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Summary comments on Treasury Laws Amendment (Design and Distribution Obligations and Product Intervention Powers)

Overview

The design and distribution obligations have been conceived of to address shortcomings in the ability of disclosure to protect consumers. To this end, a key objective of the amendments is to ensure that product issuers consider and define their intended target market and how they distribute to consumers in that target market.

The design and distribution obligations attach to the requirement issue a PDS.

ISA broadly supports this concept of a product intervention power. Nevertheless, we believe there is room for improvements in the explanatory memorandum and draft legislation.

Our submission will focus on the design and distribution obligations. We broadly support the drafting and EM (Chapter 2) on the operation, procedural fairness, and penalties of the power. The only additional suggestion we would make is that when ASIC considers the level of consumer harm/detriment in deciding to exercise the intervention power, it should be broad enough to capture mis-selling of products with limited or no use value to consumers. Bundling of financial services products remains a significant issue – in this context, consumers paying for additional services or products they are unlikely to use should be a clearly recognised basis for intervention.

In what follows we comment on the design and distribution obligations.

Scope

We note the product intervention power will only apply to **new products**. This is troubling and a fatal flaw. Existing products are being sold, yet the consumer protections meant to be provided by the design and distribution obligations, and ASIC powers would not apply. Excluding all existing products also could provide issuers with a way to avoid the power, such as by “modifying” an existing product rather than creating a new product. The consumer harm in not covering existing products is high. In superannuation and life insurance, for example, there are large numbers of legacy products where the consumers in those products are either deriving poor value, not aware they still hold that product, or cannot exit the product easily due to exit fees or penalties. The product intervention power could help clean up these legacy products for consumers in such scenarios.

The product intervention power attaches to the PDS regime. This means there will be an issue where a retail super fund provides superannuation through an investment platform (for example, an IDPS or IDPS-like scheme). Given the way ASIC's relief for platform operators works, the design and distribution obligations might not apply to the retail platform. Retail funds could shift the design obligations onto sub funds and the distribution obligations back onto financial advisers. It is therefore important that design and distribution obligations for platforms attach to the platform operators, including any decisions they make about the funds and sub funds on the platform.

Given the existing significant design requirements under which MySuper products operate, it makes sense that they are exempt from the design and distribution obligations. While this will create a few issues around the joint advertising of MySuper and Choice superannuation, we broadly support this approach as MySuper is a default product and by definition the target market is universal.

Design Obligations

The design obligations require the issuer to determine a target market, review and ensure the target market remains appropriate, keep records of the decisions made with respect to the target market, and notify the regulator if dealings in the product are inconsistent with the determined target market. While the current drafting aims to set broad principles around determining an appropriate target market, it has dropped the requirement to also consider a non-target market. Requiring issuers to consider and specify who should not be sold a product is an important protection. As such, the Bill sets up an incentive for product issuers to define their target market as broad as they possibly can, so as to avoid breach reporting to ASIC of significant examples of customers who don't match the target market. ISA recommends the reintroduction of the concept of a non-target market.

In determining a target market, the Bill is somewhat vague. It requires the issuer to consider if the product is likely to meet the objectives, financial situation, and needs of the persons within the target market. ISA notes this closely follows the personal advice provisions in the Corporations Act. This should work well where the product issuer has a well-developed idea of the target market. We also believe there is value in defining the use-value of the product for the target market. This is particularly important where consumers receive bundled products and may not be aware of certain features, or may not need nor use products they are currently paying for.

The concept of using a potential customer's objectives, financial situation, and needs will struggle to be effective in situations where the target market is defined too broadly. This test in those situations is likely to become a 'tick a box' compliance approach. We would therefore support a definition similar to the non-target market' where the product issuer follows a line of reasoning from ASIC regulatory guidance where it also defines when it is not appropriate to people's financial circumstances and needs.

The obligation to review a target market determination is important – however, the proposed legislation should be more specific about the ways the market determination is tested.

The record keeping obligations, including those related to review triggers, are appropriate.

The draft legislation then creates an obligation to notify ASIC where there are dealings that are not consistent with the target market. The draft legislation proposes using the term 'significant dealings', based on the definition of 'significant' in ASIC breach reporting. This allows the issuer to determine what is significant to them numerically. The flaw in this test is that what is significant to the consumer may not be significant to the issuer. We recommend that the concept of significance be based on a consumer detriment test. For example, a small number of vulnerable consumers – who were not intended to be included in the target market – might be sold a given product. While numerically small from the issuer's perspective, the consequences of losses from that product are very significant to the individual customers affected. However, that may not be breach reported by the issuer because they do not feel there are enough affected customers. We therefore believe there should be an obligation to consider significance for the consumer.

Distribution Obligations

In the UK and other overseas jurisdictions where product intervention powers are available to regulators, there is a focus on ensuring that the distribution model is consistent with the target market and, importantly, restricts access to the product where it may not be appropriate. For example, personal advice might be required as the distribution model on a complex funds' management product, and over the counter distribution restricted, so that a suitability assessment is also undertaken at the point of distribution.

This approach aligns the suitability decisions at point of design across the product lifecycle and into distribution. The original proposal for the product intervention power did seem to encapsulate this thinking. However, the more recent draft of the distribution obligations in draft legislation stop short of this approach, and instead focus on how distribution operates in relation to a target market. For example, not to distribute until a target market is defined/determined. We note one worthy obligation relates to not distributing where a target market may not be appropriate. This is an excellent condition, but does not require the issuer to have reasonably determined that the method of distribution is appropriate taking into account the kind of product being offered, the target market, and the risk of selling to those outside the target market.

There should be an explicit requirement to define which type of distribution system was appropriate and not appropriate for the target and non-target markets.

ISA has some concerns about the reasonable steps obligation to ensure compliance with the target market determination. The issuer should be reasonably able to determine that dealings and advice on the product is in keeping with the target market determination. There is a very real risk, where an issuer has adopted a very broad target market determination, that these steps will be developed by compliance and legal departments into a 'tick a box' compliance approach. The danger of this is the determination becomes about form rather than substance. Difficult questions about who the product is really for, who will use it, who should not use it, and, indeed, if it is of any use at all (for example, add-on insurance in car sales), are not asked. Rather, the product review committee assigns a risk rating, severity, and mitigation strategy, and then the responsible person signs an attribution that reasonable steps have been taken.

We broadly support defining the target market in promotional material, but note that statements in promotional material have to date been insufficient to protect consumers; while this requirement is unlikely

to be harmful, it is also unlikely to be particularly effective. We also note that, in TV advertising and some social media advertising, it may prove difficult to satisfy this requirement. In these instances we would support providing a link to a website for further important information around the target market statement.

Kind regards

A handwritten signature in black ink, appearing to read 'Nick Coates', written in a cursive style.

Nick Coates

Head of Research and Campaigns

Industry Super Australia