be helpful for a consumer and be a more efficient way for them to find an alternative investment opportunity, but again there is a risk that this amounts to personal advice and does not fit into the personal advice exemption. If ASIC has a different view or considers that this kind of activity is within the intention of the section 766B(3A) exemption, we would be grateful if this could be noted in the regulatory guide to provide more certainty for issuers and distributors that they can use knock out questions in this way to deliver a more consumer–centric experience.

Recommendation: ASIC provide greater guidance on what can be done that is within the personal advice exemption while still resulting in good consumer outcomes.

As a more general observation, we consider the draft RG is unclear at RG 000.177 in stating that distributors should not set up interactions in 'a way that gives the consumer the impression their personal circumstances are being considered, and any recommendation to buy the financial product has taken into account the consumer's individual circumstances.'

We request further expansion of this sentence, which would benefit from an example. As stated elsewhere in this submission, a higher risk investment product could be suitable for many consumers if it forms a small part of a larger portfolio. However, to determine accurately if a consumer is sufficiently diversified to be in the TMD for a higher risk product might mean questions have to be asked of the consumer such that the consumer is left with the impression that their personal circumstances have been considered.

It is difficult to imagine an interaction where a consumer has provided details of their needs, objectives and financial situation to a distributor and that distributor then having considered this data makes any attempt to redirect the consumer to a different product, or restrict the

consumer to certain investment options within a particular product, that the consumer is not given the impression their personal circumstances are being considered.

This is a dilemma for issuers and distributors that we submit should be clarified in the RG. Issuers and distributors do not have a choice – they must comply with the reasonable steps obligations of the design and distribution regime, and they also must comply with the licensing regime in not providing personal financial product advice (unless licenced to do so). This is why some further clarification on meeting both these obligations is sought.

One way to address this issue is through consumer attestation for limited components of the target market assessment. This may involve a consumer indicating they are acquiring the product as part of a diversified portfolio, or the consumer indicating what they seek from a product (capital protection, income, capital growth etc). This is not the consumer self-certifying they are in the target market of a product as a whole; this would be self-certification relating to individual components of a TMD assessment.

We recognise ASIC has concerns with relying on disclosure or attestations, but here we are considering consumers self-certifying factual information that could potentially be verified such as whether the consumer has a diversified portfolio.

A self-certification approach would need to address the issue of how long certifications would last.

D4 Consumers outside target market

We propose to provide guidance that the reasonable steps a distributor should take when selling a financial product to consumers who are outside the target market for the product depends on the circumstances of the interaction, the nature and degree of harm that might result, and the steps that can be taken to mitigate the harm.

See draft RG 000 at RG 000.170–RG 000.175.

ASIC Question D4Q1

Do you have any comments on our proposed guidance on the content of the reasonable steps obligation in these circumstances?

FSC response

There would be value in the RG providing more guidance on the type of information that needs to be captured to provide back to the issuer in these circumstances, including how to make the information meaningful without being client specific.

ASIC Question D4Q2

Are there any specific methods that you consider our guidance should identify for distributors seeking to meet the reasonable steps obligation in the context of interacting with consumers who are outside the target market for a financial product?

FSC response

There would be value in further guidance on “nature and degree of harm” to allow the distributor to properly assess this issue.

An example in relation to MIS would be instructive, for example a high volatility product is sought by a consumer, and the distributor, based on the TMD process, reasonably believes the customer would be better suited to a lower volatility product. This consumer may be intending to use this product as a small part of their portfolio. In this circumstance, would self-certification regarding diversification equate to sufficient reasonable steps?

We agree the nature and degree of harm will depend on the circumstances of the consumer, however, we do not necessarily believe the TMD process will provide an exhaustive list of circumstances to the distributor (in the same way as personal advice might) to confidently assess the nature and degree of harm. Therefore, further guidance on this matter would be helpful.

The draft RG suggests a distributor might have to recommend a more suitable product to a consumer as a reasonable step. In practice a distributor recommending alternate products (without formally providing personal advice) might have personal advice, hawking and competition implications where a consumer seeking a product from issuer A is redirected to a product issued by B (see our response to C10Q4). In addition, there may be hundreds of suitable products, making any redirection or recommendation even more challenging for distributors.

D5 Interaction with personal advice

We propose to provide guidance that a target market determination for a financial product should be considered by a financial adviser in providing the advice and meeting their best interests duty.

See draft RG 000 at RG 000.180–RG 000.183.

ASIC Question D5Q1

Do you agree that a target market determination for a financial product should be considered by a financial adviser in providing the advice and meeting their best interests duty? If not, please explain.

FSC response

We note that providers of personal advice are required to report significant dealings that are outside the TMD under section 994F(6), as well as report certain information to the product issuer. Therefore, advisers already have a legislative obligation to consider the TMD. However, this requirement relates to reporting after advice has been formulated, and it is not clear that requiring the TMD to be considered earlier in the advice process is appropriate. We note that an earlier consideration of the TMD is not a legislative requirement; the note to RG 000.181 puts this consideration as optional; and personal advice already involves consideration of the client’s individual circumstances and is subject to the best interest and other obligations under Part 7.7A of the Corporations Act.

Dealings following personal advice from a non-associated adviser

The FSC submits that the definition of 'excluded conduct' in the legislation does not reflect the Parliamentary intention because the definition is limited and does not extend to dealings following personal advice from a non-associated adviser.

This situation is common, particularly in relation to IDPS products. A large proportion of retail financial products are held via platforms where advice is provided by a third party entity which is not an associate of the platform provider.

This could include a situation where an adviser recommends a portfolio of investments through a platform, then arranges for the investments (the subject of the personal advice) to be acquired by the platform provider and accessed by the retail client through the platform. This process is repeated each time that further personal advice is received by the client.

While the adviser in this case is exempt from the 'reasonable steps' obligations, based on the current legislation, the platform provider does not appear to be (where they are not associated to the adviser or dealer group providing the advice). This is despite the fact that the platform provider is only executing the personal advice being provided.

In circumstances where personal advice is provided, this would then seem to require the platform provider to take reasonable steps that will, or are reasonably likely to, result in distribution of the underlying financial products on the platform being consistent with the TMD. In this event, there appears to be a transfer of the reasonable steps obligations from the adviser to the platform provider. In addition, the other distribution obligations around notifying issuers of significant dealings and collecting and reporting data appear to be duplicated between the adviser and the platform provider.

We do not believe this is reasonable in practice where the platform provider is simply giving effect to advice provided by the adviser, for the following reasons:

- The adviser has considered the individual's personal circumstances and deemed the underlying products appropriate having regard to their best interests duty. It would seem counterintuitive, and impractical, for the platform provider to then conduct a similar exercise to determine whether the distribution of the underlying products is consistent with the TMD for the underlying funds, while the reasonable steps in relation to distribution of the platform itself would not need to be considered (due to the platform playing the role of product issuer in this instance, and the adviser as the distributor).
- If platform providers are required to take reasonable steps in these circumstances, this is likely to place a considerable burden on platform providers in collecting data from advisers about the individual. While data required in relation to the platform itself may be limited due to the distribution channel (advice only), platforms may need to collect a variable amount of data based on which underlying products are being acquired to give effect to the advice provided. This is impractical where hundreds of products are available on the platform (consisting of millions of different possible variations).

- There is an overlap in collecting and reporting data. In distributing the underlying financial products, the adviser would have collected the necessary data from the individual necessary to report to the product issuer, as prescribed in the TMD. There is little benefit to the product issuer receiving data from both the adviser and the platform provider in relation to the same individual. This is inefficient and increases costs unnecessarily.
- There are unwarranted risks of legal action under the DDO regime against platforms with non-associated advice, while the same platform, subject to the same advice, but from an associated adviser, would not face this risk.
- It is unclear which distributor is required to notify the product issuer of any significant dealings in the underlying product – the adviser or the platform provider?

The FSC's preference is for ASIC to use its modification powers in section 994L to exempt issuers and distributors from the DDO distribution requirements or modify those requirements where the dealing is consistent with personal advice from non-associated advisers. This would treat platforms in the same way whether they are subject to associated advice or non-associated advice. There are no clear reasons to require more reasonable steps for non-associated advice than for associated advice. To ensure parity of treatment, the distribution requirements should be removed for non-associated advice.

To be clear, we are only requesting this in relation to platforms that are distributed via advisers, not for platforms distributed directly to consumers.

We would fully support a change to the RG to indicate ASIC would accept that platform providers satisfy the 'reasonable steps' requirement by verifying personal advice has been provided. However, a change to the RG will not ensure all risks of legal action under the DDO regime are removed; as a consequence platforms with non-associated advice may consider they need to apply some DDO distribution restrictions which will result in many of the problems outlined above.

D7 Provision of information to issuers

We do not propose to provide specific guidance on the practical aspects of the relationship between the issuer and the distributor regarding information exchange.

ASIC Question D7Q1

Do you think it would be useful to provide guidance on the following arrangements between the issuer and the distributor:

(a) whether there is a need for information requirements to be set out in an agreement between the issuer and the distributor;

(b) the format of information exchange; and

(c) the mode of delivery and communication of information?

If so, what considerations are relevant to these factors?

FSC response

The arrangements between issuers and distributors are critical to the operation of the DDO. The FSC's members have been working together for some time on these and related issues.

The relevant arrangements are best structured as a result of commercial negotiations between parties, and collectively through organisations such as the FSC.

Therefore, we do not consider it necessary for ASIC to provide guidance in an RG on these issues, particularly as commercial negotiations can be more adaptable to changing technology and circumstances compared to regulatory guidance.

However, we consider this is a critical issue for the operation of the DDO and we would be happy to work together with ASIC on how this could be implemented in a practical way, outside the more formalised context of an RG.

ASIC Question D7Q2

Are there other considerations that need to be taken into account in the collection and exchange of information between an issuer and a distributor?

FSC response

The '*excluded conduct*' exemption applies to the reasonable steps obligation but not the obligation to collect, keep and provide distribution information (see section 994F). Practically, if a platform provider and financial adviser are both distributors, this may mean that the platform provider and the financial adviser have to provide the '*distribution information'* to the product issuer. Where personal advice is given to a client to acquire products through a platform, the platform provider should be exempt from the distribution obligations (see section on FSC recommended exemptions under section E1 **Error! Bookmark not defined.**).

In addition, we request further ASIC clarification on who will be responsible to comply with the above obligations in the event that more than one distributor is involved with the retail product distribution conduct.

E1 ASIC administration of DDO – factors to take into account

We propose to give guidance on the factors that we will take into account when considering whether to provide an exemption from, or modification to, the design and distribution obligations. These factors include:

(a) whether the objects of Ch 7 are being promoted, including the provision of suitable financial products to consumers (see s760A(aa));

(b) the policy intention underlying the design and distribution obligations to:

(i) improve consumer outcomes; and

(ii) require financial services providers to have a consumer-centric approach to making initial offerings of products to consumers; and

(c) Parliament's intent (as reflected in the law) for these obligations to apply to a broad range of financial products.

See draft RG 000 at RG 000.232.

ASIC Question E1Q2

Are there any additional factors that you consider we should take into account?

FSC response

See answer to previous question.

ASIC compliance approach

The CP at paragraph 22 states that the ASIC guidance will be a useful starting point for industry, and that over time, ASIC's approach to administering the DDO regime may evolve with the benefit of experience, and that ASIC will update their guidance as required to reflect this.

The CP at paragraph 24 recognises that the approach to issuers and distributors to comply with the DDO on commencement of the regime may be different from the approach taken several years from now. And that it is expected that systems and processes will develop, be tested and refined and improved over time.

The FSC supports this approach and recognises that the industry will continue to mature as the requirements become more embedded and would be interested in hearing more from ASIC as to how it intends to supervise the regime in the short to medium term taking these sentiments in the CP in to account.

For example, fund managers and insurers will need to work closely with distributors to educate and take them on the journey to understand the ongoing expectations to enable issuers to meet their reasonable steps obligations. Fund managers would be aware that practically speaking on day one, the larger platforms and distributors are more likely to be at a higher level of maturity due to their scale, and they are also often issuers themselves. As an industry we want to work with distributors that exhibit the right approach and are making positive steps toward compliance – however recognise that their own maturity directly relates to our ability to meet our own obligations.

We also note that distributors may not know the distribution and information requirements placed on them by issuers until the exact start date of the DDO regime – they could have a large variety of requirements placed on them by issuers from the start date, but they could be unaware of these requirements until the date arrives. Distributors will not be able to implement these requirements instantaneously, which the black letter law indicates is a requirement.

This also indicates a period of facilitative compliance for the DDO regime is warranted.

Facilitative compliance

The FSC notes ASIC's view that the proposals in the draft RG were developed on the basis that they will help issuers and distributors understand what is required to comply with DDO requirements, and also help them implement the requisite appropriate measures to design products that comply with the DDO (paragraph 136 of CP 325). While the FSC supports this goal, CP 325 and the draft RG would require substantial additional guidance before issuers and distributors can fully understand their obligations and therefore begin to implement the appropriate measures. The issues raised in this submission, which was compiled with the participation and input from many FSC members, attest to there being considerable uncertainty as to the practical application of the DDO regime. Many of the issues raised in this submission do not simply go to seeking guidance on implementing the measures, but to more fundamental issues. Given the significant consequences (including potential criminal penalties), greater certainty is required before the industry can comply with the DDO.

While there are many fundamental and practical questions, there is not much time left – there is just over a year until these obligations are due to take effect. Even though the legislation was passed a year ago in April 2019, the Regulations and ASIC draft proposed regulatory guidance was only published about 4 months ago in December 2019. We are still considering how customer choice and filtering will work in the context of not providing personal advice. In addition, there are a number of key modifications that FSC is seeking, as detailed elsewhere in this submission – these modifications are critical to how DDO will apply in some specific cases.

We are concerned that, given the questions that remain and the tasks that need to be completed, issuers and distributors will be severely strained to comply with these obligations within the timeframe currently proposed. We also note the developing Covid-19 situation may further complicate the implementation of the regime in the time available.

DDO compliance will require new IT systems to be designed, implemented and tested. It will also require issuers and distributors to agree and amend their contractual arrangements to address the new requirements, something that cannot sensibly be done without knowing the potential limits of the IT solutions. Given these expectations, commencing this work before the release of final ASIC regulatory guidance would have been inappropriate.

During the Treasury consultations, which were attended by representatives of ASIC and some of our members, to discuss the DDO legislation, our members had understood that many of the uncertainties in the legislation would be addressed by ASIC in its regulatory guidance. There was also an expectation that ASIC's guidance addressing these uncertainties would be provided within a timeframe that would give issuers and distributors time to consider ASIC's proposals and respond to them; time for ASIC to finalise its regulatory guidance; and then time for subsequent implementation by issuers and distributors. This has not eventuated, with the result that what may appear to be a period of 24 months to comply with these obligations, is really only half that time with several fundamental issues outstanding.

Facilitative compliance by ASIC during a period after the regime commences would be welcome. If this does not occur, given the nature of the penalties that exist for non-

compliance, there is a high likelihood, that financial product distribution will be severely curtailed and the Australian financial services industry, more generally, will be placed at a competitive disadvantage compared to other jurisdictions in the region.

Recommendation: ASIC make an explicit commitment to implement a 'facilitative compliance' regime for the first 12 months of the operation of the DDO regime.

Other uses of modification powers

Other parts of this submission detail FSC requests for ASIC to use its modification powers in a number of areas, particularly Dealings following personal advice from a non-associated adviser, and various superannuation related modifications.

4. Other matters

Special issues for superannuation

We have prepared a separate section about the special issues that arise for superannuation as these issues relate to a number of parts of the proposed Regulatory Guide. The application of the DDO legislation in these situations is unclear and because of the significant potential penalties that apply for breaches of the DDO legislation, it is important that these provisions be clarified.[2] It has been established that where "the language of the statute remains ambiguous or doubtful the ambiguity or doubt may be resolved in favour of the subject by refusing to extend the category of criminal offences."[3] This was seen in the recent case of *Gore v ASIC (2017)* whereby a "regrettably unclear" provision of the Corporations Act was deemed "unsuited to a provision creating a criminal offence".[4] That clarity can be provided by ASIC exercising its modifications power.

Accordingly, the FSC requests ASIC to:

(a) exercise its modifications power to alter the way that DDO provisions apply to superannuation products by:
    - Exempting default super arrangements:
    - Exempting successor fund transfers; and
    - Exempting Family Law splits.

(b) Take a facilitative compliance approach to the DDO regime for the first 12 months (see also response to E1Q2).

(c) Adjust various parts of the RG to reflect the positions in this section of the submission.

What is a financial product in super?

The DDO provisions impose obligations on issuers and distributors when a retail customer acquires or is issued a financial product.[5] Therefore, the first question is, what is the financial product for superannuation?

A "financial product" in superannuation is the acquisition of "a superannuation interest".[6] This is a beneficial interest in the superannuation entity.[7]

"Choice products" and "MySuper products" embedded within a superannuation product are not themselves separate financial products. Rather they are just classes of beneficial

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[2] *Beckwith v R* [1976] HCA 55 Gibbs J at 576 ; 1976 135 CLR 569
[3] *Beckwith v R* [1976] HCA 55 Gibbs J at 576 ; 1976 135 CLR 569
[4] *Gore v Australian Securities and Investments Commission (2017)* 341 ALR 189 at 194.
[5] Under sections 994D and 994E, issuers and distributors have obligations in relation to "retail product distribution conduct", which is modified by the definition of 'dealing' in s994A(1) to broadly be issuing financial products to retail clients or arranging for retail clients to acquire financial products
[6] s 764A of the Corporations Act 2001.
[7] s 10 Superannuation Industry (Supervision) Act 1993 "superannuation interest"

interest[8] within that superannuation product (and are part of that member's broader beneficial interest in the superannuation entity).

In the EM for the legislation that introduced MySuper it states that the definition of a 'MySuper product' "*is not intended to imply that a MySuper product is a separate financial product under the Corporations Act. In most cases, the interest in the superannuation fund will be the relevant financial product.*"[9]

The FSC asks that ASIC clarify in the RG that the use of "choice superannuation product" is because the only part of the superannuation product relevant for DDO is the non-MySuper part of the product[10] (which ASIC is calling the "choice superannuation product") and ***not*** because ASIC's view is that the MySuper and the individual investment and insurance choice components in a superannuation plan are each separate financial products for DDO purposes.

It follows that a target market determination should *only* be required when the initial superannuation interest is acquired by the retail client and *not* when the client makes *subsequent* choices of underlying features whether they be insurance or other investment choices, within the fund.

It also follows that no TMD is needed if a retail client becomes a MySuper[11] member of a superannuation plan when they first join that plan and none is required when that client later makes investment or insurance choices within that super plan[12].

The FSC asks ASIC to include statements in the Regulatory Guide to reflect the paragraphs above.

However, if the description above is not the way that ASIC believes that the DDO provisions should operate, then the FSC asks ASIC to exercise its powers of modification of Part 7.8A (after consultation with the industry) to alter the way that the DDO provisions apply to superannuation products. Given the onerous penalties that can apply for breach of the DDO provisions, it is imperative that it is clear and transparent how the DDO legislation applies to issuers and distributors of superannuation products.

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[8] s 10 Superannuation Industry (Supervision) Act 1993 "MySuper Product" and "Choice Product"
[9] s 3.18 Explanatory Memorandum for the Superannuation Legislation Amendment (MySuper Core Provisions) Bill 2011
[10] Section 994B(3)(a) - MySuper is exempt from the DDO requirements
[11] Section 994B(3)(a)
[12] The DDO provisions only apply to "retail product distribution conduct" (definition in s994A, and see sections 994D and 994E prohibiting retail distribution conduct unless compliant with the DDO provisions). "Retail product distribution conduct" does not include varying or disposing of a financial product (s 994A (1) definition of "dealing"). Therefore, if the financial product is the super product, making choices within that product is 'varying' that product but is not 'applying for' or 'issuing' a new financial product. Therefore, the DDO provisions do not apply to the client making those investment and/or insurance choices.

However, where a person does not initially become a MySuper member when they first join the superannuation product (the super plan), the DDO provisions *will* apply at the time they join the super plan.

Where the person applies to become a member of the super plan, the person engages with the trustee (issuer) or with a distributor and there is some opportunity to collect the information needed to test if that person is in the target market.

However, where that person becomes a member of the super plan by another means, then there is little opportunity for the issuer/distributor to obtain the information needed to assess if that person is in the target market. And indeed, it is not clear what ASIC would expect the trustee to do (if it was possible to determine the person was not in the target market).

Here are 4 examples:

a) Employer sponsor enrolling an employee into a default fund (but not MySuper) to satisfy its obligations under the Superannuation Guarantee (Administration) Act;

b) A successor fund transfer;

c) A reversionary beneficiary (who acquires the interest on the death of the member); and

d) A spouse of a member who acquires an interest in the super product as a result of the split of the member's super benefit under Part VIIIB Family Law Act 1975 (Cth)

(a) Employer sponsor enrolling an employee into a default fund

Employers must give each employee a notice (choice form) setting out the default fund.[13] The employer may also pass on the PDS for that default fund. This choice form gives each employee the opportunity to choose a different super fund for their SG contributions if they wish (in the cases where employee choice is not prevented, for example by an enterprise agreement).

Where the employee has not chosen a fund, an employer is required to make the superannuation guarantee (**SG**) contributions for that employee to the default fund chosen by the employer.[14]

By contrast, a member is put into MySuper in a super fund if they do not make an investment choice.[15] An employee in a default fund and a MySuper member are not the same thing.

An employee in the default fund may or may not be a MySuper member – it depends whether that employee has any of their super invested in the MySuper component of the

[13] Section 32P of the Superannuation Guarantee (Administration) Act 1992 ('SGA Act')
[14] Section 32C of the Superannuation Guarantee (Administration) Act 1992 ('SGA Act')
[15] Section s29WA Superannuation Industry (Supervision) Act 1993

fund. Similarly, a MySuper member may not be in their employer's default fund (because the employee chose a MySuper product in a different fund).

Therefore, the MySuper exemption for DDO will not always apply to employees enrolled in a super fund by their employer. For example:

- SG contributions for an employer are made quarterly;[16]
- the employer may enrol a new employee into the employer's default fund at the beginning of a quarter (when the employee starts work);
- but the first SG contribution for that employee is not received until after the end of that quarter;
- during those 3 months, the employee has received their welcome pack and may be able to make an investment choice using an online facility provided by the trustee. If that investment choice is made before the first contribution is received, and assuming that choice does not include the MySuper option, that employee will not be considered a MySuper member. Instead the DDO provisions would have applied at the time that the employee joined the default fund (at the beginning of the quarter) and an assessment should have been made *then* about whether that employee was in the target market for the default fund.

Under regulation 7.8A.25, the employer is not a distributor (and so has no obligation to check that the employee is within the target market). For all the reasons set out in previous submissions, the FSC supports employers not being subject to the DDO requirements.

However, that leaves the trustee (as issuer) in a difficult position:

- the employer enrolled that employee into the super plan. The employer had a statutory obligation to do so in satisfaction of the employer's obligations under the Superannuation Guarantee legislation.[17]
- The trustee potentially has an opportunity to test the employee against the TMD at the time the employee chooses an investment option ***but*** arguably that is too late and the trustee is already in breach of the DDO provisions. In addition, if there is an expectation that members not within the target market are required to leave the fund, this would be a very poor customer experience and potentially exposes the employer to liability under the SGA Act.
- It is unclear how the DDO regime would apply to the trustee:
    - Would it be acceptable that 'reasonable steps' for the trustee are to not test employees put into the plan by their employer against the TMD?
    - If the employee was found to be outside the target market, the trustee could refuse to accept any contributions for that employee – but that would put the

[16] SGA Act, Part 3
[17] Section 32C of the SGA Act

employer in breach of the Superannuation Guarantee (Administration) Act 1992 [18]

- The trustee could force all employees enrolled in a default fund by their employer to initially become MySuper members (so that the DDO provisions don't apply on enrolment). It could do this by not offering investment choice until after the first contribution is received for each employee. However, this is a poor member experience for engaged members who wish to make investment choices.

– Arguably, the time to test was when the employee was enrolled into the super fund by their employer.[19] But *at that time* the trustee didn't know if the employee would make an investment choice and regardless, the trustee didn't have access to the information needed to test that employee against the TMD.

Recommendation: ASIC should exercise its modification powers and exempt default super products from the DDO regime by adding a new paragraph (g) to section 994B(3):

"(g) an interest in a superannuation product issued to an employee of an employer who, under section 32P of the Superannuation Guarantee (Administration) Act 1992, has specified the superannuation product as the fund to which the employer will contribute for the benefit of the employee if the employee does not make a choice."

(b) A successor fund transfer

Under superannuation legislation,[20] a member can be transferred to a new superannuation fund without their consent if the new fund is a "successor fund" – that is, a fund that confers on the member equivalent rights to the rights that the member had under the original fund.[21]

This is the most common way for a group of members to be transferred from one super fund to another. Much of the consolidation of the superannuation industry (in line with APRA's policy objectives) is achieved by way of successor fund transfer (**SFT**).

In addition, there are some cases where members are transferred between products within the same fund, commonly known as intra fund transfer (**IFT**). This is becoming more common, particularly for funds with legacy products. While not expressly legislated, the process trustees typically follow to approve these transfers is undertaken using the same equivalency tests that apply to successor fund transfers.

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[18] Because the employer must make the contributions to the fund in the notice that it gave the employee.
[19] That is, the time at which the DDO provisions apply is at the time that retail product distribution conduct occurred – ie at the time the employee was put into the super plan
[20] SIS Regulation 6.29(c)
[21] Regulation 1.03(1) of the Superannuation Industry (Supervision) Regulations, definition of "successor fund"

The interest issued to the members in the successor fund would be subject to the DDO provisions.

On transfer, if the same investment option is not available in the successor fund, members' accounts will be mapped to the investment options in the successor fund that most closely match the option (or options) in which they were invested in the original fund and insurance provided will also be consistent, in accordance with the equivalency requirement.

The DDO provisions will apply for any member whose account is wholly or partially invested in any superannuation interest other than MySuper.[22] And those DDO provisions will apply in relation to the whole of their interest in the receiving fund (the investment options, the insurance etc).

If the target market of the successor fund is similar to the target market of the original fund, then the trustee of the successor fund ***may*** be able to rely on information held by the original fund about the transferring members, ***but***:

- If those members joined the original fund before April 2021, it is very unlikely that the original trustee will have the information to demonstrate whether those members were within the target market for the original fund. And as the transferring members do not interact with the trustee of the successor fund in an SFT, there is no opportunity for the successor fund trustee to collect that information.
- The original fund will have only tested against the target market at the time each member joined that fund – which for many members may be many years before the SFT. Hence, that information will not be up to date. Again, as the transferring members do not interact with the trustee of the successor fund in an SFT, there is no opportunity for the successor fund trustee to update that information.
- It is unclear how DDO would apply to those members who may fall outside the target market based on information from the original fund trustee. Would those members need to be retained in the original fund? If so, there would generally be adverse outcomes for a small group of members retained in the original fund – eg fees and insurance premiums would typically increase[23] and some benefits (like insurance) terms may be changed unfavourably.[24]

By definition, the benefits in the successor fund will be equivalent to the benefits in the original fund. In that sense, members are in the same or equivalent position (from a DDO perspective) in the successor fund as they would be if they had remained in the original fund.

We note if this issue is unaddressed it could act as a barrier to fund mergers and industry consolidation which is an important policy priority for Government.

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[22] Because they will not be a MySuper member and so will not attract the exemption in s994B(3)(a)
[23] Due to the loss of scale of that cohort of members
[24] Again, reflecting the impracticality of maintaining benefit categories for only a small group of members.

Recommendation: ASIC should exercise its modification powers and exempt successor fund transfers from the DDO regime by adding new paragraphs (h) and (i) to section 994B(3).

"(h) where an interest in a superannuation product is issued to a retail client as a result of a successor fund transfer (as defined in Regulation 1.03(1) of the Superannuation Industry (Supervision) Regulations).

(i) where an interest in a superannuation product is issued to a retail client in superannuation product B because that client's benefits in superannuation product A are transferred to superannuation product B as a result of an internal fund transfer in circumstances where both the original product A and the new product B issued are products within the same superannuation fund as superannuation product A and the rights in respect of the retail client's benefits provided are equivalent."

(c) Reversionary beneficiaries

Typically, reversionary beneficiaries are the spouse or child of a member. The reversionary beneficiary acquires an interest in the superannuation product on the death of the member.

Generally, the interest acquired is a continuation of the benefit that the member was receiving before their death.

The reversionary beneficiary generally does not choose to acquire the benefit.[25] They would have been nominated by the member, usually at the time that the member acquired that product.

While there is some interaction between the trustee of the super fund and the reversionary beneficiary – eg to obtain bank account details to enable the benefit to continue to be paid and for AML/CTF purposes, typically, the trustee would not have the information to determine whether the beneficiary is in the target market.

It is unclear how the DDO would apply if the issuer/distributor cannot determine if the beneficiary is in the target market. One option is for the trustee to pay the entire benefit to the beneficiary as a lump sum payment to avoid breaching the DDO requirements. However this approach may not be in the beneficiary's best interests. It could have adverse tax consequences and once the benefit has been cashed out, the reversionary benefit cannot be reinstated and the beneficiary may not be able to re-contribute the benefit back into superannuation.

Recommendation: ASIC should use its modification powers to provide an exemption from the DDO requirements for reversionary benefits to the extent the reversionary beneficiary has no choice over the benefit.

[25] An automatic reversionary beneficiary does not choose to receive the benefit however the option to receive the benefit as an income stream may be offered to a nominated beneficiary or to a beneficiary the trustee determines is entitled to the benefit where no nomination is made.

If this approach is not taken, ASIC should set out in the Regulatory Guide what its expectations are in relation to the reasonable steps that a trustee needs to take before paying a death benefit pension to a reversionary beneficiary. In particular, in the Regulatory Guide, ASIC should state what the trustee is expected to do where:

- the trustee cannot obtain the required information to assess whether the reversionary beneficiary is in the target market; or
- the trustee is able to obtain that information and determines the reversionary beneficiary is not in the target market

(d) Family law splits

Part VIIIB Family Law Act 1975 (Cth) contains the superannuation splitting scheme that treats superannuation as property for the purposes of dividing property between spouses on the breakdown of the relationship.

Splitting of super may be by Financial Agreement (or Superannuation Agreement) under the Family Law Act or be by order of the Court. Typically, this involves a lump sum being set aside from the member's superannuation for the spouse. That amount will accrue in the super fund until paid to the spouse or as the spouse directs. Therefore, the spouse acquires an interest in the super fund as a result of the split.

The splitting arrangements are binding on the trustee of the fund and typically, there is little opportunity for the trustee of the super fund to collect information about the spouse (but even if it did, it is still bound by the splitting order or agreement).

We ask that ASIC exercise its modification powers to exclude spouse who acquire a super interest as a result of the split of a superannuation benefit of a member of that superannuation product under Part VIIIB of the Family Law Act 1975 (Cth). If that is not possible, we ask ASIC to include in the regulatory guide that in the circumstances of a family law split, the issuer/distributor will have taken reasonable steps by doing nothing more than complying with the Court order or Financial Agreement.

Recommendation: that ASIC exercise its modification powers and exempt family law splits from the DDO regime by adding /a new paragraph (i) to section 994B(3)

"(i) where an interest in a superannuation product is issued to a non-member spouse in a superannuation product as a result of the split of a superannuation benefit of a member of that superannuation product under Part VIIIB Family Law Act 1975 (Cth)"

Employers as retail clients

Employer sponsors of superannuation products are retail clients for some purposes under the Corporations Act. Generally speaking an employer would not acquire a beneficial interest in a super fund to which it contributes.[26] However, there are some circumstances where it

[26] See analysis earlier about what is a superannuation interest.

may do so (for example, where there is a surplus and the employer is entitled under the governing rules to be paid a share of that surplus).

It seems clear that the DDO obligations were directed at individuals acquiring a financial product as an investor (rather than the employer sponsor choosing a fund for its employees). The FSC asks that ASIC clarify in its Regulatory Guide that the DDO obligations were not intended to apply to the interaction between an employer sponsor (as a retail client) and a tender manager (as a possible distributor) or the employer sponsor and the trustee of a super fund in relation to that employer choosing that fund for its employees.

Secondary sales and exchange traded products

Secondary sales

The Revised Explanatory Memorandum (**Revised EM**) to the DDO regime sets out the following:

> 1.45 The new obligations only apply to primary or initial offerings of financial products to retail clients. They do not apply to sales of products on secondary markets unless such sales are made in circumstances that could otherwise be used to avoid the obligations. These situations are those already discussed in paragraphs 1.19 and 1.24 of this memorandum. This means that the obligations cease to apply if the product is no longer available to consumers by way of primary or initial offering.[23]

Paragraphs 1.19 to 1.24 of the Revised EM sets out the general position that the DDO regime applies to financial products that require disclosure in the form of a PDS. Typically, such disclosure is required upon the *issue* of financial products to retail clients. However, the EM notes circumstances where *sales* of financial products require disclosure, namely: off-market sales where the seller controls the issuer; sales amounting to an indirect issue; and indirect off-market sales where the seller controls the issuer. These sale situations require disclosure under section 707 (for securities) and section 1012C (for other financial products) of the Corporations Act, and are defined in the DDO regime as 'regulated sales'.

In RG 000, ASIC sets out the following:

> RG 000.17 Issuers and distributors do not have to comply with the design and distribution obligations for secondary sales of products, unless such sales are made in circumstances that could otherwise be used to avoid the obligations (regulated sale).
>
> Note: For the definition of 'regulated sale', see s994A(1).

ASIC provides no further guidance in relation to secondary sales of products. The FSC submits that RG 000 should provide clear guidance, consistent with the DDO's stated intention, that the DDO regime does not apply to products traded on secondary markets, including financial markets such as the ASX. Such guidance will provide regulatory certainty

to issuers of products which are traded on secondary markets, including issuers of listed securities (for example, listed investment companies and trusts) and exchange-traded quoted products (for example, ETFs and other quoted managed funds).

Offers of securities and exchange-traded products which are listed or admitted to trading status on the ASX market (as the case may be) must be able to be freely traded by retail investors following the listing or admission without infringing section 707(3) or section 1012C(6) of the Corporations Act. This requirement is set out in ASX Guidance Note 30 and reflected in the warranties that issuers make to the ASX upon application for listing or quotation (for example, see Appendix 1A and Appendix 3B):

> If the AQUA Products are to be admitted to Trading Status or to the AQUA Quote Display Board, an offer of the AQUA Products for sale within 12 months after their issue will not require disclosure under section 707(3) or section 1012C(6) of the Corporations Act.

That is, issuers of listed securities and exchange-traded products must warrant to the ASX that sales of their products do not amount to an indirect issue.

For completeness, such sales clearly do not amount to a direct or indirect off-market sale by a controller and therefore do not fall within sections 707 and 1012C of the Corporations Act.

Accordingly, there is little doubt that sales of products which are listed or admitted to trading status on the ASX are not "regulated sales" within the meaning of the DDO legislation and the DDO regime does not apply to such trading.

In the Revised EM, Treasury states that the DDO obligations cease to apply if the product is no longer available to consumers by way of primary or initial offering. Again, any product which is listed or admitted to trading status on a licensed market ceases to be available by way of a primary or initial offering.

Recommendations:

- ASIC confirms in RG 000 that the DDO regime does not apply to sales of products on secondary markets *including* the sale of products which are admitted to trading status on the ASX (or similarly traded on another financial market).
- The RG provide further clarity in relation to the scope of the secondary sale exemption as it applies to both issuers *and* distributors. For example, by clarifying that distribution conduct in relation to secondary sales does not attract distribution obligations. An example of such distribution conduct may be online brokers.
- In addition to specific guidance, ASIC should extend Example 11 (*Listed Investment Companies*) to confirm that the DDO obligations cease to apply once the product is freely traded on the secondary market and no longer available to consumers by way of primary or initial offering.

Exchange traded products

Regulation 7.8A.09 provides that an issuer must make a TMD for an exchange traded product that is designed to be sold to a retail client. However, RG 000 provides no guidance in relation to the treatment of exchange traded products or other financial products for which

TMDs are required to be made under Part 7.8A Division 2 (as amended by the DDO regulations).

The FSC supports the DDO legislative intent that "issuers of exchange traded products such as ETFs should have the responsibility to issue a TMD in relation to the product, as they design the product and are therefore well placed to determine the target market for the product". The TMD is the cornerstone of the DDO regime as it requires issuers to focus on all aspects of product development, design and distribution and maintain effective governance processes across the lifecycle of financial products.

It is not clear, however, how the obligation for an issuer to make a TMD for an exchange traded product aligns with the secondary sale exemption (discussed above) which provides that the DDO regime does not apply to products traded on secondary markets (such as exchanges).

There may be instances of retail product distribution conduct in respect of exchange traded products that takes place outside of the exchange market. For example, direct to retail marketing campaigns and other direct and intermediated sales practices. In these cases it may be appropriate for issuers and distributors to ensure such conduct is consistent with the TMD for the product. However, the FSC submits that RG 000 should clarify that issuers and distributors do not have obligations under the regime to the extent that conduct relates to secondary market trading. The rationale for this is set out in the above submission relating to secondary sales.

Should ASIC hold the contrary view that the DDO regime *does* apply to exchange traded products traded on a secondary market, then the FSC submits that RG 000 should include guidance to assist issuers and distributors to comply with any obligations that may arise. There are considerable challenges for issuers and distributors to implement and comply with the requirements where products are freely traded by retail investors on a secondary market such as the ASX.

In particular if the regime does apply to ETPs on secondary markets, the FSC submits ASIC's guidance should address:

- the inability for issuers to specify conditions or restrictions on distribution on the secondary market;
- the inability for issuers to take steps to ensure distribution on the secondary market is consistent with the TMD;
- the inability for issuers to supervise and monitor distribution conduct arising on the secondary market;
- in relation to distributors, firstly who ASIC may identify as a distributor of exchange traded products sold on the secondary market. Example 11 (in respect of LICs and LITs) sets out a 'distribution network' of wealth management, private banking, stockbroking and financial advisory firms. Exchange traded products typically do not rely on a distribution network to facilitate the primary offering and instead engage relevant market participants (typically, authorised participants) who do not carry out retail product distribution conduct:

- Would ASIC consider the ***market participant*** to be a distributor for these purposes? Such an approach would fundamentally alter the function of this market participant and result in systemic issues adverse to the interests of consumers.
- Would ASIC consider the ***issuer*** to be a distributor for these purposes? Such an approach would be impractical as the issuer has no on-market relationship with retail clients. The issuer cannot distinguish between wholesale and retail clients, does not know the identity of the trading participant, has no ability to gather information to determine consistency with the TMD and has no ability to engage with the investor prior to them acquiring the product. Issuers clearly do not engage in retail product distribution conduct when it comes to secondary market trading.
- Would ASIC consider the ***executing broker*** to be the distributor for these purposes? In this case, the FSC sees no policy justification or legislative basis to treat the executing broker as a distributor of exchange traded products but not a distributor of other listed investment products (noting that ASIC does not identify brokers as a distributor in Example 11). While brokers are certainly better placed to identify and gather information from the underlying retail client, such parties (in particular those that perform an execution-only service) would need to implement substantial infrastructure changes to meet DDO requirements. Such parties also do not currently have a relationship with issuers that would facilitate compliance with information exchange requirements.

Essentially, there are no reasonable steps for an issuer to take to ensure that distribution of exchange traded products via the secondary market will be, or will likely be, consistent with the product's TMD.

Should ASIC require issuers and distributors of exchange traded products to comply with the DDO regime in relation to secondary market trading activity, the FSC submits that the substantial, onerous and impractical changes required to seek to implement and comply with the requirements would lead to a significantly poorer consumer experience, wide confusion, and a considerable increase in investor complaints. The FSC further submits that such an approach is not supported by the legislative provisions or Treasury's stated policy intention.

Recommendation: The FSC recommends that ASIC confirms in RG 000 that, whilst issuers of exchange traded products are required to make a TMD, the DDO regime does not apply to sales of exchange traded products on secondary markets such as the ASX.