

# Property Funds Association Master Class: Design and distribution obligations

Presentation to: PFA members

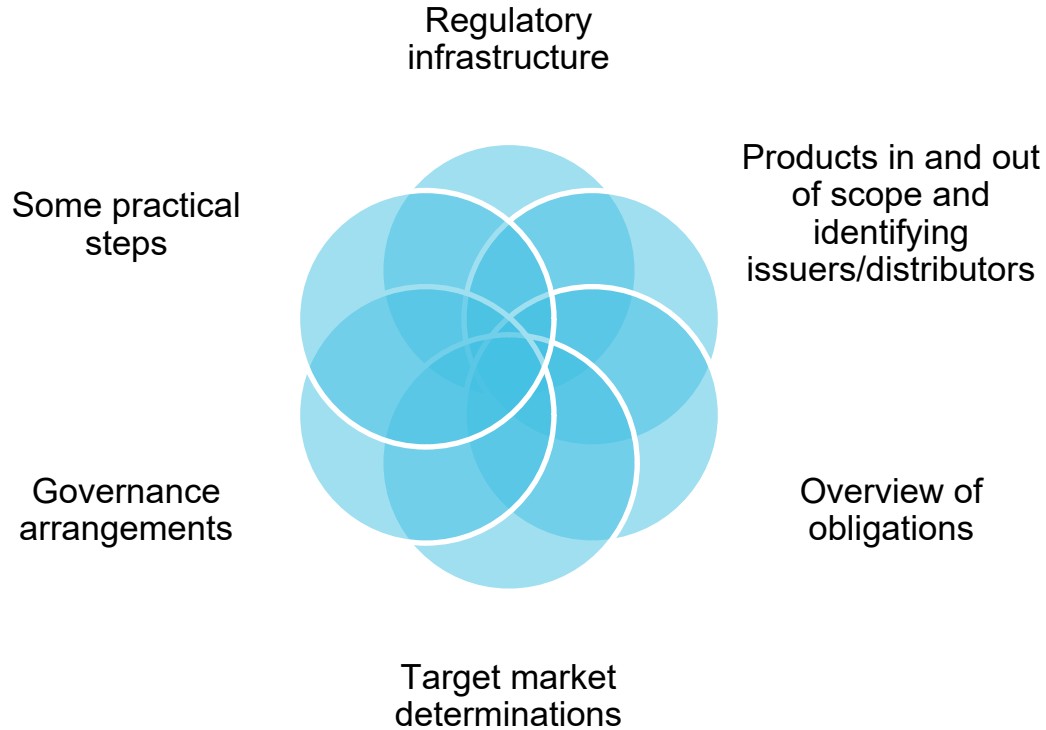
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Date: 6 May 2021

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# What we will discuss



# Regulatory infrastructure



# Background, legislation and guidance

## Background

- Recommendation of Financial System Inquiry (2014)
- *Treasury Laws Amendment (Design and Distribution Obligations and Product Intervention Powers) Act 2019* [PIP and DDO]
- ASIC deferred commencement to 5 October 2021

## Legislation

- Part 7.8A of the Corporations Act
- *Corporations Amendment (Design and Distribution Obligations) Regulations 2019*
- *ASIC Corporations (Design and Distribution Obligations—Exchange Traded Products) Instrument 2020/1090*
- Advertisements (s1018A) to describe the target market or specify where the TMD is available

## Guidance

- ASIC Regulatory Guide 274 (December 2020) → largely principles-based

*“The existing framework relies heavily on disclosure, financial advice and financial literacy. However, **disclosure can be ineffective for a number of reasons**, including consumer disengagement, complexity of documents and products, behavioural biases, misaligned interests and low financial literacy. **Many consumers do not seek advice, and those who do may receive poor-quality advice**. Many products are also distributed directly to consumers.*

*Such issues have contributed to consumer detriment from financial investment failures, such as Storm Financial, Opes Prime, Westpoint, agribusiness schemes and unlisted debentures... Although these losses have a number of contributing causes, **poor product design and distribution practices** that disregarded consumer behavioural biases and information imbalances **played a significant role**.*

*... Although FOFA has made significant changes to reduce incentives for inappropriate distribution where personal advice is provided, more can be done during the product design phase to complement these measures”*

Financial System Inquiry Final Report, pp199-200

# Products and scope

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# Some key terms

‘financial product’

- Financial product under s.761A
- Financial product within the meaning of Div 2 of Pt 2 of ASIC Act (ie credit facilities)

‘retail product distribution conduct’

- Dealing in a financial product to a retail client
- Giving a prospectus for an offer to a retail client
- Giving a PDS for product to a retail client
- Providing financial product advice to a retail client

‘dealing’

- Excludes variation and disposal
- Includes a regulated sale on own behalf
- Excludes effect of exemption of company issuing own securities if a prospectus is required

‘excluded conduct’  
[qualifies retail product  
distribution conduct rules]

- ‘excluded dealing’ – arranging for a retail client to apply for or acquire a product for the purpose of implementing personal advice
- providing personal advice

# Financial products – in scope

- Financial products for which a PDS must be prepared under the Corporations Act, subject to exemptions (next slide)
- Securities (e.g. shares and debentures) for which a disclosure document must be prepared under the Corporations Act (e.g. hybrid securities), subject to exemptions (next slide)
- Credit facilities, subject to exemptions (next slide) – e.g. credit cards, home loans, funeral expenses policies
- Simple corporate bonds depository interest\*
- Debentures of an ADI or a life insurer\*
- Banking deposit products\*
- Interests in IDPSs that are MISs\*
- Exchange traded products\*
- Custodial services provided to retail clients\*

\* Prescribed by the regulations



# Financial products – out of scope

- MySuper products
- Margin lending facilities
- Securities issues under an employee share scheme
- Fully paid ordinary shares in a company or a foreign company (except those shares that (b) convert to preference shares within 12 months or (b) are of an investment company)
- Financial product issued or sold under an exempt body or exempt public authority
- Products not available for acquisition in Australia\*
- Securities under a 'recognised offer' in a recognised jurisdiction\*
- Interests in eligible rollover funds\*
- Defined benefit interests\*
- Medical indemnity insurance products\*
- Depository interests in fully paid ordinary shares in a foreign company\*
- Bank drafts, bank cheques and Australia Post money orders\*
- Offers for issue or sale not received in Australia\*
- Credit facilities not issued in the course of a business of providing credit\*
- Credit facilities where the credit is provided wholly or predominantly for business purposes\*
- Credit facilities that do not involve the provision of credit\*
- Credit facilities that are the provision of a mortgage\*
- Provision of credit by a pawn broker provided in the ordinary course of a pawnbroker's business\*

\* Prescribed by the regulations

# Legacy products

## Included

- Existing products that will be continuously issued or offered on or after 5 October 2021 (ie a PDS or prospectus is required)

## Excluded

- Closed products for which no further issues or offers are being made on or after 5 October 2021 (ie no PDS or prospectus is required)
- Secondary sales (except ETPs and regulated sales (ie ss707 and 1012C secondary sales))

# Issuers vs. distributors

## Issuers

- Issuers of financial products to retail clients where give PDS (Pt 7.9)
- Offerors of securities to retail clients where give prospectus (Pt 6D.2)
- Sellers under regulated secondary sales
- Issuers of products included under the ASIC Act
- Issuers of products/services included under DDO regulations

### *Examples*

- Responsible entities, including ETP issuers
- IDPS/platform operators (as issuers)
- Superannuation fund trustees
- Life insurers
- General issuers
- LICs

## Distributors

- Gives a PDS or a prospectus
- Dealers of financial products
- Arrangers of deals in financial products
- Providers of general advice
- Distributors of basic deposit products, general insurance products, CCI products (regs)
- Credit licensees and credit representatives (regs)

Wide 'retail product distribution conduct' definition means issuers can be distributors too

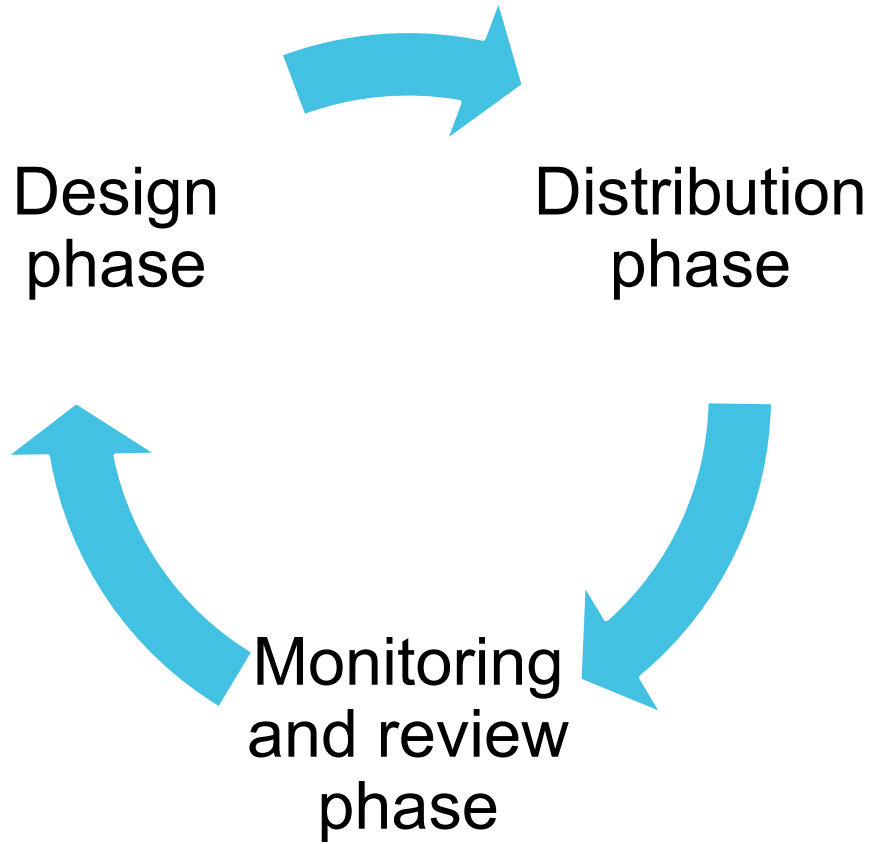
### *Examples*

- Platforms (as distributors of investment menu products)
- Financial advisers (except excluded conduct)
- Investment managers and fund sponsors who have retail client contact (e.g. arrange to deal or giving general advice)
- Referrers (if arranging); comparison websites

# Overview of obligations

# The obligations

Obligations on product designers	Obligations on product distributors
Product issuers must <b>make a target market determination</b> for most financial products that require disclosure.	Distributors are <b>prohibited from distributing</b> a product unless a current target market determination is in place.
Product issuers must make target market determinations available to the <b>public free of charge</b> .	Distributors must not distribute a product where a target market determination <b>may no longer be appropriate</b> .
Product issuers must develop a plan for <b>reviewing target market determinations</b> and abide by that plan.	
Product issuers must <b>notify ASIC of any significant dealings</b> in a product that are not consistent with the product's target market determination.	Distributors must <b>notify a product issuer of a significant dealing</b> in a product that is not consistent with the product's target market determination.
Product issuers must <b>specify distribution information</b> that distributors must collect, keep and provide back to the issuer.	Distributors must <b>provide to issuers numbers of complaints</b> about the product <b>and distribution information</b> relating to the product that issuers have specified.
Product issuers and distributors must each <b>take reasonable steps so that distribution is consistent with</b> the most recent target market determination.	
Product issuers and distributors must <b>each maintain records and information</b> relating to their obligations under the regime.	



# Financial advisers

Providing personal advice is governed by FOFA and is excluded conduct

However DDO applies:

- Where undertake distribution activity that is not personal advice (eg dealing or arranging outside the ancillary 'excluded dealing' exemption; general advice)
- Where provide personal advice, advisers still have to:
  - notify issuers of complaints
  - notify issuers of significant dealings
  - provide issuers with reportable information specified in the TMD
  - maintain records relating to distribution obligations

When giving personal advice should consider TMDs to meet their best interests duty: RG 274.202

Can advise a consumer to acquire a product where the consumer is outside the target market if it's in the consumer's best interests: RG 274.203

# Target market determinations



# Target market determinations - content

## Form

- In writing
- Publicly available

## Target market

- Describe the class of retail clients that comprise the 'target market' (within its ordinary meaning)

## Specifics

- Specify conditions and restrictions on distribution of the product
- Specify review triggers and TMD review periods
- Specify reporting periods for when complaints about the product should be provided from the distributor to the issuer
- Specify information from distributors to help issuer determine whether review trigger occurred or TMD no longer appropriate

## Appropriateness

- For a TMD to be appropriate, it must be reasonable to conclude that:
  - if sold in accordance with the distribution conditions – it would be **likely** that the retail client is in the target market; and
  - if sold to a retail client in the target market – it would **likely** be consistent with the **likely** objectives, financial situation and needs of the retail client.

# Possible review triggers

Significant  
withdrawal  
requests

Poor  
performance

Significant  
Dealing

Investment  
strategy  
change

Complaints

Regulatory  
change

Costs  
increase

ASIC  
investigation

# Governance arrangements

“The design and distribution obligations **do not equate to an individualized product suitability test** that requires assessment of each individual’s personal circumstances at point-of-sale. Instead the obligations **require issuers and distributors to develop and maintain effective product governance arrangements** across the life cycle of financial products to ensure that consumers are receiving products that are likely to be consistent with their likely objectives, financial situation and needs.”

RG 274.6

# Some details of ASIC's expectations

A product design and approval system: RG 274.39

Robust testing of new products: RG 274.42(c)

Review existing distribution arrangements to determine whether likely being distributed to target market: RG 274.42(c)

Where required, re-design products or cease to offer them: RG 274.43(c)

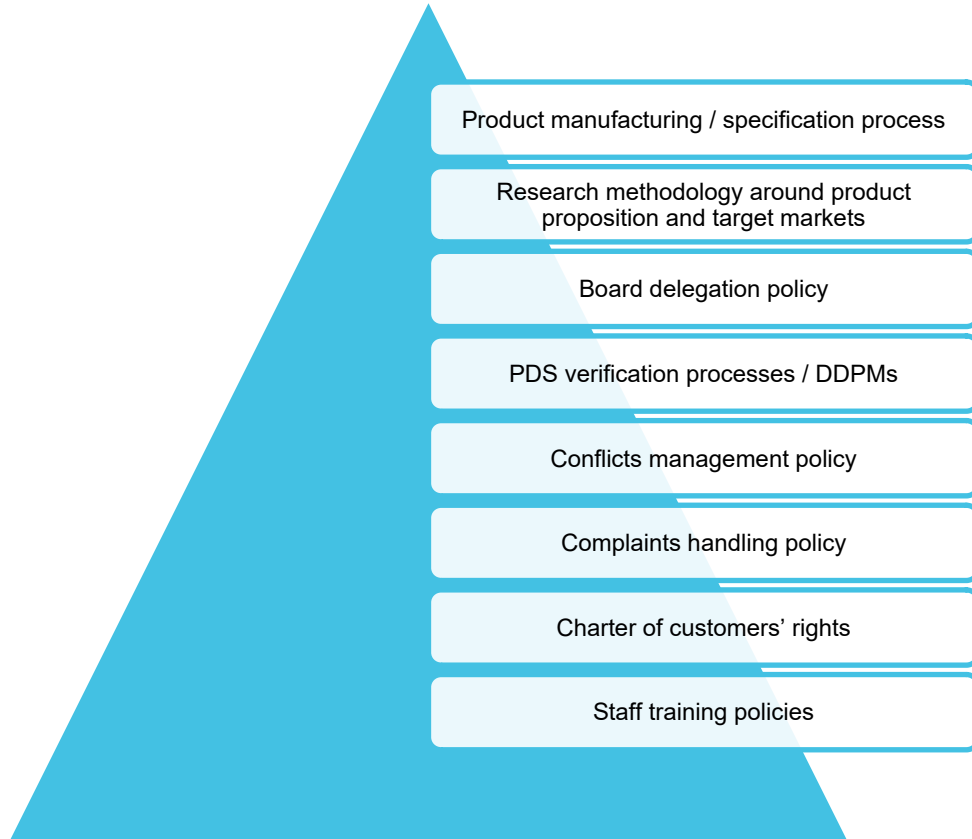
Consider the 'choice architecture' of products: RG 274.45

Consider consumer behaviour and vulnerability: RG 274.47

Post sales, consider actual consumer outcomes: RG 274.51

Document governance arrangements and regularly review them: RG 274.52ff

# Interaction with other policies and processes



# Distribution agreements - issues

Is there one in writing?

Amend or rely on 'applicable laws'?

Develop 'distribution information' and complaints reporting?

Specify distributor's 'significant dealings'?

Specify distributor's 'reasonable steps'?

Industry standardisation on standard distributor obligations?

Indemnities? If so, mutual indemnities for mutual dependencies?

Fee review?

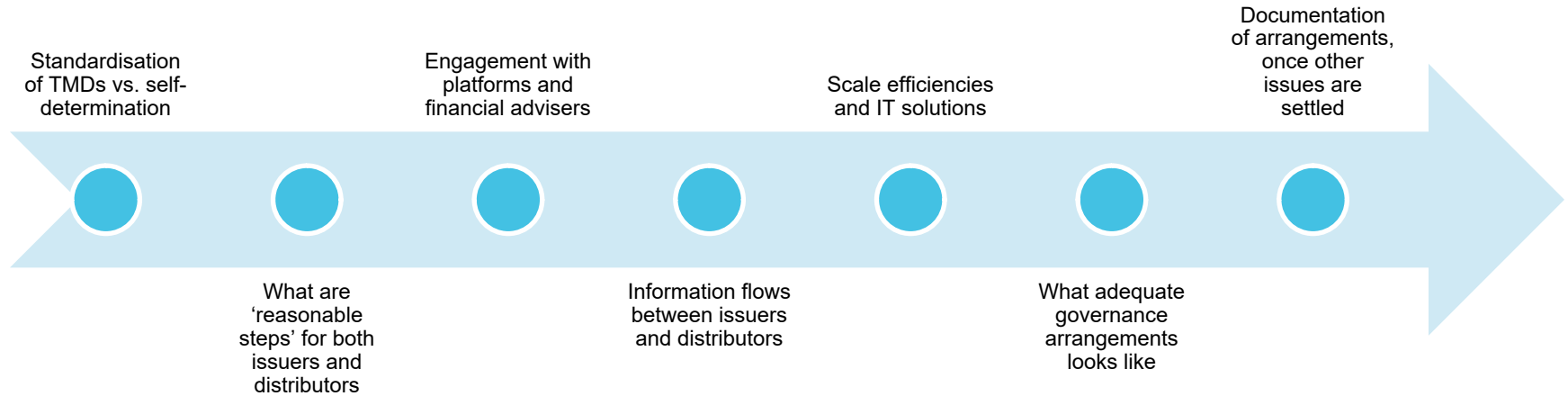
IT systems compatibility between issuer and distributor?

# Practical steps

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# Current issues



# Some practical steps

Identify your retail products (open, closed, fund vs. class, bundled products)



Identify whether you are an issuer and a distributor



Identify your distributors and engage early with them



Develop product governance arrangements / amend policies



Develop a TMD for each product



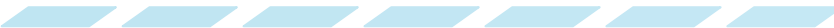
Develop a 'reasonable steps' plan



Draft / amend / examine distribution agreements



Review / enhance IT arrangements to facilitate and capture



**Questions?**



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# Thank you

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