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THE PARLIAMENT OF THE COMMONWEALTH OF AUSTRALIA

HOUSE OF REPRESENTATIVES

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TREASURY LAWS AMENDMENT (DESIGN AND DISTRIBUTION  
OBLIGATIONS AND PRODUCT INTERVENTION POWERS) BILL 2018

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EXPOSURE DRAFT EXPLANATORY MEMORANDUM



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# ***Glossary***

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The following abbreviations and acronyms are used throughout this explanatory memorandum.

<b><i>Abbreviation</i></b>	<b><i>Definition</i></b>
ASIC	Australian Securities and Investments Commission
Corporations Act	<i>Corporations Act 2001</i>
Credit Act	<i>National Consumer Credit Protection Act 2009</i>
credit product	Credit contracts, mortgages, guarantees, and consumer leases regulated under the Credit Act
FSI	Financial System Inquiry









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# Chapter 1

## Design and distribution obligations

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### Outline of chapter

1.1 Schedule 1 to the Bill amends the *Corporations Act 2001* (Corporations Act) to introduce design and distribution obligations in relation to financial products. It sets out:

- the new obligations;
- the products in relation to which the obligations apply;
- ASIC’s powers to enforce the obligations; and
- the consequences of failing to comply with the obligations.

### Context of amendments

1.2 The Corporations Act relies heavily on disclosure to assist consumers in their understanding and selection of appropriate financial products. 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. The availability of financial advice may not be sufficient to overcome these issues. A consumer may not seek financial advice or may receive poor-quality advice.

1.3 The Financial System Inquiry recognised these shortcomings of the existing disclosure regime.<sup>1</sup> In response, it recommended the introduction of a targeted and principles-based product design and distribution obligation.<sup>2</sup> The obligation assists consumers to select appropriate financial products by requiring issuers and distributors to appropriately market and distribute financial products.

1.4 The Government accepted the FSI recommendation to introduce design and distribution obligations on 20 October 2015.<sup>3</sup> On 13 December 2016, the Minister for Revenue and Financial Services, the Hon Kelly

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<sup>1</sup> Financial System Inquiry (Final Report), November 2014, at p.199

<sup>2</sup> Recommendation 21 of the Financial System Inquiry (Final Report), November 2014, at p.198

<sup>3</sup> Improving Australia’s financial system, Government response to the Financial System Inquiry, December 2016, at pp.7 and 19.

O'Dwyer MP, released a proposals paper on the implementation of the obligations.<sup>4</sup>

## Summary of new law

1.5 Schedule 1 to the Bill amends the Corporations Act to introduce design and distribution obligations in relation to financial products. These new obligations improve consumer outcomes by ensuring that financial services providers appropriately promote the provision of suitable financial products to consumers of those products.

1.6 The obligations generally apply to offers of financial products about which the offeror must make disclosure under the Corporations Act or which are exempt from such disclosure due to a mutual recognition scheme. This consists of products that require a disclosure document, such as a product disclosure statement or prospectus, and recognised offers of New Zealand products.<sup>5</sup> There are, however, exceptions for products that would not benefit from the new obligations.

1.7 The new law gives ASIC powers to enforce the new arrangements. These include the ability to request necessary information, issue stop orders where there is a suspected contravention of the law and to make exemptions and modifications to the new arrangements. These powers are similar to those that ASIC has under the current disclosure regime.

1.8 There are civil and criminal penalties that apply to contraventions of the new arrangements. The combination of civil and criminal penalties allows ASIC or the prosecutor (as the case may be) to take a proportional approach to enforcing the new obligations. In addition, a person who suffers loss or damage because of a contravention of the new obligations may recover that loss by bringing a civil claim.

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<sup>4</sup> Design and Distribution Obligations and Product Intervention Powers, Proposals Paper, December 2016.

<sup>5</sup> See Chapter 8 of the Corporations Act and Part 8.1 of the *Corporations Regulations 2001*.

## Comparison of key features of new law and current law

<i>New law</i>	<i>Current law</i>
Offerors must make a target market determination for most financial products that require disclosure and for those exempt from disclosure due to a mutual recognition scheme.	No equivalent.
Offerors must develop a plan for reviewing target market determinations and abide by that plan.	No equivalent.
Offerors and distributors are prohibited from dealing and providing advice in relation to a product unless a current target market determination is in place.	No equivalent.
Offerors and distributors must take reasonable steps to ensure that dealings in, and advice provided in relation to, a product are consistent with the most recent target market determination.	No equivalent.
Distributors must notify a product's offeror, and an offeror must notify ASIC, of a significant dealing in a product that is not consistent with the product's target market determination.	No equivalent.
Offerors and distributors must maintain records and information relating to their obligations under the new regime.	There are numerous provisions in the Corporations Act that require people to maintain records and information relevant to their current obligations under the Act.
ASIC is given powers to enforce the new arrangements, including: the ability to request necessary information; issue stop orders; and, make necessary exemptions and modifications to the new arrangements.	ASIC has similar powers to support its enforcement of the current disclosure arrangements in the Corporations Act.
A person who suffers loss or damage because of a contravention of the design and distribution obligations may recover that loss by civil action.	A similar cause of action currently exists in relation to loss or damage caused by defective disclosure and contraventions of several other provisions of the Corporations Act.

## Detailed explanation of new law

1.9 Schedule 1 to the Bill amends the Corporations Act to introduce design and distribution obligations in relation to financial products.

1.10 The object of the new design and distribution regime is to promote the provision of suitable financial products to consumers of those products. In particular, the new regime assists consumers to understand and select suitable financial products by requiring issuers and distributors to appropriately market and distribute financial products to consumers. *[Schedule 1, item 1, paragraph 760A(aa) of the Corporations Act]*

1.11 To achieve this objective the Bill inserts a new part into the Corporations Act that contains the new design and distribution regime and associated provisions. The new part details:

- the products to which the new regime apply;
- the content of the new obligations;
- ASIC's powers with respect to the new regime; and
- the consequences of failing to comply with the obligations.

## To which products do the new obligations apply?

1.12 The obligations generally apply to offers of financial products that require disclosure under the Corporations Act or which are exempt from such disclosure under a mutual recognition scheme. This consists of products that:

- require disclosure in the form of a product disclosure statement under Part 7.9 (Financial product disclosure) of the Corporations Act;
- require disclosure to investors under Chapter 6D (Fundraising) of the Corporations Act; and
- are exempt from disclosure under Part 7.9 and Chapter 6D of the Corporations Act due to the mutual recognition scheme contained in Chapter 8 of the Corporations Act. *[Schedule 1, item 3, subsections 993DB(1)(a)-(c) of the Corporations Act]*

1.13 Some products requiring disclosure are exempt from the new regime: MySuper products, margin lending facilities, securities to which an employee share scheme applies and ordinary shares. The regulations may also apply the new regime to additional financial products or provide additional exemptions from its operation. *[Schedule 1, item 3, section 993DA, subparagraph 993DB(1)(d) and subsection 993DB(2) of the Corporations Act]*

## Financial products requiring a PDS

1.14 The new design and distribution regime generally applies to a financial product<sup>6</sup> if it requires disclosure in the form of a PDS. Subdivision B of Division 2 of Part 7.9 of the Corporations Act details when a PDS needs to be given. In particular, sections 1012A and 1012B provide that a PDS must be given whenever a regulated person<sup>7</sup> recommends or issues a financial product. [*Schedule 1, item 3, paragraph 993DB(1)(b) of the Corporations Act*]

1.15 A regulated person does not generally need to give a PDS in relation to a sale of a financial product. A sale occurs when a financial product is sold by, or purchased from, a person who acquired the product at or after its issue.<sup>8</sup> However, section 1012C requires a PDS to be given in sale situations which could otherwise be used to avoid the requirement to give a PDS. These situations include: 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. [*Schedule 1, item 3, section 993DA, paragraph 993DB(1) and subsection 993DF(3) of the Corporations Act*]

1.16 There are several benefits of linking the new design obligations to the existing requirement to provide a PDS. It:

- links the new regime to the principal problem it seeks to address, that is, shortcomings of the current disclosure regime;
- provides clarity about when the new regime applies, reducing uncertainty and compliance costs for business; and
- allows the existing legislative framework for PDSs to apply to the new regime.<sup>9</sup>

1.17 Nonetheless, some financial products requiring a PDS are not subject to the new design and distribution regime: MySuper products and margin lending facilities.<sup>10</sup> These products are currently subject to product-specific regulations that negate the need to apply the new

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<sup>6</sup> Financial Product is defined in Division 3 of Chapter 7 of the Corporations Act.

<sup>7</sup> Regulated person is defined in section 1011B of the Corporations Act as: the issuer of a financial product; any person required to hold a financial services licence or who is exempt from holding such a licence by a specified provision; any authorised representative of such a licensee; and sellers of financial products where the sale requires a PDS.

<sup>8</sup> See section 1010C of the Corporations Act.

<sup>9</sup> The legislative framework in Part 7.9 of the Corporations Act is generally consistent with the policy intent behind the new regime. For example, it: has appropriate exclusions, including for issuances to wholesale clients or not in the course of business; and, has appropriate anti-avoidance provisions and rules for complex products such as derivatives.

<sup>10</sup> Margin lending facility is defined in section 761EA of the Corporations Act.

regime.<sup>11</sup> MySuper products are subject to special rules under the *Superannuation Industry (Supervision) Act 1993*. Similarly, margin lending facilities are subject to Division 4A (special provisions relating to margin lending facilities) of Part 7.8 of the Corporations Act. [*Schedule 1, item 3, subsection 993DB(2) of the Corporations Act*]

## Securities requiring disclosure

1.18 The new design and distribution regime also applies to financial products that require disclosure to investors under Part 6D.2 of the Corporations Act. [*Schedule 1, item 3, paragraph 993DB(1)(a) of the Corporations Act*]

1.19 The requirement to provide a PDS does not apply to securities.<sup>12</sup> Chapter 6D of the Corporations Act provides for disclosure for offers relating to securities. Section 700 defines ‘securities’ for the purposes of Chapter 6D of the Corporations Act as meaning: a share in a body; a debenture of a body (except a simple corporate bond depository interest issued under a two-part simple corporate bonds prospectus); or a legal or equitable right or interest in such a share or debenture.<sup>13</sup>

1.20 Part 6D.2 of the Corporations Act details when an offer of securities requires disclosure. Section 706 provides that issues of securities generally require disclosure and section 707 requires disclosure in certain sale situations which could otherwise be used to avoid the requirement to disclose. The sale situations covered by section 707 reflect those requiring a PDS under section 1012C, referred to above.

1.21 Section 708 provides exceptions to the requirement to disclose under Part 6D.2. These exceptions are:

- small scale offerings;
- offers to sophisticated or professional investors;
- certain offers to present holders of securities;
- issues or sales for no consideration;
- offers to people associated with a senior manager of the body;
- offers under a deed of company arrangement or a compromise or arrangement under Part 5.1;

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<sup>11</sup> For similar reasons, the regime does not apply to products regulated under the Credit Act. Products regulated under that Act are already subject to specific rules such as the responsible lending provisions in that Act.

<sup>12</sup> See section 1010A of the Corporations Act.

<sup>13</sup> See sections 700 and 761A of the Corporations Act.

- offers relating to takeovers or to exempt bodies (non-companies incorporated under state law<sup>14</sup> and exempt public authorities); and
- offers relating to debentures in ADIs or life insurers.

As these products are excluded from disclosure under Part 6D.2, they are not subject to the new design and distribution regime.

1.22 There are benefits of linking the application of the design and distribution regime to the requirement to disclose under Part 6D.2. These are similar to those already discussed in the context of products requiring a PDS.

1.23 There are some securities that require disclosure under Part 6D.2 that are not subject to the new design and distribution regime. These are ordinary shares and securities to which an employee share scheme applies. Ordinary shares are excluded as they are fundamental to corporate fundraising and because there is a level of understanding regarding such securities among consumers.<sup>15</sup> Employee share schemes are excluded because they a mechanism by which employees can become part owners in the company for which they work. In addition, products issued under an employee share scheme must be fully paid ordinary shares, units in fully paid ordinary shares, or options issued for nominal consideration for such shares.<sup>16</sup> [*Schedule 1, item 3, subsection 993DB(2) of the Corporations Act*]

1.24 The exemption of ordinary shares from the new regimes requires two anti-avoidance provisions.

1.25 The first anti-avoidance provision ensures that the new regime applies to issues of ordinary shares where the company's constitution provides that ordinary shares may be converted into preference shares.<sup>17</sup> This ensures that the operation of the new regime cannot be avoided by a company that may seek, in effect, to disguise an issue of preference shares as an issue of ordinary shares. [*Schedule 1, item 3, paragraph 993DB(3)(a) of the Corporations Act*]

1.26 The second anti-avoidance provision ensures that the new regime can apply where a company issues ordinary shares to carry on a business of investing in financial products or other investments. This

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<sup>14</sup> See section 66A of the Corporations Act.

<sup>15</sup> Ordinary share is not defined in the Corporations Act. Consistent with existing practice, the term is to take its ordinary meaning having regard to the legislative context in which it is used and the purpose of the new regime. However, the use of the term 'ordinary share' is intended to distinguish such shares from other types of shares, particularly preference shares.

<sup>16</sup> See the definition of Employee Share Scheme in section 9 of the Corporations Act.

<sup>17</sup> Section 254G provides that a company may convert an ordinary share into a preference share (except a redeemable preference share) in certain circumstances.

prevents a person avoiding the new regime by effectively selling a product through an investment company. It also ensures the new regime extends to issues of ordinary shares in investment companies more generally, in recognition of the derivative nature of their business model. [*Schedule 1, item 3, paragraph 993DB(3)(b) of the Corporations Act*]

## Financial products issued under a mutual recognition scheme

1.27 The new design and distribution obligations apply to products that are exempt from disclosure under Part 7.9 or Chapter 6D of the Corporations Act by a mutual recognition scheme. Chapter 8 of the Corporations Act regulates the foreign offers of financial products to which this exemption applies. Currently, only certain offers of financial products under New Zealand law are eligible for an exemption.<sup>18</sup> The application of the new regime to these financial products ensures that they are subjected to the same design and distribution rules that apply to Australian-issued financial products. [*Schedule 1, item 3, paragraph 993DB(1)(c) of the Corporations Act*]

## Products prescribed by the regulations

1.28 The new design and distribution regime also applies to any financial product prescribed by the Minister in regulations. This regulation making power means the new regime can apply to any prescribed financial product in any prescribed circumstance, regardless of whether or not the product requires disclosure. By doing so, the power provides the flexibility necessary to future-proof the new regime to ensure its ongoing relevance and effectiveness. The regulations will be subject to parliamentary scrutiny through the disallowance procedures of the *Legislation Act 2003*. [*Schedule 1, item 3, paragraph 993DB(1)(d) and subsection 993DB(7) of the Corporations Act*]

1.29 At the outset, the Government proposes to make regulations that would apply the regime to a number of products that do not presently require disclosure. These products are:

- simple corporate bonds depository interests in simple corporate bonds, where the simple corporate bonds are, or are to be, issued under a two-part simple corporate bonds prospectus;
- debentures of a body that is an Australian ADI or registered under section 21 of the *Life Insurance Act 1995*;
- basic deposit products; and

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<sup>18</sup> See Parts 8.1 and 8.2 of the *Corporations Regulations 2001*.



- custodial arrangements that are not already subject to the new regime, including an interest in an investor directed portfolio service.

1.30 The regulations may also exclude a product from the new regime. Again, this regulation making power is aimed at future proofing the new regime by providing flexibility to exempt products where appropriate. [*Schedule 1, item 3, paragraph 993DB(2)(e) of the Corporations Act*]

1.31 All references to ‘financial products’ are references to products to which the new regime applies unless indicated otherwise.

## **What are the design and distribution obligations?**

1.32 The new law inserts four design obligations and five distribution obligations for product issuers and distributors into the Corporations Act.

1.33 The design obligations are:

- to make a target market determination in relation to the product;
- to review the target market determination as required to ensure it remains appropriate;
- keep records of the person’s decisions in relation to the new regime; and
- to notify ASIC of any significant dealings in a product that are not consistent with the product’s target market determination.

1.34 The distribution<sup>19</sup> obligations are:

- not to deal, or provide financial product advice, in relation to a product unless a target market determination has been made;
- not to deal, or provide financial product advice, where a target market determination may no longer be appropriate;
- to take reasonable steps to ensure that products are distributed in accordance with the target market determination;
- to collect information related to the distribution of a product; and

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<sup>19</sup> Note that the issuer of a financial product may also be a distributor of the product.

- to notify the issuer of a product of any significant dealings in the product that are not consistent with the product's target market determination.

1.35 In addition, the new law amends existing section 1018A of the Corporations Act to require advertising or other promotional material for a financial product to refer to the product's target market. [*Schedule 1, item 4 and 5, subparagraphs 1018A(1)(c)(ii) and 1018A(2)(c) of the Corporations Act*]

## Design obligations

1.36 The design obligations are imposed on the person who is responsible for developing the financial product. This is the person who is responsible for preparing the disclosure document<sup>20</sup> for the product.<sup>21</sup> All references to 'issuer' are references to the person who is subject to the design obligations unless a contrary intention is indicated. [*Schedule 1, item 3, subsections 993DB(4), 993DB(5), 993DB(6), and 993DB(7) of the Corporations Act*]

### *Obligation to make a target market determination*

1.37 The first design obligation requires an issuer to make a **target market determination** for their product. The target market determination must be appropriate for the product, be in writing and set out:

- the class of persons who comprise the target market for the product; and
- any conditions and restrictions on dealings in, or providing financial product advice in relation to, the product (defined by the amendments as 'distribution conditions').<sup>22</sup> [*Schedule 1, item 3, section 993DA, subsections 993DB(4), 993DB(5), 993DB(6), 993DB(7), 993DB(8), 993DB(9), and 993DB(10) of the Corporations Act*]

1.38 For a target market determination to be valid it must be **appropriate**. Whether a determination is appropriate is determined by reference to new subsection 993DB(10) of the Corporations Act. A

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<sup>20</sup> The disclosure document may be required by Part 7.9 or Chapter 6D of the Corporations Act, or by a prescribed law of New Zealand (in the case of a recognised offer).

<sup>21</sup> Under the new regime as enacted, the person required to make a target market determination for a financial product is always the issuer of the product. As the person who owes the obligations under the product or the body issuing the securities, the issuer would generally be best placed to make the determination. However, it is possible for a regulation to be made for the purposes of subsection 993DB(7) to impose the obligation on someone other than the issuer of a product, if necessary.

<sup>22</sup> Subsection 993DB(9) provides that the distribution conditions need not include any such conditions or restrictions imposed by or under the Corporations Act, other than conditions and restrictions set out under the new regime.

determination is appropriate if it is reasonable to conclude that, if the product were issued in the target market in accordance with the distribution conditions, the product would generally meet the likely objectives, financial situations and needs of the persons in the target market. This formulation provides flexibility in determining what is appropriate for a particular product in particular circumstances. For example, it would enable an issuer to conclude that it is appropriate to distribute a product to an investor as part of balanced portfolio, even if it would not otherwise be appropriate for the investor. *[Schedule 1, item 3, subsection 993DB(10) of the Corporations Act]*

1.39 The amendments use language currently used in the Corporations Act in the context of personal advice. In particular, a target market determination is only appropriate where it would “generally meet the likely *objectives, financial situations and needs* of persons in the target market” [emphasis added]. This reflects that the factors that are important to providing good personal advice are also important to good product design, particularly when determining the hypothetical consumers in a product’s target market. The use of the language does not reflect a requirement to take into account the personal circumstances of any particular person or to provide personal advice. *[Schedule 1, item 3, subsections 993DB(9) and 993DB(10) of the Corporations Act]*

1.40 An issuer must take into account all relevant factors in determining whether a product is likely to meet the objectives, financial situations and needs of persons within the target market. Relevant factors may include:

- the key features of the product, including its complexity, risk profile (over the lifetime of the product), any applicable fees, and the investment needs that the product is seeking to meet; and
- the circumstances of persons within a particular market, such as their understanding of product features, capacity to meet financial obligations or bear losses, and whether their investment needs are the same as those the product seeks to meet.

1.41 These are just two examples of potential factors that may need to be taken into account in making a target market determination. There are likely to be other factors that need to be taken in account.

1.42 The amendments let an issuer determine a wide range of distribution conditions applicable to a product. The amendments provide examples of distribution conditions. These include a condition that the product should not be issued unless the person has received personal advice and restrictions limiting the distribution of the product to specified distribution channels. *[Schedule 1, item 3, subsection 993DB(9) of the Corporations Act]*

***Obligation to review a target market determination***

1.43 The second design obligation requires an issuer to review a target market determination as necessary to ensure it remains appropriate. The obligation applies to all financial products, but is particularly pertinent for complex products and products that are likely to be issued over an extended period of time.

1.44 The review obligation stipulates that a person who makes a target market determination must at the same time:

- identify events and circumstances (called ‘review triggers’) that would reasonably suggest that the target market determination is no longer appropriate; and
- determine the maximum period between reviews of the target market determination (called the ‘review period’), which must be reasonable in the circumstances. [*Schedule 1, item 3, section 993DA and subsections 993DB(12) and 993DB(13) of the Corporations Act*]

1.45 The obligation to determine the review triggers and review period is imposed on the issuer of the product. The issuer, as the person who makes the target market determination, is best placed to determine the review triggers and review period.

1.46 The requirement on a product issuer to determine review triggers ensures that they review and remake a target market determination when events or circumstances suggest that it may no longer be appropriate. What can constitute a review trigger will vary from product to product depending on the nature of the product and the circumstances surrounding its issue, including the way in which it is distributed. For this reason, it is not possible to provide a definitive statutory list of possible review triggers. However, some examples of the broad range of possible review triggers include:

- an event or circumstances that would materially change a factor taken into account in making the target market determination for the product;
- the discovery of a material and relevant defect in the product’s disclosure documentation;
- whether the product is being distributed and purchased as envisaged by its target market determination; and
- the nature and extent of any feedback received from those who distribute or invest in the product. [*Schedule 1, item 3, section 993DA and paragraph 993DB(12)(a) of the Corporations Act*]

1.47 Issuers must also determine the review period for a target market determination and review a determination during that period. The review period is the maximum period of time that elapses between completed reviews of a determination. These requirements ensure that a determination does not become inappropriate over time where it has not otherwise been reviewed. *[Schedule 1, item 3, section 993DA, paragraph 993DB(12)(b) and subsection 993DC(2) of the Corporations Act]*

1.48 The obligation is designed to encourage an issuer to adopt a risk management approach in determining a reasonable review period. This would require issuers to consider the likelihood and consequences of the risk to investors of a determination becoming inappropriate due to the passage of time. Under such an approach a complex product with a high risk profile would likely have a relatively short review period. A simple product with a low risk profile would likely have a longer review period. While a review period must be determined for every product, a product that is issued over a very short period may never need to be reviewed. *[Schedule 1, item 3, paragraph 993DB(12)(b) and subsection 993DB(13) of the Corporations Act]*

1.49 Notwithstanding the above arrangements, an issuer may review a target market determination and make a new determination at any time. *[Schedule 1, item 3, subsection 993DC(1) of the Corporations Act]*

### ***Record keeping obligation***

1.50 The third design obligation requires issuers to keep records of their decisions about:

- a product's target market determination; review triggers; and review period; and
- the reasons for those decisions. *[Schedule 1, item 3, subsection 993DF(1)]*

1.51 These record keeping provisions support the effectiveness of the new regime. In particular, it ensures that evidence exists concerning an issuer's compliance with the new obligations. The records will assist issuers in meeting their design obligations, particularly those concerning the review of previous decisions. The records may also be requested by ASIC to support its compliance activities. *[Schedule 1, item 3, subsections 993DF(1) and 993DH(2) of the Corporations Act]*

1.52 The new record keeping provisions are supported by current provisions of the Corporations Act. In particular, it is presently an offence to destroy, conceal or falsify records required to be kept under a provision of Chapter 7 of the Corporations Act.<sup>23</sup> In addition, the Corporations Act currently provides that records required to be kept by a provision of

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<sup>23</sup> See sections 1101C, 1101E and 1101F of the Corporations Act, respectively.

Chapter 7 must be preserved for 5 years.<sup>24</sup> These provisions apply in relation to the new regime.

***Obligation to notify ASIC of a significant dealings that are not consistent with a product's target market determination***

1.53 The fourth (and final) design obligation requires issuers to notify ASIC of significant dealings in a product that are not consistent with the product's target market determination. Should an issuer become aware of such a dealing they must notify ASIC in writing as soon as practicable, and in any case within 10 business days. [*Schedule 1, item 3, section 993DG of the Corporations Act*]

1.54 Consistent with existing provisions of the Corporations Act, 'significant' is not defined for the purposes of the new obligation. The meaning of significant is intended to take its ordinary meaning in the context of the new provision. Generally, this would require an issuer to inform ASIC of dealings that would be worthy of its attention having regard to the object of the new regime and ASIC's role as its regulator. However, ultimately whether or not a dealing is significant would be a matter to be determined in the circumstances of each case.

1.55 This notification obligation supports the effectiveness of the new regime. In particular, it ensures that ASIC is advised, where possible, of significant dealings in a product that are not consistent with its target market determination. By doing so, the requirement assists ASIC in making timely and appropriate decisions in support of the new regime.

## **Distribution obligations**

1.56 The distribution obligations apply to those people that engage with a potential investor in relation to a product. These are the people responsible for giving disclosure documents to potential investors. They will generally be the issuer of the product (where the issuer distributes their own product) or be carrying on a financial services business in Australia. All references to 'regulated person' are references to a person responsible for the distribution obligations.<sup>25</sup> [*Schedule 1, item 3, section 993DA (definition of regulated person) of the Corporations Act*]

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<sup>24</sup> See section 1101C of the Corporations Act.

<sup>25</sup> Note that persons who are merely engaged to support a regulated person (for example, media companies, legal advisers and search engines) do not owe the obligations.

***Obligation not to deal or advise unless a target market determination has been made***

1.57 The first distribution obligation prohibits the distribution of a financial product if the issuer has failed to make a target market determination for the product. Specifically, the obligation provides that a regulated person must not deal in, or provide financial product advice in relation to, a product unless a determination for the product has been made. *[Schedule 1, item 3, subsection 993DD(1) of the Corporations Act]*

1.58 This obligation promotes the effectiveness of the new regime. It ensures the distribution of non-compliant products is minimised. It also provides an additional incentive for issuers to comply with their obligation to make a target market determination.

1.59 For the purposes of the obligation, a regulated person (except the issuer) may reasonably rely on the validity of the target market determination made by the issuer. This ensures that a regulated person does not need to make undue inquiries as to the compliance of a target market determination with the requirements of the new regime. However, where reliance on a determination is not reasonable, for example, because it is not in writing or appears inappropriate, the regulated person must make necessary inquiries or not distribute the product. *[Schedule 1, item 3, subsection 993DD(2) of the Corporations Act]*

1.60 A regulated person must notify ASIC if the person becomes aware that they have contravened the first distribution obligation. The notification must be made as soon as practicable, and in any case within 10 business days. The requirement supports the new regime by promoting ASIC's ability to act quickly to minimise any consequences of a breach of the obligation. *[Schedule 1, item 3, subsection 993DD(3) of the Corporations Act]*

***Obligation not to distribute where target market determination may not be appropriate***

1.61 The second distribution obligation is aimed at minimising the distribution of products which may have inappropriate target market determinations. For the purposes of the obligation, a target market determination may not be appropriate if the issuer knows, or ought reasonably to know that: a review trigger has occurred; or, another event or circumstance has occurred that would reasonably suggest that the determination is no longer appropriate. *[Schedule 1, item 3, subsection 993DC(3) of the Corporations Act]*

1.62 To minimise the risk of distributing a product in these circumstances, the amendments implement a regime with the following features:

- Issuers are prohibited from dealing in, or providing financial product advice in relation to, the product until they have

reviewed the determination and, if necessary, made a new determination.

- Issuers must, as soon as practicable, take reasonable steps to ensure regulated persons are directed not to distribute the product until they are notified that the review is complete, and where applicable, are notified of the new determination.
- A regulated person must comply with any such direction. *[Schedule 1, item 3, subsection 993DC(4), 993DC(5) and 993DC(6) of the Corporations Act]*

1.63 This regime is based on existing section 1021J of the Corporations Act, which makes similar arrangements for defective disclosure documents or statements.

***Obligation to take reasonable steps to ensure compliance with a target market determination***

1.64 The third distribution obligation requires regulated persons to take reasonable steps to ensure that they distribute a product in accordance with its target market determination. Specifically, a regulated person must take reasonable steps to ensure that their dealings in or advice about the product are consistent with the most recent determination. *[Schedule 1, item 3, subsection 993DE(1) and 993DE(2) of the Corporations Act]*

1.65 The new law uses a risk management approach to determine what satisfies the requirement of ‘reasonable steps’ for the purposes of the obligation. ‘Reasonable steps’ means steps that are, in the circumstances, reasonably able to be taken to ensure that dealings in and advice about a product are in accordance with its target market determination. In making this assessment, distributors are to take into account all relevant matters, including:

- the likelihood of their dealings or advice resulting in a person acquiring a product otherwise than in accordance with its target market determination (that is, the likelihood of the risk);
- the nature and degree of harm that might result from the product being issued otherwise than in accordance with the determination (that is, the consequence of the risk);
- the availability and suitability of ways to eliminate or minimise the likelihood and the harm (that is, the extent to which the risk may practicably be mitigated); and
- what the responsible person knows, or ought reasonably to know, about the matters referred to above (that is, the responsible person’s understanding of the risk and ways to



mitigate it). *[Schedule 1, item 3, section 993DA and subsection 993DE(3) of the Corporations Act]*

1.66 A risk management approach ensures the obligation is scalable according to the risk associated with an inappropriate distribution of a product and the practicability of mitigating the risk. For example, other things being equal, the content of the obligation would be greater for a complex product with a high risk profile than for a simple product with a low risk profile. However, what constitutes ‘reasonable steps’ will ultimately depend upon the circumstances of each case.

***Obligation to collect distribution information***

1.67 The fourth distribution obligation requires a distributor to collect, and keep records of, distribution information. In particular, the obligation requires a responsible person who deals in, or provides financial advice in relation to, a financial product to collect and keep distribution information.

1.68 ‘Distribution information’ is defined as:

- the number, and dollar value, of issues of the product made by the person;
- the proportion of those issues that were consistent with the product’s target market determination;
- the ways in which the person’s dealings in, or provision of advice in relation to, the product occurred; and
- the steps the person took to ensure compliance with the product’s target market determination (that is, the steps to comply with the third distribution obligation). *[Schedule 1, item 3, section 993DA and subsection 993DF(2) of the Corporations Act]*

1.69 These record keeping provisions support the effectiveness of the new regime. In particular, they ensure that the information necessary to review and remake a target market determination is collected and kept by distributors. The provisions also support compliance with the other distribution obligations by ensuring distributors have visibility of their activities with respect to the product. Distribution information may also be requested by ASIC to support its enforcement of the new regime. *[Schedule 1, item 3, subsections 993DF(2) and 993DH(1) of the Corporations Act]*

1.70 As noted above, the effectiveness of the record keeping provisions in the new law is supported by current provisions of the Corporations Act. In particular, it is currently an offence to destroy, conceal or falsify records required to be kept by a provision of Chapter 7 of the Act.<sup>26</sup> In addition, the Act presently provides that records required

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<sup>26</sup> See sections 1101C, 1101E and 1101F of the Corporations Act, respectively.

to be kept by a provision of Chapter 7 must be preserved for 5 years.<sup>27</sup> These provisions apply to the new record keeping provisions, as the provisions are inserted into Chapter 7 of the Act.

1.71 The regulations can impose requirements about distribution information. This power ensures that the distribution information required to be collected and kept by regulated persons can be adjusted if necessary to support the effective operation of the new regime. [*Schedule 1, item 3, subsection 993DF(4) of the Corporations Act*]

***Obligation to notify issuer of significant dealings that are not consistent with a product's target market determination***

1.72 The final distribution obligation requires a regulated person to notify a product's issuer of significant dealings in a product that are not consistent with the product's target market determination. Should the person become aware of such a dealing they must notify the issuer in writing as soon as practicable, and in any case within 10 business days. [*Schedule 1, item 3, subsection 993DF(5) of the Corporations Act*]

1.73 Consistent with existing provisions of the Corporations Act, 'significant' is not defined for the purposes of the new obligation. The meaning of significant is intended to take its ordinary meaning in the context of the new provision. Generally, this would require a regulated person to inform an issuer of dealings that would be worthy of their attention having regard to the object of the new regime and the issuer's role as the product's designer. However, ultimately whether or not a dealing is significant would be a matter to be determined in the circumstances of each case.

1.74 This notification obligation supports the effectiveness of the new regime. It ensures that an issuer is advised of a significant dealing in a product that is not consistent with the product's target market determination. By doing so, the requirement assist issuers in making timely and appropriate decisions in support of the new regime and in meeting their obligations to notify ASIC of significant dealings.

**Promotional material must refer to target market**

1.75 Currently, section 1018A of the Corporations Act requires advertising and promotional material for a financial product to refer to a product disclosure statement. The new law amends section 1018A to require such advertising and promotional material to also refer to a product's target market.

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<sup>27</sup> See section 1101C of the Corporations Act.

1.76 To achieve this, the new law amends two existing subsections within section 1018A so that they make appropriate reference to the new regime.

- The first amendment is to subsection 1018A(1) of the Corporations Act, which applies where a financial product is available for acquisition by retail clients. The amendment requires an advertisement or published statement (that is reasonably likely to induce people to acquire the product) in relation to the product to describe the target market or specify where the description is available. *[Schedule 1, item 4, paragraph 1018A(1)(ca) of the Corporations Act]*
- The second amendment is to subsection 1018A(2) of the Corporations Act, which applies where a product is reasonably likely to become available for acquisition by retail clients. The amendment again requires an advertisement or published statement in relation to the product to describe the target market or specify where the description is available. *[Schedule 1, item 5, paragraph 1018A(2)(ca) of the Corporations Act]*

1.77 The remaining provisions of existing section 1018A are not affected by the amendments.

1.78 Existing section 1018A only applies in relation to products that require a product disclosure statement. Existing section 734 of the Corporations Act generally prohibits advertising and promoting securities.<sup>28</sup>

## **ASIC's powers and associated matters**

1.79 The new law gives ASIC powers to support its regulatory role with respect to the new obligations. In particular, ASIC is provided with powers to:

- request information relevant to its regulatory role;
- issue stop orders in relation to suspected contraventions of the new regime; and
- make exemptions and modifications to the new regime.

### **Information gathering power**

1.80 ASIC will have information gathering powers to obtain information concerning :

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<sup>28</sup> There are limited exceptions and ASIC has provided some relief in relation to this prohibition, see ASIC Regulatory Guide 254.

- distribution information that a regulated person possesses or has access to (see paragraphs 1.67-1.71); and
- records the issuer must keep under the new regime (see paragraphs 1.50-1.52). *[Schedule 1, item 3, subsections 993DH(1) and 993DH(2) of the Corporations Act]*

1.81 The new law sets out the process by which ASIC must request information and how it ought to be provided. Specifically:

- ASIC's request for the information or records must be in writing; and
- the response to a request must be in writing and given to ASIC by the date specified in the request, or if no date is specified, within 10 business days after the day the person receives the request. *[Schedule 1, item 3, section 993DH(3) of the Corporations Act]*

## Stop orders power

1.82 The new law gives ASIC the power to make a stop order with respect to certain contraventions of the new regime. The relevant contraventions are those relating to:

- a failure to make a target market determination;
- dealing in, or providing financial advice in relation to, a product without a determination; and
- failing to take reasonable steps to comply with a determination.

1.83 The power to make stop orders with respect to these contraventions reflects their key role in promoting the provision of suitable financial products to consumers. *[Schedule 1, item 3, subsection 993DI(1) of the Corporations Act]*

1.84 There are three principal obligations associated with a stop order. These are:

- the person on whom the order is served, or a person who is aware of the order, must not engage in conduct contrary to the order;
- the order can state that specified conduct will be regarded as non-compliance with a specified provision of the new regime and, if that conduct is engaged in, the statement has effect accordingly; and
- the person on whom the order is served must take reasonable steps to ensure other people who engage in the conduct to

which the order applies are aware of the order. *[Schedule 1, item 3, subsections 993DI(2), 993DI(3), 993DI(8), and 993DI(9) of the Corporations Act]*

1.85 Before making a stop order ASIC must hold a hearing and take submissions on whether it should be made. However, if the delay from that process would be prejudicial to the public interest an interim 21 day order can be made without consultation. An interim order can also be made at any time during the hearing, in which case it will last until ASIC makes a final order or the interim order is revoked. *[Schedule 1, item 3, subsections 993DI(4), 993DI(5) and 993DI(6) of the Corporations Act]*

1.86 ASIC currently has the power to make a stop order in relation to contraventions of key provisions of the disclosure regime for financial products.<sup>29</sup> The amendments, in effect, replicate these existing provisions so that they may be applied in the context of the new design and distribution obligations. The principles applicable to ASIC's existing stop order powers with respect to the disclosure regime apply equally in the context of the stop order power contained in the Bill. *[Schedule 1, item 3, section 993DI of the Corporations Act]*

1.87 The amendments provide that a stop order is not a legislative instrument. This provision is included only to inform readers of the character of a stop order. A stop order is non-legislative in character as it must relate to a suspected contravention of the law and therefore applies the law in a particular case.<sup>30</sup> *[Schedule 1, item 3, subsection 993DI(2) of the Corporations Act]*

## **Exemption and modification powers**

1.88 The new law gives ASIC the power to make exemptions and modifications to the new regime. In particular, ASIC may:

- exempt a person or class of persons from all or specified provisions of the new regime;
- exempt a financial product or a class of financial products from all or specified provisions of the new regime; or
- declare that the new regime applies in relation to a person or financial product (or class of person or products) as if specified provisions were omitted, modified or varied as specified in the declaration. *[Schedule 1, item 3, sections 993DJ and 993DK of the Corporations Act]*

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<sup>29</sup> See sections 739 and 1020E of the Corporations Act.

<sup>30</sup> See section 5 of the *Legislative Instruments Act 2003*.

1.89 ASIC presently has exemption and modification powers concerning the disclosure regime for financial products.<sup>31</sup> The amendments, in effect, replicate these existing provisions and apply them as appropriate to the new design and distribution regime. The principles applicable to ASIC's existing exemption and modification powers with respect to the disclosure regime also apply in the context of the present amendments. [*Schedule 1, item 3, sections 993DJ and 993DK of the Corporations Act*]

1.90 The exemption and modification powers support the effective operation of the new regime. In particular, they provide ASIC with the flexibility to make exemptions and modification to the regime should a need arise in future. For example, ASIC would be able to tailor the operation of the regime so as to avoid any unintended consequences that may arise with respect to a particular person or product.

1.91 For the same reasons, the regulations are also empowered to make exemptions and modifications to the new regime. The exemptions that may be made by the regulation are the same as those that ASIC can make under its corresponding power. However, a broader range of modifications can be made by the regulations than by ASIC. In particular, the regulations may provide that the new regime applies as if a specified provision were omitted, modified or varied as specified in the regulations. [*Schedule 1, item 6, section 993DL of the Corporations Act*]

## Consequences of breaching the new provisions

1.92 The consequences of breaching the new provisions fall into two main categories. These are:

- liability to the state through civil penalty proceedings or criminal prosecution; and
- liability to persons suffering loss or damage through civil action.

## Civil and criminal penalties

1.93 A contravention of every obligation in the new regime is both a civil penalty provision and an offence. This allows the regulator or prosecutor (as the case may be) to take a proportional approach to the enforcement of the new regime.

1.94 The maximum penalties applicable to each obligation in the Bill are detailed in the following tables. The new law gives effect to the

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<sup>31</sup> See sections 741 and 1020F of the Corporations Act.

penalties by making the necessary amendments to existing subsection 1317E of the Corporations Act (in relation to civil penalties) and Schedule 3 of the Corporations Act (in relation to criminal penalties). [Schedule 1, items 6 and 7, subsection 1317E(1) and Schedule 3 of the Corporations Act]

**Table 1.1 Penalties concerning obligations**

<i>Obligation</i>	<i>Penalty</i>
<i>Design obligations</i>	
Determining target market for financial products	Criminal – 200 penalty units or imprisonment for 5 years, or both. Civil penalty – \$200,000 for an individual; or 1 million for a body corporation
Determining review triggers and review period for target market determination	Criminal: 200 penalty units or imprisonment for 5 years, or both. Civil penalty – \$200,000 for an individual; or 1 million for a body corporation
Keeping records of decisions and reasons for target market determination, review triggers and review period	Criminal – 50 penalty units or imprisonment for 12 months, or both. Civil penalty – \$200,000 for an individual; or 1 million for a body corporation
Reviewing target market determination within the review period	Criminal – 50 penalty units or imprisonment for 12 months, or both. Civil penalty – \$200,000 for an individual; or 1 million for a body corporation
Reviewing target market determination in response to triggers or other events and circumstances	Criminal: 200 penalty units or imprisonment for 5 years, or both. Civil penalty – \$200,000 for an individual; or 1 million for a body corporation
Notifying ASIC of significant dealings outside target market	Criminal – 50 penalty units Civil penalty – \$200,000 for an individual; or 1 million for a body corporation
<i>Distribution obligations</i>	
Distributing a financial product without a target market determination	Criminal: 200 penalty units or imprisonment for 5 years, or both.

<i>Obligation</i>	<i>Penalty</i>
	Civil penalty – \$200,000 for an individual; or 1 million for a body corporation
Distributing a financial product where its target market determination may no longer be appropriate	Criminal: 200 penalty units or imprisonment for 5 years, or both. Civil penalty – \$200,000 for an individual; or 1 million for a body corporation
Failure to direct distributors not to distribute a product where the target market determination may no longer be appropriate	Criminal: 200 penalty units or imprisonment for 5 years, or both. Civil penalty – \$200,000 for an individual; or 1 million for a body corporation
Failure of distributor to comply with direction not to distribute a product where the target market determination may no longer be appropriate	Criminal: 100 penalty units or imprisonment for 2 years, or both. Civil penalty – \$200,000 for an individual; or 1 million for a body corporation
Failing to take reasonable steps to comply with a target market determination	Criminal: 200 penalty units or imprisonment for 5 years, or both. Civil penalty – \$200,000 for an individual; or 1 million for a body corporation
Failing to collect and keep distribution information	Criminal – 50 penalty units or imprisonment for 12 months, or both. Civil penalty – \$200,000 for an individual; or 1 million for a body corporation
Failing to notify issuer of significant distributions that are not consistent with a product’s target market determination.	Criminal – 50 penalty units Civil penalty – \$200,000 for an individual; or 1 million for a body corporation
<i>Stop orders</i>	
Engaging in conduct contrary to a stop order	Criminal: 100 penalty units or imprisonment for 2 years, or both. Civil penalty – \$200,000 for an individual; or 1 million for a body corporation
Failure of person on whom stop order is served to take reasonable steps to ensure that other people who engage in the conduct are aware of the order	Criminal: 100 penalty units or imprisonment for 2 years, or both. Civil penalty – \$200,000 for an individual; or 1 million for a body corporation



*[Schedule 1, items 3, 6 and 7, sections 993DB, 993DC, 993DD, 993DE, 993DF, 993DG, 993DH, and 993DI, table items 40AA to 40AI in subsection 1317(1), and table items 290CAA to 290CAK in the table to Schedule 3 of the Corporations Act]*

1.95 The penalties applicable to each obligation are broadly consistent with current penalties applicable to comparable provisions in the Corporations Act. The principles set out in the *Guide to Framing Commonwealth Offences, Infringement Notices and Enforcement Powers*<sup>32</sup> were also considered in determining the applicable penalties.

## Civil liability

1.96 A person who suffers loss or damage because of a relevant contravention of the new regime may recover that loss or damage by civil action. The relevant contraventions relate to:

- distributing a product without a target market determination; and
- failing to take reasonable steps to comply with a target market determination.

1.97 The first cause of action arises where a person suffers loss or damage because a product is distributed without a target market determination. The amendments provide a person with a cause of action if:

- a regulated person deals in, or provides financial advice in relation to, a product that does not have a target market determination; and
- the person suffers loss or damage because of the dealing or provision of financial product advice. *[Schedule 1, item 3, subsection 993DM(1) of the Corporations Act]*

1.98 However, the first cause of action does not arise if a regulated person (except the issuer) reasonably relied on a target market determination made by the issuer. This ensures that a distributor is not liable to civil action in circumstances where any wrongdoing is ultimately attributable to the issuer. *[Schedule 1, item 3, subsection 993DM(2) of the Corporations Act]*

1.99 The second cause of action arises where a person suffers loss or damage because a distributor failed to take reasonable steps to comply with a target market determination. The amendments provide a person with a cause of action if:

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<sup>32</sup> Attorney-General's Department, September 2011 edition.

- a regulated person is required to take reasonable steps to ensure compliance with a target market determination and fails to take those steps; and
- the person suffers loss or damage because of the failure.  
*[Schedule 1, item 3, subsection 993DM(3) of the Corporations Act]*

1.100 The new causes of actions do not affect any liability that a person has under any other law. In addition, the causes of actions arise regardless as to whether any person has been convicted of an offence or ordered to pay a civil penalty with respect to the relevant contravention.  
*[Schedule 1, item 3, subsection 993DM(1), 993DM(3), and 993DM(5)]*

1.101 The limitation period applicable to each cause of action is 6 years. The limitation period commences on the day on which the cause of action arose, meaning that any action must be commenced within 6 years of that date. *[Schedule 1, item 3, subsection 993DM(4)]*

1.102 The court dealing with one of the new causes of action is intended to be able to make a variety of orders. To ensure the court has appropriate powers, the amendments provide that the court may, in addition to awarding loss or damage:

- make an order declaring that a contract entered into by the person who suffered loss or damage is void; and
- if it makes such an order – make such other orders as it thinks are necessary or desirable because of that order.  
*[Schedule 1, item 3, subsection 993DN(1) of the Corporations Act]*

1.103 There are other orders that a court may make where it has declared a contract void, including, for example: an order for the return of money paid by a person and an order for payment of an amount of interest specified in, or calculated in accordance with, the order. *[Schedule 1, item 3, subsection 993DN(2) of the Corporations Act]*

## Consequential amendments

1.104 The new law makes a consequential amendment to existing section 760B of the Corporations Act. The amendment updates the table in the section so that it refers to the new law. The amendment ensures that the outline to Chapter 7 of the Corporations Act, which is contained in section 760B, remains current. *[Schedule 1, item 2, section 760B of the Corporations Act]*

## **Application and transitional provisions**

The new law contains transitional arrangements for existing financial products. An existing financial product is one where the first issue of the product occurs before the commencement of Schedule 1 of the Bill. The new design and distribution regime applies to such products 24 months after the new law receives the Royal Assent.<sup>33</sup> [*Section 2 and schedule 1, item 14*]

1.105 The new design and distribution regime applies to all other financial products on the day that Schedule 1 of the Bill commences. That is, 12 months after the new law receives the Royal Assent [*section 2 and Schedule 1, item 14*]

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<sup>33</sup> The transitional arrangement for exiting products is unlikely to be relevant for most issues of securities, as disclosure documents for securities expire after 13 months. See existing sections 711 and 715 of the Corporations Act.



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## **Chapter 2**

# **Product Intervention Power**

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### **Outline of chapter**

2.1 Schedule 2 to the Bill amends the Corporations Act and the Credit Act to introduce a product intervention power for ASIC to prevent or respond to significant consumer detriment. It sets out:

- the new power and when it can be exercised;
- the range of products which can be subject to the power;
- ASIC's obligations when exercising the power; and
- the consequences for failing to comply with an ASIC order.

### **Context of amendments**

2.2 The current regulatory system focuses on the protection of consumers when a product is acquired through a financial adviser or credit assistance provider, and relies heavily on the disclosure of information to customers.

2.3 ASIC has powers under certain parts of the Corporations Act to impose conditions and take actions to rectify consumer detriment after a breach or suspected breach of the law. However, these powers provide ASIC with limited scope to regulate proactively.

2.4 ASIC can only intervene in certain situations where there is a suspected contravention of the law. For example, ASIC can stop the issuance of products where the disclosure documents are defective. This limits ASIC's ability to intervene in the distribution of products where there is no defective disclosure.

2.5 The FSI considered the scope of ASIC's powers in the context of past situations where consumers had suffered significant consumer detriment and ASIC had exhausted its regulatory toolkit.<sup>34</sup> The FSI found that early intervention by ASIC could be more effective in reducing harm to consumers compared with waiting for a breach to occur. It recommended introducing a proactive intervention power that would

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<sup>34</sup> Financial System Inquiry (Final Report), November 2014, at p 207 and 208.

enhance the regulatory toolkit available where there is risk of significant consumer detriment.<sup>35</sup>

2.6 The Government accepted the FSI recommendation to introduce an intervention power on 20 October 2015.<sup>36</sup> On 13 December 2016, the Minister for Revenue and Financial Services released a proposals paper on the implementation of the obligations.<sup>37</sup>

2.7 The intervention power will allow ASIC to regulate, or if necessary, ban potentially harmful financial and credit products where there is a risk of significant consumer detriment. The power is intended to enable ASIC to take action before harm, or further harm, is done to consumers.

## Summary of new law

2.8 Schedule 2 to the Bill amends the Corporations Act and the Credit Act to introduce the intervention power. The intervention power allows ASIC to make a range of orders prohibiting specified conduct in relation to products regulated under those Acts. The intervention power allows ASIC to proactively reduce the risk of consumers suffering significant detriment from financial and credit products.

2.9 To ensure appropriate accountability, ASIC must satisfy consultation and notification obligations before an intervention order is made. Affected parties will be given the opportunity to make submissions to ASIC before an intervention is made, and all interventions will be made public.

2.10 Civil and criminal penalties apply to contraventions of the new arrangements. The combination of civil and criminal penalties allows the prosecutor or ASIC (as may be the case) to take a proportional approach when enforcing the new obligations. In addition, a person who suffers loss or damage because of a contravention of the new obligations may recover that loss by civil action.

2.11 ASIC may only intervene in relation to products that are made available for acquisition after the commencement of the new power. This ensures that the new power cannot interfere with existing arrangements between consumers and providers.

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<sup>35</sup> Financial System Inquiry (Final Report), November 2014, at p.206.

<sup>36</sup> Improving Australia's financial system, Government response to the Financial System Inquiry, December 2016, at pp.7 and 19.

<sup>37</sup> Design and Distribution Obligations and Product Intervention Powers, Proposals Paper, December 2016.

## Comparison of key features of new law and current law

<i>New law</i>	<i>Current law</i>
ASIC can proactively intervene in relation to financial and credit products by making orders to prohibit specified conduct related to the product.	ASIC can make stop orders in relation to suspected breaches of some obligations under the Corporations Act
ASIC must consult affected parties before making the intervention orders and must make all orders public.	Similar consultation requirements are in place for stop orders. However, temporary stop orders lasting for 21 days can be made without consultation taking place.
A person who suffers loss or damage because of a contravention of the design and distribution obligations may recover that loss by civil action.	A similar cause of action currently exists in relation to loss or damage caused, for example, by defective disclosure under the Corporations Act.

### Detailed explanation of new law

2.12 Schedule 2 to the Bill amends the Corporations Act and the Credit Act to introduce the intervention power.

2.13 The object of the intervention power is to give ASIC a proactive power to reduce the risk of significant detriment to consumers resulting from financial and credit products. *[Schedule 2, items 2 and 8, sections 1022CA of the Corporations Act and section 301A of the Credit Act]*

2.14 To do this the Bill inserts a new part into both the Corporations Act and Credit Act that contains the new intervention power. The new parts detail:

- the products which can be subject to the power;
- when the power can be used;
- the content of the power, including the types of interventions that can be made and the process for making them; and
- the consequences for failing to comply with an intervention.

### What products are subject to the intervention power?

2.15 The intervention power applies to products regulated under the Corporations Act and Credit Act.

- In the case of the Corporations Act, the intervention power generally only applies to financial products that are, or are likely to be, available for acquisition by retail clients by way of issue. However, the power also applies to such products in certain anti-avoidance sale situations.
- In the case of the Credit Act, the intervention power applies to all products that may be provided by a person in the course of engaging in a credit activity or proposed credit activity. Such products consist of credit contracts, mortgages and guarantees in relation to those contracts, and consumer leases. *[Schedule 2, items 2 and 8, subparagraph 1022CC(1)(a) and 1022CC(3)(a) of the Corporations Act and subparagraph 301C(1)(a) of the Credit Act]*

### ***Financial products***

2.16 There are two main limitations on the types of financial products that can be subject to the intervention power under the Corporations Act. First, the power generally only applies in an ‘issue situation’. Second, the power only applies where a product may be made available to ‘retail clients’.

2.17 The intervention power generally only applies to financial products that are, or are likely to be, available by way of issue. What constitutes a financial product is defined in existing Division 3 of Chapter 7 of the Act. ‘Financial product’ is a broad term that covers a range of products that meet the investment and risk management needs of investors. Examples include securities, insurance products, derivatives, and superannuation products. *[Schedule 2, item 2, subparagraph 1022CC(1)(a) and 1022CC(3)(a) of the Corporations Act]*

2.18 The intervention power cannot generally apply to a sale of a financial product. A sale occurs when a financial product is sold by, or purchased from, a person who acquired the product at or after its issue.<sup>38</sup> However, existing sections 707 and 1012C of the Corporations Act detail certain sale situations which could potentially be used to avoid the intervention power.<sup>39</sup> These situations include:

- 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.

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<sup>38</sup> See section 1010C of the Corporations Act.

<sup>39</sup> Sections 707 and 1012C of the Corporations Act are anti-avoidance provisions that aim to ensure that the requirement to provide disclosure in relation to a financial product cannot be avoided by an arrangement that utilises certain sale situations.



2.19 To prevent these and similar sale situations being used to avoid the intervention power, the new law enables the power to be used in the sale situations detailed in sections 707 and 1012C of the Corporations Act. *[Schedule 2, item 2, subparagraph 1022CC(1)(a)]*

2.20 The intervention power only applies where the relevant product may be offered to retail clients. What constitutes a retail client is defined in existing sections 761G and 761GA of the Corporations Act. The precise definition depends on a range of circumstances, but roughly captures those persons that may be considered ordinary consumers of financial products, as opposed to wholesale clients. The fact the intervention power only operates in relation to retail clients reflects its objective of enhancing consumer protections under the Act.

2.21 The intervention power can be used regardless as to whether or not the financial product requires disclosure under Chapter 6D or Part 7.9 of the Corporations Act. This ensures that the power is not unduly limited in its operation.

2.22 The regulations may exclude financial products from the operation of the new intervention power. This may be appropriate, for example, where the new power may have unintended consequences in the context of a particular product. This flexibility to exclude financial products from the new regime is therefore necessary to future-proof the new power. *[Schedule 2, item 2, section 1022CA of the Corporations Act]*

### ***Credit products***

2.23 The intervention power also applies to products that may be provided by a person who engages in a credit activity under the Credit Act. Section 6 of the Credit Act defines a ‘credit activity’ to include a broad range of activities in relation to credit products. *[Schedule 2, item 8, section 301B and subsection 301C(1)(a) of the Credit Act]*

2.24 Credit products are credit contracts, consumer leases, mortgages, and guarantees. What constitutes these products is defined in the National Credit Code (the Code) at Schedule 1 of the Credit Act as follows:

- A ‘credit contract’ is a contract that provides credit where:
  - the debtor is a consumer (that is, a natural person or strata corporation);
  - the credit is intended to be used for: personal, domestic, or household purposes; or, to purchase, renovate or improve residential property for investment purposes or to refinance such credit;
  - a charge is or may be made for providing the credit; and

- the credit is provided in the course of a business.<sup>40</sup>
- A ‘consumer lease’ is a contract for the hire of goods by a consumer under which:
  - the consumer does not have a right or obligation to purchase the goods;
  - the goods are hired for a personal, domestic or household purpose;
  - the hire charge exceeds the price of the goods; and
  - the lessor hires the goods in the course of a business.<sup>41</sup>
- A mortgage or guarantee is regulated where it is granted by a consumer and secures or guarantees obligations under a credit contract.<sup>42</sup>

2.25 The new intervention power only applies prospectively. An intervention cannot affect any product that already been entered into. This ensures that while the new power can operate with respect to products yet to be acquired; it cannot operate so as to vary any existing contractual obligations or arrangements between a consumer and a credit provider, lessor, mortgagee or beneficiary of a guarantee. Likewise, the new power cannot affect any assignment of an existing right under a credit product.

2.26 The term ‘product’ is used to describe any product that may be subject to the new intervention power.

## When can the intervention power be used?

2.27 The new intervention power can be used where ASIC is satisfied that a product or class of products has resulted, or is likely to result, in significant detriment to relevant persons. Relevant persons are retail clients for the purposes of the new power under the Corporation Act and consumers proposing to acquire credit products for the purposes of the new power under the Credit Act. These persons will be collectively referred to as consumers unless a contrary intention is indicated.

*[Schedule 2, items 2 and 8, subparagraphs 1022CC(1)(a)-(b) and 1022CC(3)(a)-(b) of the Corporations Act and subparagraphs 301C(1)(b) and 301C(3)(b) of the Credit Act]*

2.28 Consistent with existing provisions of the Corporations Act, ‘significant’ is not defined for the purposes of the new power. The meaning of significant is intended to take its ordinary meaning in the context of the new provision. Generally, this would require the detriment

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<sup>40</sup> See sections 4 and 5 of the Code.

<sup>41</sup> See sections 169 and 170 of the Code.

<sup>42</sup> See sections 7 and 8 of the Code.

to be sufficiently great to justify an intervention, having regard to the circumstances of the case and the object of the intervention power.

2.29 The new law provides guidance about matters that must be considered in determining whether a detriment for the purposes of the new power is significant. These factors are:

- the nature and extent of the detriment, including any actual or potential financial loss to consumers;
- the impact that the detriment has had, or will or is likely to have, on consumers; and
- any other matter prescribed by the regulations. *[Schedule 2, items 2 and 8, subsection 1022CD(1) of the Corporations Act and subsection 301D(1) of the Credit Act]*

2.30 The factors are non-exclusive. ASIC can consider any other relevant factor when determining the significance of the relevant detriment. ASIC can take into account a range of objective and subjective factors in determining whether a loss is significant. For example, objective factors could include the number of consumers affected and the total amount of the detriment. Subjective factors could include the impact of the detriment on the consumers affected by it. *[Schedule 2, items 2 and 8, subsection 1022CD(2) of the Corporations Act and subsection 301D(2) of the Credit Act]*

2.31 The new law does not define a detriment for the purposes of the new power. The meaning of detriment is intended to take its ordinary meaning in the context of the new provision. However, it is intended to cover a broad range of harm or damage that may flow from a product. The harm or damage may arise from any number of sources associated with the product, including the product's features, defective disclosure, poor design, or inappropriate distribution.

2.32 A product's compliance with existing provisions of the law may be relevant to whether it is likely to cause significant consumer detriment. However, a product may cause such detriment even if it complies with all applicable laws. In particular, a product may result in significant detriment to consumers even if a person has complied with all applicable disclosure requirements, and with the person's design and distribution obligations, in relation to the product. *[Schedule 2, items 2 and 8, subsection 1022CD(3) of the Corporations Act and subsection 301D(3) of the Credit Act]*

### **What is the content of the new intervention power and how is it exercised?**

2.33 The new power allows ASIC to make an intervention order that may last for up to 18 months, unless it is extended by the Minister.

### ***Intervention orders***

2.34 The new power allows ASIC to make intervention orders. Under an intervention order, ASIC may make three types of orders in relation to a product or class of product. In particular, ASIC may order that:

- a person must not engage in specified conduct in relation to the product;
- a person must not engage in specified conduct in relation to the product except in circumstances specified in the order; or
- a person must not engage in specified conduction in relation to the product unless steps specified in the order have been taken. *[Schedule 2, items 2 and 8, subparagraphs 1022CC(1)(c)-(e) and 1022CC(3)(c)-(e) of the Corporations Act and subparagraphs 301C(1)(c)-(e) and subparagraphs 301C(3)(c)-(e) of the Credit Act]*

2.35 An intervention order may generally operate in relation to any person or class of persons. However, it cannot operate in relation to a person in their capacity as a retail client. In addition, the regulations may provide additional people in relation to which an intervention order cannot be made. *[Schedule 2, items 2 and 8, subsection 1022CC(5) of the Corporations Act and section 301C(5) of the Credit Act]*

2.36 The range of orders that ASIC can make under a temporary intervention order is extensive. Some examples of the breadth of possible orders include:

- banning a person from issuing a product or class of product to consumers;
- directing that a particular product or class of product only be offered by way of issue to particular classes of consumers or in particular circumstances; and
- directing that a product or class of product not be distributed unless accompanied by an appropriate warning or label.

2.37 An intervention order can also include a statement that conduct in contravention of the order is regarded as not complying with a specified provision of the disclosure provisions of Chapters 6D or 7 of the Corporations Act. If the specified conduct is engaged in any relevant statement included in the order has affect accordingly and applies in addition to any other consequences of the conduct. *[Schedule 2, item 2, subparagraph 1022CC(4) of the Corporations Act]*

2.38 However, the new law provides some limitations on the matters that may be subject to an intervention order. These limitations provide that an intervention order cannot:

- require a person satisfy a standard of training, or meet a professional standard, other than a standard prescribed for the person by or under this Act; or
- require a person who is not required to hold an Australian financial services licence to join an external dispute resolution scheme; or
- impose requirements in relation to a person's remuneration, other than so much of the remuneration as is conditional on the achievement of objectives directly related to the financial product. [*Schedule 2, items 2 and 8, subparagraph 1022CC(6) of the Corporations Act and subsection 301C(5) of the Credit Act*]

2.39 An intervention order with respect to the above matters would not be appropriate. Existing laws already provide comprehensive regimes in relation to training, professional standards, and dispute resolution. These regimes are not to be affected by the new intervention power. In addition, the new power should not generally be able to affect remuneration arrangements between parties. However, an exception is made where the remuneration arrangement is contingent upon the achievement of objectives directly related to the financial product. In such situations, an arrangement could promote adverse consumer outcomes.

2.40 ASIC may delegate its power with respect to intervention orders to an ASIC commissioner, or a senior executive staff member of ASIC. [*Schedule 2, item 10, subsection 102(2C)C of the Australian Securities and Investments Commission Act 2001*]

#### ***Duration of intervention order***

2.41 An intervention order made by ASIC may continue for up to 18 months (the prescribed period) unless the period is extended by the Minister. The Minister may delegate their power to extend an intervention order to ASIC. In addition, if a court makes an order staying or other affecting the operation or enforcement of an intervention order, the period of the court's order is not included towards the prescribed period. [*Schedule 2, items 2, 4 and 8, section 1022CB, subsections 1022CF(1) and 1022CF(2) and section 1101J of the Corporations Act and section 301B, subsection 102(2D), subsections 301F(1) and 301F(2) of the Credit Act*]

2.42 The regulations may vary the prescribed period, but only so as to shorten the period. The regulations cannot lengthen the prescribed period beyond 18 months. An intervention order can only be lengthened beyond 18 months if the Minister extends it for a set period of time or declares it permanent. [*Schedule 2, items 2 and 8, subsections 1022CF(1) and 1022CG of the Corporations Act and subsection 301F(1) and section 301G(1) of the Credit Act*]

2.43 There are strict rules relating to remaking an intervention order. In particular, if an order expires or is revoked, ASIC may not remake the

order in substantially the same terms unless: the circumstances have materially changed from those when the order was made; or, the Minister approves the remaking of the order. *[Schedule 2, items 2 and 8, section 1022CK of the Corporations Act and section 301L of the Credit Act]*

### ***Procedural requirements***

2.44 ASIC must comply with two key procedural requirements prior to making an intervention order. These procedural requirements relate to consultation and the issuance of a public notice with respect to the intervention.

#### *Consultation*

2.45 The first procedural requirement that ASIC must meet prior to making an intervention order relates to consultation. There are three consultation requirements that may be applicable to the making of an intervention order.

2.46 The first requirement is for ASIC to consult with people or entities that are likely to be affected by the order. This consultation requirement is intended to assist with the operation of the new regime. In particular, it would assist ASIC in framing an appropriate intervention (if any). It may also provide an opportunity for affected parties to work with ASIC to resolve ASIC's concerns, potentially without the need for the intervention order. *[Schedule 2, part 1, items 2 and 8, subparagraph 1022CE(1)(a) of the Corporations Act and subparagraph 301E(1)(a) of the Credit Act]*

2.47 The requirement is for ASIC to consult with 'affected parties'. If ASIC undertakes a targeted consultation process it must identify these parties and invite them to participate in the consultation process. However, ASIC is taken to have complied with the requirement to consult affected parties if it undertakes a public consultation process. Such a process requires ASIC: to make a proposed order, or a description of such an order, available on its website; and, to invite public comment on the proposed order. *[Schedule 2, items 2 and 8, subsection 1022CE(2) of the Corporations Act and item 8, section 301K of the Credit Act]*

2.48 The second consultation requirement is for ASIC to consult with APRA prior to making an intervention order in which APRA may have an interest. In particular, ASIC must consult with APRA on a proposed product intervention order that would apply to a body regulated by APRA. *[Schedule 2, items 2 and 8, subparagraph 1022CE(1)(b) of the Corporations Act and subparagraph 301E(1)(b) of the Credit Act]*

2.49 Finally, ASIC must also comply with any further consultation requirements prescribed by the regulations. *[Schedule 2, items 2 and 8, subsection 1022CE(1)(c) of the Corporations Act and subparagraph 301E(1)(c) of the Credit Act]*

2.50 This consultation process is intended to be mandatory. However, a failure to comply with the requirements does not invalidate an intervention order. This ensures that an otherwise valid intervention order is effective despite any defect in the relevant consultation process. However, ASIC must include in its annual report details of any instances where it has failed to meet the requirements. *[Schedule 2, items 2, 8 and 10, subsection 1022CE(3) of the Corporations Act, subsection 301E(3) of the Credit Act and subsection 136(1)(cb) of the ASIC Act]*

*Public notice of intervention orders*

2.51 The second procedural requirement that ASIC must meet prior to making an intervention is for a public notice to be issued in relation to the intervention. The notice must be published on ASIC's website and contain certain information. In particular, the notice must:

- describe the product or class of product the order applies to;
- describe the significant detriment to consumers in relation to which the intervention is made;
- set-out or summarise the terms of the product intervention order;
- specify the date the order is to take effect;
- describe the consultation ASIC had undertaken on the order;
- set out why the order is an appropriate way of reducing the significant detriment. *[Schedule 2, items 2 and 8, subsection 1022CJ(1) of the Corporations Act and subsection 301K(1) of the Credit Act]*

2.52 ASIC must make a similar public notice if an intervention order is varied. Such a notice must detail the amendment, when the amendment takes effect, the consultation undertaken with respect to the amendment and why the amendment is appropriate. *[Schedule 2, items 2 and 8, subsection 1022CJ(2) of the Corporations Act and subsection 301K(2) of the Credit Act]*

2.53 In the case of a revocation of an intervention order, ASIC need only publish the notice of the revocation on its website. *[Schedule 2, item 2, subsection 1022CJ(3) of the Corporations Act and subsection 301K(3) of the Credit Act]*

*Commencement of intervention orders*

2.54 The commencement date of an intervention order depends on whether it is a legislative instrument or not. In the case of an intervention order made by ASIC:

- An intervention order is a legislative instrument where it relates to a class of product or class of persons. In such a case, the order commences the day after the legislative instrument is registered.

- An intervention order is not a legislative instrument if it relates to a particular person or a particular product. In such a case, the order applies from the date specified in the public notice related to the intervention. *[Schedule 2, items 2 and 8, subsections 1022CC(2) and 1022CC(7) of the Corporations Act and subsections 301C(2) and 301C(6) of the Credit Act]*

### ***Amendment and revocation***

2.55 ASIC can revoke or amend intervention orders at any time. However, the Minister's approval is needed to revoke or amend a permanent order unless the power has been delegated to ASIC. ASIC cannot amend an intervention order so as to extend its operation beyond 18 months unless the Minister has delegated the power to do so. *[Schedule 2, items 2 and 8, subsections 1022CH(1), 1022CH(2), 1022CI(1) of the Corporations Act and subsections 301H(1), 301H(2), 301H(3) and section 301J of the Credit Act]*

2.56 The Minister may only revoke or amend an intervention order after considering a report by ASIC in relation to the decision. *[Schedule 2, items 2 and 8, sections 1022CH and 1022CI of the Corporations Act and sections 301H and 301J of the Credit Act]*

2.57 The character of an intervention influences the process relevant to amending or revoking the order.

- Orders that are legislative instruments may only be amended or revoked by legislative instrument. Such amendments commence the day after the legislative instrument is registered (unless another date is specified in the instrument).
- Orders that are not legislative instruments must be amended or varied in writing. Such amendments commence from the day the amendment is published on the ASIC website (unless another day is specified in the public notice). *[Schedule 2, items 2 and 8, subsection 1022CH(4) of the Corporations Act and subsection 301H(4) of the Credit Act]*

### ***Obligations associated with intervention orders***

2.58 There are three obligations associated with intervention orders.

2.59 The first (and principal) obligation is for a person not to engage in conduct that is contrary to the order. This obligation applies in relation to all intervention orders. *[Schedule 2, items 2 and 8, subsection 1022CL(1) of the Corporations Act and subsection 301M(1) of the Credit Act]*

2.60 The second obligation only arises if a person is served with an intervention order. The obligation requires the person to take reasonable steps to ensure that other persons who engage in conduct to which the order applies are aware of the order. A similar obligation applies in relation to stop orders made under existing provisions of the Corporations



Act.<sup>43</sup> [*Schedule 2, items 2 and 8, subsection 1022CL(3) of the Corporations Act and subsection 301M(3) of the Credit Act*]

2.61 This obligation is not necessary where an intervention order is made by legislative instrument. In the case of an instrument of a legislative character, a person does not need to be notified of the instrument in order to be obligated to comply with the instrument. [*Schedule 2, items 2 and 8, subsections 1022CL(1) and 1022CL(2) of the Corporations Act and subsection 301M(1) and 301M(2) of the Credit Act*]

2.62 The third (and final) obligation enables ASIC to require a person to notify their customers of an intervention order in certain circumstances. These circumstances are where: an intervention order has been made in relation to a product; and, the person has dealt in, or provided financial advice in relation to, the product with respect to consumers. In these circumstances, ASIC may require the person to notify those customers of the terms of the intervention order and any other matters that may be prescribed in the regulations. [*Schedule 2, items 2 and 8, subsection 1022CM(1) of the Corporations Act and subsection 301N(1) of the Credit Act*]

2.63 The notice ASIC provides to the person may specify the way in which the person is to notify their customers. If the notice is a legislative instrument, the notice must also be a legislative instrument. If the notice is not a legislative instrument, a person does not need comply with the notice if they are not aware, and could not reasonably be aware, of the notice. [*Schedule 2, items 2 and 8, subsections 1022CM(2), 1022CM(3) and 1022CM(5) of the Corporations Act and subsections 301N(2), 301N(3) and 301N(5) of the Credit Act*]

## **What are the consequences of contravening the new power?**

2.64 The consequences of breaching the new provisions fall into two main categories. These are:

- liability to the state through civil penalty proceedings or criminal prosecution; and
- liability to persons suffering loss or damage through civil action.

### ***Civil and criminal penalties***

2.65 A contravention of every obligation in the new regime is both a civil penalty provision and an offence. This allows the regulator or prosecutor (as the case may be) to take a proportional approach to the enforcement of the new regime.

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<sup>43</sup> See, for example, existing section 1020E of the Corporations Act

The maximum penalties applicable to each obligation in the Bill are detailed in the following table.

**Table 2.1 Penalties concerning obligations**

<i>Obligation</i>	<i>Penalty</i>
Engaging in conduct contrary to an intervention order	Criminal – 200 penalty units or imprisonment for 5 years, or both. Civil penalty – \$200,000 for an individual; or 1 million for a body corporation
Failure to take steps to ensure other persons are aware of the intervention order	Criminal – 200 penalty units or imprisonment for 5 years, or both. Civil penalty – \$200,000 for an individual; or 1 million for a body corporation
Failure to notify consumers of the intervention order	Criminal – 200 penalty units or imprisonment for 5 years, or both. Civil penalty – \$200,000 for an individual; or 1 million for a body corporation

*[Schedule 2, items 2, 5, 7, and 8, subsections 1022CL(1), 1022CL(3) and 1022CM(4), table items 40A to 40C in subsection 1317E(1) and table items 309AG to 309AH in Schedule 3 of the Corporations Act, and subsections 301M(1), 301M(3) and 301N(4) of the Credit Act]*

2.66 The penalties applicable to each obligation are broadly consistent with current penalties applicable to comparable provisions in the Corporations Act. The criminal penalties applicable to breaching an intervention order are, however, greater than those applicable to breaching a stop order made under an existing provision of the Corporations Act. The difference reflects the broader range of orders that can be made under the new power and that an intervention order can only be made where consumers may suffer significant detriment. The principles set out in the *Guide to Framing Commonwealth Offences, Infringement Notices and Enforcement Powers*<sup>44</sup> were also considered in determining the applicable penalties.

2.67 The way the law gives effect to the penalties varies between the Corporations Act and the Credit Act. In the case of the Corporations Act,

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<sup>44</sup> Attorney-General’s Department, September 2011 edition

the penalties are given effect to by making the necessary amendments to existing subsection 1317E of the Corporations Act (in relation to civil penalties) and Schedule 3 of the Corporations Act (in relation to criminal penalties). In the case of the Credit Act, the penalties are specified in the provisions that create the offence. [*Schedule 2, items 2 and 8, subsections 1022CL(1), 1022CL(3) and 1022CM(4) of the Corporations Act and, subsections 301M(1), 301M(3) and 301N(4) of the Credit Act*]

### **Civil liability**

2.68 A person who suffers loss or damage because of a contravention of an intervention order may recover that loss or damage by civil action. In particular, the amendments provide a consumer with a cause of action if:

- a person is required to comply with an intervention order and contravenes the order; and
- the consumer suffers loss or damage because of the other person's contravention of the order. [*Schedule 2, item 2, subsection 1022CN(1)*]

2.69 The new cause of action does not affect any liability that the person who contravenes the intervention order has under any other law. In addition, the cause of action arises regardless as to whether or not the person who contravenes the order has been convicted of an offence or ordered to pay a civil penalty with respect to the relevant contravention. [*Schedule 2, item 2, subsection 1022CN(3) of the Corporations Act*]

2.70 The limitation period applicable to the cause of action is 6 years. The limitation period commences on the day on which the cause of action arose, meaning that any action must be commenced within 6 years of that date. [*Schedule 2, item 2, subsection 1022CN(2) of the Corporations Act*]

2.71 The court dealing with the new cause of action is intended to be able to make a variety of orders. To ensure the court has appropriate powers, the amendments provide that the court may, in addition to awarding loss or damage:

- make an order declaring that a contract entered into by the person who suffered loss or damage is void; and
- if it makes such an order – make such other orders as it thinks are necessary or desirable because of that order.

2.72 There are other orders that a court may make where it has declared a contract void, including, for example: an order for the return of money paid by a person and an order for payment of an amount of interest specified in, or calculated in accordance with, the order. [*Schedule 2, item 2, section 1022CO of the Corporations Act*]

2.73 The Bill only creates a new cause of action for a contravention of an intervention order when the order is made under Part 7.9A of the Corporations Act. Equivalent amendments are not required in relation to intervention orders made under the Credit Act. The Credit Act currently contains arrangements for compensating consumers for loss or damage resulting from a contravention of a civil penalty provision or the commission of an offence against the Act. In particular, Part 4-2 of the Credit Act currently provides the court with powers to grant a range of remedies in such circumstances, including compensation orders. The existing provisions in Part 4-2 apply in relation to a contravention of an intervention order made under the Credit Act, as such a contravention is both a civil penalty provisions and an offence.

## Consequential amendments

2.74 The new law makes a consequential amendment to existing section 760B of the Corporations Act. The amendment updates the table in the section so that it refers to the new law. The amendment ensures that the outline to Chapter 7 of the Corporations Act, which is contained in section 760B, remains current. [*Schedule 2, item 1, section 760B of the Corporations Act*]

## Application and commencement provisions

2.75 Schedule 2 of the Bill commences on the day after the Royal Assent. [*Table item 3 of section 2 to the Bill*]

2.76 The power applies from the day after the Royal Assent. However, the power is not retrospective. It only applies in relation to products that are acquired by consumers on or after the commencement date.

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## **Chapter 3**

# **Regulation Impact Statement**

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### **Outline of chapter**

3.1 On 20 October 2015, as part of its response to the FSI, the Government agreed with the recommendation that the government should introduce targeted and principles-based product design and distribution obligations and product intervention power. In committing to these objectives and subsequent decisions on the details of the legislative amendment package, the Government was informed of the regulatory impacts of various reform options by the findings of the FSI and targeted consultations with industry stakeholders.

3.2 The Australian Government Guide to Regulation identifies seven questions that a RIS should address. Following is a summary of the analysis of these questions that occurred as part of the independent reviews and stakeholder consultation process.

### **Consultation**

3.3 The FSI received over 180 submissions, complemented by extensive stakeholder engagement through meetings and roundtables.

3.4 In response to the December 2016 consultation paper, a range of relevant industry and consumer group stakeholders provided 38 submissions, four of which were confidential. Treasury also met with key industry representative bodies and consumer groups.

### **Design and Distribution Obligations**

#### **The problem**

3.5 The FSI found that the existing regulatory framework governing financial products 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.

3.6 Such issues contributed to consumer detriment from financial investment failures, such as Storm Financial, Opes Prime, Westpoint, agribusiness schemes and unlisted debentures, which affected more than 80,000 consumers. Losses from these failures totalled more than \$5 billion or \$4 billion after compensation and liquidator recoveries. 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.

3.7 The quality of product design and distribution controls was found to be variable. ASIC's report on Regulating Complex Products observed that some consumers acquire structured products that are riskier than they realise. For example:

- Insufficient information provided in the disclosure documents, advertising and seminars relating to over-the-counter contracts for difference (CFD) made it difficult for retail consumers to make informed investment decisions.
- Some firms distributing hybrid securities included sales information in addition to, or inconsistent with, the information in the prospectus. This information tended to emphasise high yield while downplaying risk.

3.8 The FSI was also concerned that certain less complex add-on insurance products may not meet the needs of some consumers. For example, an ASIC report revealed that Consumer Credit Insurance (CCI) products were being bought by consumers whose situation made them ineligible to claim under the policy.

3.9 The financial services industry had already attempted to address this problem through broader risk management processes and specific initiatives. For example, the Australian Financial Markets Association (AFMA) developed product approval principles for retail structured finance products. However, they do not cover all issuers and distributors, and, in any event, are not enforceable. Government intervention is required to ensure that ASIC has the necessary toolkit to prevent consumer detriment by subjecting product issuers and distributors to more positive obligations in regard to the appropriateness of its products to their end consumer.

## **Policy options and net benefits**

3.10 The FSI considered a range of policy options to reduce the number of consumers buying products that do not match their needs. These included:

- introducing individual appropriateness tests at point of sale for complex products; and
- implementing a new obligation through a fully self-regulatory approach by setting expectations for industry and monitoring their progress, with regulatory follow-up if progress is not made.

3.11 An individual appropriateness test requires the assessment of some of an individual's personal circumstances before making the product available to them. An individual appropriateness test, where no personal advice is provided, would introduce significant costs for issuers and distributors due to necessary changes to the sales process. Appropriateness tests are also open to manipulation. The FSI found that the objective can be achieved by taking a principles-based approach to product design and distribution that is less prescriptive.

3.12 Implementing a new obligation through a self-regulatory approach would build on work of AFMA, rely on the financial services industry to monitor how standards are applied and take relevant disciplinary action if required. However, experience with industry self-regulation in the financial sector suggested that improving the design and distribution of products for consumers would not be achieved by self-regulation alone.

3.13 The FSI found that past industry-led standards have not been sufficient by themselves to address serious conduct issues; for example, managing conflicts in financial advice driven by remuneration. Despite efforts over many years, the financial advice industry failed to improve financial advisers' conduct, leaving it unable to prevent or reduce the effect of recent serious cases of poor advice. Self-regulation alone would also fail to underscore the importance of this recommendation to improve consumer outcomes.

## **Agreed Option**

3.14 As part of its response to the FSI, the Government announced its agreement to creating targeted and principles-based financial product design and distribution obligations.

3.15 Increasing the accountability of product issuers and distributors in this way boosts consumer confidence and trust in the system. This view was supported in submissions to the FSI by many consumer groups and financial advice groups. However, industry submissions noted that many firms already have sophisticated controls in place, and regulatory intervention would increase product costs or decrease product offerings for consumers. Submissions from issuers, distributors and industry groups also raised concerns about the difficulty for product issuers in determining the suitability of products and the additional compliance cost involved

with introducing new obligations. Firms believed their processes would need to be reviewed even if they already have controls in place.

3.16 Nevertheless, the FSI noted that the obligations are likely to have substantial benefits for consumers. As discussed earlier, in conjunction with other measures, a product issuer and distributor obligations are intended to reduce the incidence of cases such as:

- Storm Financial, where margin lending products did not suit consumer risk profiles, such as those approaching retirement who could only cover significant losses by selling the family home. Close to 2,800 consumers faced around \$500 million net losses.
- Opes Prime, where complex securities lending arrangements were not understood by consumers. As a result, hundreds of clients, many of whom were retail consumers, faced close to \$400 million net losses.

3.17 The FSI considered that industry concerns about implementation costs could be dealt with by ensuring the obligation builds on good practice, is principles-based and is applied on a scaled basis, allowing scope for firms to adapt their existing practices. Thus, the new obligation imposes minimal costs on firms with existing good practices. Some incremental costs for industry may include client categorisation, record keeping, updating documentation and staff training, as well as monitoring changes in the external environment.

3.18 Some stakeholders suggested that a new obligation of this kind should be limited to the design and distribution of complex products. Although many of the cases of concern leading up to the FSI involve distribution of complex products to retail clients, examples of concern have also included distribution of less complex products such as add-on insurance and debentures. There were ASIC Enforceable Undertakings that raised concerns with the quality of distribution plans for credit cards. The FSI's view was that the obligations should not be restricted. As such, the obligations are broad in its nature and scalable in line with the nature of the product.

3.19 This option delivers benefits to industry, including strengthening internal risk management for product design, which may mitigate future problems, as well as signalling a higher level of customer focus. This approach also avoids new, more complex and interventionist regulation in the future, promoting efficiency in the financial system overall.

3.20 A regulatory costing has been prepared, consistent with the Government's Regulatory Burden Measurement Framework.



3.21 For product issuers and distributors, implementation and ongoing costs are associated with:

- developing policies and procedures to ensure that they are complying with the new requirements;
- changing product review and distribution standards; and
- communicating with other distributors and issuers as relevant.

3.22 The costs include that of updating IT systems to ensure that existing systems are compliant with requirements and that they will be able to monitor products and customers on an ongoing basis.

3.23 It is estimated that the increase in annual compliance costs for the industry as a whole will amount to \$232.1 million.

**Table 3.1: Regulatory burden estimate table**

<i>Change in costs (\$ million)</i>	<i>Business</i>	<i>Community organisations</i>	<i>Individuals</i>	<i>Total change in costs</i>
<i>Total, by sector</i>	<i>\$232.1</i>	<i>\$0</i>	<i>\$0</i>	<i>\$232.1</i>

## Product Intervention Power

### The problem

3.24 The FSI identified that ASIC lacked a broad regulatory toolkit to respond effectively and in a timely way to an emerging risk of significant consumer detriment.

3.25 Australia had cases of significant consumer detriment where ASIC had exhausted its current regulatory toolkit and where there was no clear basis to take enforcement action. These include:

- Mortgage managed investment schemes (MISs), where close to 100 were frozen in the market downturn during the global financial crisis. More than 4,000 consumers received hardship relief, indicating that many did not expect an investment of this type to be illiquid.
- Unlisted debenture investments, such as Banksia Securities, where many consumers thought the products they bought were similar to bank term deposits. More than 1,500 consumers lost more than \$100 million after recoveries. Prior to the collapses, ASIC took action to stop a number of individual pieces of marketing, but that did not correct

consumers' overall impressions about the level of risk involved.

3.26 In both cases, ASIC responded to the emerging risk of significant consumer detriment by providing guidance on the nature of disclosure that should accompany these products. However, ASIC did not have power to impose such disclosure requirements, instead seeking to create an expectation on firms to provide clearer disclosure that outlined the risk and central features of the products.

3.27 There have also been cases where ASIC lacked a broad toolkit to respond effectively and in a timely way to an emerging risk of significant consumer detriment. For example, the following cases involving leveraged investment strategies that exacerbated the loss for many consumers:

- Agribusiness schemes did not perform in the way that consumers were led to believe. This included schemes relying on ongoing sales to fund their operations. Many consumers did not understand the potential risk of borrowing to invest in these products. In total, more than 65,000 consumers invested and lost close to \$3 billion.
- Financial collapses, such as Storm Financial and Opes Prime, involved poor distribution practices. More than 3,000 consumers lost more than \$1.4 billion, of which around half was recovered.

3.28 The FSI found that recent changes in technology have meant that consumers have had increasing access to complex products, which can involve complicated structures and heightened risk. These products may be difficult for consumers to understand, testing the limits of the disclosure-based regulatory regime.

- For example, some structured products have a high degree of risk, but are labelled, described and promoted in a way that suggests they have lower risk. In such cases, consumers may still not understand the risk/return trade-off or the central features of the financial product or strategy, even where they are accurately disclosed.

3.29 The FSI found that:

- although complexity does not necessarily correlate to higher risk, complex features make it particularly difficult for consumers to assess the risk and appropriate pricing of higher-risk products – ASIC found that 71 per cent of survey respondents, including industry participants, consumers and financial literacy specialists, believe that Australian

consumers do not understand the risk involved with complex products;

- complex products are particularly influenced by behavioural biases – people respond automatically and unconsciously to try to simplify the decision-making process, leading to poor financial decisions.

3.30 The FSI noted, however, that the risk of consumer confusion about risk and features is not limited to complex products. Past case studies involving margin loans, mortgage schemes and debentures indicate consumers may also misunderstand less complex products and their core features and risk. Many consumers find information imbalances or behavioural biases hard to overcome. Some current product distribution strategies also hamper understanding.

3.31 The FSI's recommendation also took into account the Senate Economics References Committee's report on ASIC's performance. The Senate Committee suggested that urgent attention should be given to providing ASIC with the necessary toolkit to prevent consumer detriment through allowing ASIC to intervene and prohibit the issue of certain products in retail markets.

### **Policy options and net benefits**

3.32 The FSI considered a range of policy options to reduce instances of consumer detriment, including:

- introducing default products for a range of basic financial needs; for example, deposits, home and contents insurance and basic investments; and
- prohibiting the distribution of certain classes of non-mainstream products to retail clients.

3.33 Introducing default products would involve significant new powers and require considerable resources and skilled personnel. Although some areas may need default products, such as superannuation, where consumers are compelled to participate, the FSI did not believe this rationale extended to other product types. They thought that widening the pool of default products may risk significantly limiting innovation and reducing competition.

3.34 In relation to prohibiting the distribution of products, some international jurisdictions have prohibited the distribution of certain classes of product to retail consumers.

3.35 Although such measures may reduce the risk of detriment, they take a broad approach and remove choice across a range of products for

consumers who may understand the risk involved. For this reason, the FSI did not recommend them.

## Agreed Option

3.36 As part of its response to the FSI, the Government announced that it supported amending the law to provide ASIC with a product intervention power in conjunction with new design and distribution obligations for financial products. This will allow ASIC to take a more proactive approach to reducing the risk of significant detriment to consumers through more timely and targeted intervention.

3.37 This power can be used as a last resort or pre-emptive measure where there is risk of significant detriment to a class of consumers. This power also enables intervention without a demonstrated or suspected breach of the law. However, consistent with the FSI, ASIC is held to a high level of accountability for its use, given the potential significant commercial impact of this power.

3.38 The power is not intended to address problems with pricing of retail financial products, where consumers might be paying more than expected for a particular product or where a large number of consumers have incurred a small detriment.

3.39 The FSI noted that targeted early intervention would be more effective in reducing harm to consumers than waiting until detriment has occurred. The regulator should be able to be proactive in its supervision and enforcement. Significant consumer detriment could be reduced if ASIC had the power to stop a product from being sold or, where the product had already been sold, to prevent the problem from affecting a larger group of consumers.

3.40 A regulatory costing has been prepared, consistent with the Government's Regulatory Burden Measurement Framework.

3.41 For product issuers and distributors, implementation and ongoing costs are associated with:

- changing their marketing materials for a particular product;
- infrequent instances of a product being banned; and
- changing the way products are distributed to clients.

3.42 It is estimated that the increase in annual compliance costs for the industry as a whole will amount to \$7.7 million.

**Table 3.2: Regulatory burden estimate table**

<i>Change in costs (\$ million)</i>	<i>Business</i>	<i>Community organisations</i>	<i>Individuals</i>	<i>Total change in costs</i>
<i>Total, by sector</i>	\$7.7	\$0	\$0	\$7.7

## Implementation and evaluation

3.43 The Government will implement these reforms by introducing the Treasury Laws Amendment (Design and Distribution Obligations and Product Intervention Powers) Bill 2018 to introduce a targeted and principles-based product design and distribution obligation in the [...].

3.44 The Bill will make amendments to legislation including the *Corporations Act 2001* and the *National Consumer Credit Protection Act 2009*.

3.45 Given the significant nature of the reforms, the Government will review them after five years to ensure that they are operating effectively.