



Law Council
OF AUSTRALIA

Legal Practice Section

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Manager
Financial Services Unit
Financial System Division
The Treasury
Langton Crescent
PARKES ACT 2600

By email: productregulation@treasury.gov.au

Dear Sir/Madam

TREASURY LAWS AMENDMENT (DESIGN AND DISTRIBUTION OBLIGATIONS AND PRODUCT INTERVENTION POWERS) BILL 2017

1. This submission has been prepared by the Law Council of Australia's Superannuation Committee (**the Committee**),¹ which is a committee of the Legal Practice Section of the Law Council of Australia.
2. The Committee's submission on the Exposure Draft of the Treasury Laws Amendment (Design and Distribution Obligations and Product Intervention Powers) Bill 2017 (**the Bill**) is guided by its main objective, which is to ensure that the law relating to superannuation in Australia is sound, equitable and clear.

Introduction

3. As detailed further below, the Committee makes six submissions, with the first four relating to the design and distribution obligations and the other two relating to the product intervention powers:
 - Submission 1: Clarify that any dealing or financial product advice that is unrelated to the issue or sale of a financial product falls outside the regime.
 - Submission 2: Clarify the transitional provisions.
 - Submission 3: Clarify the test for target market determinations.
 - Submission 4: Clarify the test for notifications to the Australian Securities and Investments Commission (**ASIC**).
 - Submission 5: Clarify that any financial product that has been acquired by a client falls outside the regime.
 - Submission 6: Remove remuneration completely from the regime.

¹ The Law Council of Australia is a peak national representative body of the Australian legal profession. It represents the Australian legal profession on national and international issues, on federal law and the operation of federal courts and tribunals. The Law Council represents 60,000 Australian lawyers through state and territory bar associations and law societies, as well as Law Firms Australia.

Design and distribution obligations

4. Schedule 1 of the Bill is entitled 'Amendments relating to design and distribution of financial products'.

Submission 1: Clarify that any dealing or financial product advice that is unrelated to the issue or sale of a financial product falls outside the regime

5. According to the Exposure Draft of the Explanatory Memorandum (**EM**), the new obligations will assist 'consumers to select appropriate financial products by requiring issuers and distributors to appropriately market and distribute financial products'.
6. In this way, the policy objective concerns the distribution of financial products; it does not extend to anything that happens after a particular financial product has been distributed to, and acquired by, a particular customer. However, the Bill is not entirely clear in this regard. On the one hand, the Bill would appear to be confined to the policy objective, to the extent it refers to the 'issue or sale' of a financial product.² On the other hand, the Bill would arguably have an operation that is much broader than the policy objective, to the extent it refers to 'dealing in, or providing financial product advice in relation to', a financial product.³
7. The Committee submits that the Bill should be amended to make it clear that it does not apply to any dealing or financial product advice where the relevant activity is unrelated to the issue or sale of a financial product. There should be no doubt that, if a financial product has been issued or sold, then a dealing in relation to that financial product (such as a variation or disposal of that product), or the provision of financial product advice to the customer about that product (as commonly occurs during the term of a financial product), can occur without the new obligations applying. It is unclear how the obligations could be satisfied in the case of a post-issue or post-sale dealing or instance of financial product advice.
8. In the Committee's view, it would be better to be clear in the Bill that, once the acquisition of a financial product has occurred, the design and distribution obligations have no further application in relation to the financial product that has been acquired.

Submission 2: Clarify the transitional provisions

9. The proposed transitional provisions turn on when 'the first issue of the financial product' occurs. The 'first issue' of a 'superannuation product' (being a beneficial interest in a superannuation fund) may very well have occurred long ago, and the issuing of a new 'product' (using that term in the sense adopted by the industry, rather than in the sense of a 'financial product' under Chapter 7) may very well not involve the 'first issue' of any financial product. Yet this does not appear to be the understanding of the drafter of the transitional provisions. The Committee submits that the operation of the transitional provisions should be clarified. If it is intended that 'financial product' does not have its ordinary Chapter 7 meaning (in relation to superannuation) in this particular context, this should be expressly stated.

² See Exposure Draft, Treasury Laws Amendment (Design and Distribution Obligations and Product Intervention Powers) Bill 2017 (Cth) ss 993DB(10), 993DE(3)(b), 993DF(2)(c)-(e).

³ Ibid ss 993DB(4)-(6), (9)(b), 993DC(4)-(5), 993DD(1), 993DE(1), (3), 993DM(1)(a)-(c).

Submission 3: Clarify the test for target market determinations

10. Proposed s 993DB(10) is headed 'Target market determinations to be appropriate' and says:

A target market determination for a financial product must be such that it would be reasonable to conclude that, if the product were issued or sold to persons 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.

11. The Committee submits that the formulation 'the product would generally meet' is inappropriate. It is very unlikely that any given financial product will 'meet' (as in 'satisfy') anyone's objectives, financial situation and needs. It is much more likely that a person's objectives, financial situation and needs could only ever be met (or satisfied) by a combination of financial products – for example, a deposit product, plus a superannuation product, plus a life risk insurance product, etc. The Committee submits that 'meet' is not the right test. Rather, the test should be whether the product may be 'consistent with' the likely objectives, financial situations and needs of the persons in the target market. The Committee also suggests that the word 'generally' should not be used, as it is too uncertain. Instead, the Committee submits that the section should turn on whether the product 'would be likely to be consistent with' the matters referred to.

Submission 4: Clarify the test for notifications to ASIC

12. Proposed s 993DG is headed 'Notifications to ASIC' and says:

A person who makes a target market determination for a financial product must give written notice to ASIC, as soon as practicable, and in any case within 10 business days, if the person becomes aware of a significant dealing in the financial product that is not consistent with the determination.

13. The Committee submits that the obligation should turn not only on the significance of the dealing but also on the significance of the inconsistency with the target market determination. A dealing could be very significant but the inconsistency with the target market determination could be immaterial and, in that case, the reporting obligation should not apply.

Note:

In the Committee's submission on the December 2016 Proposals Paper,⁴ the Committee submitted that all superannuation products, not just MySuper products, should be excluded from the design and distribution measures. The Bill makes it clear that that submission has not been accepted.

Nevertheless, the Committee notes that, in the context of superannuation funds, the requirement to formulate a target market determination seems to overlap with existing obligations under the *Superannuation Industry (Supervision) Act 1993 (Cth)* and the

⁴ Law Council of Australia (Legal Practice Section) submission to the Treasury, *Design and distribution obligations and product intervention power – Proposals Paper*, 16 March 2017
<<https://static.treasury.gov.au/uploads/sites/1/2017/11/Law-Council-of-Australia-Law-Practice-Section.pdf>>.

Australian Prudential Regulation Authority's (**APRA**) *Prudential Standard on Investment Governance* to formulate investment objectives and strategies which are appropriate for their members having regard to all of the circumstances of the fund. Other Government and APRA reforms propose adding a further obligation, to make an annual determination that members' financial interests are being promoted by the various investment options that are offered. In a practical sense, the target market determination and reviews, and these other periodic reviews, are likely to cover the same territory and involve consideration of largely the same issues. Apart from this duplication, it will also mean that two different regulators (ASIC and APRA) will have overlapping jurisdiction in relation to what are largely the same matters.

Product intervention orders

14. Schedule 2 of the Bill is entitled 'Amendments relating to product intervention orders'.

Submission 5: Clarify that any financial product that has been acquired by a client falls outside the regime.

15. According to the EM (at [2.25]):

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.

16. However, the Bill does not include any provision to this effect. Although a precondition to the power being exercised is that a financial product 'is, or is likely to be, available for acquisition',⁵ once the power has been enlivened there is no relevant restriction on the terms of the order that may be made.⁶ The Committee submits that the Bill should include an express restriction of the kind mentioned in the EM.

Submission 6: Remove remuneration completely from the regime

17. Under proposed s 1022CC(6)(c), a product intervention order will not be able to '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'. The Committee submits that the exception to this restriction (found in the words 'other than so much of the remuneration as is conditional on the achievement of objectives directly related to the financial product') should be deleted. This would ensure that a product intervention order cannot impose requirements 'in relation to a person's remuneration', without qualification.

18. Conflicted remuneration is already comprehensively regulated under Division 4 of Part 7.7A of the *Corporations Act 2001* (Cth). That regime was originally enacted in 2012 and has been amended a number of times. Part 7.7A does not contain any regime for modification by ASIC.

⁵ See Exposure Draft, Treasury Laws Amendment (Design and Distribution Obligations and Product Intervention Powers) Bill 2017 (Cth) ss 1022CC(1)(a), (3)(a).

⁶ Ibid ss 1022CC(1)(c)–(e), (3)(c)–(e).

19. The Committee submits that it would be inconsistent with the approach taken in Part 7.7A to allow ASIC to, in effect, modify the conflicted remuneration rules by way of product intervention order. If the conflicted remuneration rules are to be supplemented, it should be done by way of legislation, not by an order of the regulator.
20. The Committee's submission is consistent with the approach taken to two other matters that are excluded from the product intervention order regime. Under proposed ss 1022CC(6)(a) and (b), a product intervention order will not be able to 'require that 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', nor will it be able to 'require that a person who is not required to hold a Australian financial services licence join an external dispute resolution scheme'. In these respects, the EM says:

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.

21. Precisely the same thing could be said about remuneration relating the financial products – 'existing laws' (ie Part 7.7A) already provide a 'comprehensive regime' in relation to that matter. The qualification in proposed s 1022CC(6)(c) should be deleted.

Contact

22. The Committee would welcome the opportunity to discuss the submission further. Please contact Chair of the Superannuation Committee, Mr Luke Barrett, at luke.barrett@unisuper.com.au or (03) 9910 6145, if you would like further information or clarification.

Yours sincerely



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