DESIGN & DISTRIBUTION BILL: A REFLECTION OF THE CURRENT "CONSUMER-CENTRIC" CLIMATE

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Misaligned advisor interests. Consumer disengagement. Low financial literacy in the face of complex documents. These themes echo throughout the revised *Treasury Laws Amendment (Design and Distribution Obligations and Product Intervention Power) Bill* (Bill) released by the Australian Government in late July 2018. These issues have also been recently ventilated in the Banking Royal Commission. Key changes to the Bill include expanding the scope of regulated products and criminal penalties have been increased for certain breaches.

This revised draft was accompanied by an "Information Note" in which the Government identified the changes to the Bill, in light of the submissions received on the December 2017 version.

AIM OF THE BILL

This Bill aims to have financial products only being sold to consumers for whom they are "suitable", through improved design and distribution obligations. Importantly, the Bill will modify the *Corporations Act 2001* (Cth) to require a mandatory "target market determination" for the majority of financial products sold to retail clients. This new statement will require issuers to describe the type of consumer the product is suitable for. Other related obligations will include record keeping obligations and a requirement to notify the Australian Securities and Investments Commission (ASIC) about any "significant dealings" in which a consumer chooses a product where they are not part of the described target market.

The Bill also arms ASIC with stronger enforcement tools. If ASIC determines that a product causes significant detriment to consumers, then the product can be banned. Every provision will have both a civil penalty provision and an offence to assist the practical prosecution of a breach. The key modifications are discussed below.

Broader Scope of Regulated Products

- A provision has been added so the regime can cover additional products or exclude products. The Government can, therefore, intervene where an unregulated product is causing or will likely cause significant consumer detriment. Government is currently considering using its regulation making power to include short term credit products that are not regulated by the National Credit Code, as well as other insurance-like products.

Target Market

- A provision requiring issuers and distributors to notify ASIC if there has been distribution without a target market determination has been removed. However, there is still an obligation on issuers to report to ASIC "significant dealings" that are inconsistent with a target market determination. While "significant dealings"

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is not defined in the Bill, a common sense approach should be taken. As the Explanatory Memorandum notes, an issuer should notify ASIC of dealings that are "worthy" of the regulator's attention in light of the aim to provide suitable financial products to consumers.

- It is not necessary for a financial product to meet all objectives, financial situation and needs of the target market. A financial product must only "likely be consistent with the likely objectives, financial situation and needs" of the people in the target market.
- The Bill now also clarifies that merely asking for information about a client to determine if they are in a target market, and informing them that they are or are not, does not constitute personal advice.

Criminal Penalties Increased

- An issuer may be required to stop the distribution of a product if it can reasonably be suggested that the target market determination is no longer appropriate. Issuers will need to notify distributors where this occurs. The criminal penalty for failing to cease distribution (where a distributor knows that an issuer has taken steps to inform distributors that distribution should cease) has been increased to be consistent with the penalties for other wrongful distributions. The criminal penalty for this type of breach may be AUD21,000 or imprisonment for two years, or both.
- The criminal penalty for failing to notify an issuer of a significant dealing outside the target market has been increased to be consistent with the penalties for other failures to provide information to the issuer. The criminal penalty for this type of breach may be AUD10,500.
- The criminal penalty for failing to notify ASIC of a significant dealing and for failing to provide ASIC with information on request has been increased to be consistent with analogous provisions in the Corporations Act 2001 (Cth). The criminal penalty for this type of breach may be AUD21,000 or imprisonment for two years, or both.

Distributors

- Ordinarily, distributors can only promote a product to retail clients where there is a target market determination. Provisions have been added to the Bill so third party distributors will not breach this obligation where they reasonably conclude that a target market determination is not required for a product. This ensures that distributors do not have to "second guess" whether an issuer has complied with the target market determination obligation.
- Where there is a target market determination, distributors must take reasonable steps to ensure the product is distributed consistently with the target market determination.

Issuers

- Issuers must make target market determinations available to the public free of charge under added provisions.
- Where an issuer's obligation to review a target market determination has been triggered (for example, because its target market determination is no longer appropriate), distribution must stop as soon as practicable or within 10 business days.

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- The new law gives ASIC power to issue stop orders where there is a suspected contravention. A person on whom the stop order is served must not engage in conduct contrary to the order and must take reasonable steps to ensure others comply with the order. Engaging in conduct contrary to a stop order may be penalised by a fine of AUD21,000 or imprisonment for two years, or both. Alternatively, a civil penalty for this breach may be AUD200,000 for an individual or AUD1 million for a body corporate.

Claim For Damages

- A consumer who suffers damage as a result of certain breaches of the Bill may be able to recover that amount of loss. These breaches have been extended from the previous draft and now include a range of other breaches which caused the client loss.
- In the earlier draft, consumers could only pursue a civil action where there was a breach of the target market determination or a failure to take reasonable steps to distribute in a manner consistent with a target market determination.
- Now, a consumer can claim damage where a review of the target market determination has been triggered and an issuer has failed to notify a distributor or the distributor failed to stop distributing when given the notification.

WHEN WILL THESE CHANGES COME INTO FORCE?

The former Minister for Financial Services, Kelly O'Dwyer, previously indicated that she would like to introduce this Bill into Parliament this year. In any event, the proposed legislation would only come into force two years after Royal Assent which could be (at the earliest) during 2021.

IMPACT OF THESE PROPOSED CHANGES

While the protection of consumers lies at the heart of this Bill, it poses real challenges for issuers and distributors. In particular, the Government's power to stop distribution of financial products raises significant practical difficulties. Moreover, the increased criminal penalties are indicative of the seriousness with which breaches will be treated. While the changes will not come into force for at least two years, distributors and issuers should begin preparing for the implications of this Bill now.

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