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THE PARLIAMENT OF THE COMMONWEALTH OF AUSTRALIA

SENATE

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TREASURY LAWS AMENDMENT (DESIGN AND DISTRIBUTION  
OBLIGATIONS AND PRODUCT INTERVENTION POWERS) BILL 2019

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REVISED EXPLANATORY MEMORANDUM

(Circulated by authority of the  
Treasurer, the Hon Josh Frydenberg MP)

THIS MEMORANDUM TAKES ACCOUNT OF AMENDMENTS MADE BY  
THE HOUSE OF REPRESENTATIVES



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# Glossary

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

<i>Abbreviation</i>	<i>Definition</i>
ASIC	Australian Securities and Investments Commission
Bill	Treasury Laws Amendment (Design and Distribution Obligations and Product Intervention Powers) Bill 2019
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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## ***General outline and financial impact***

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### **Design and distribution obligations**

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

***Date of effect:*** Two years after the Bill receives the Royal Assent

***Proposal announced:*** The Government announced these obligations as part of its response to the Financial System Inquiry.

***Financial impact:*** Nil.

***Human rights implications:*** The Schedule does not raise any human rights issues. See *Statement of Compatibility with Human Rights* — Chapter 4.

### **Product intervention power**

Schedule 2 to this 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.

***Date of effect:*** The day after the Bill receives the Royal Assent

***Proposal announced:*** The Government announced the product intervention power as part of its response to the Financial System Inquiry.

***Financial impact:*** Nil.

***Human rights implications:*** The Schedule does not raise any human rights issues. See *Statement of Compatibility with Human Rights* — Chapter 4.





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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 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 understand and select 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 Government accepted this recommendation to introduce design and distribution obligations on 20 October 2015.<sup>3</sup>

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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.

1.4 On 13 December 2016, the former Minister for Revenue and Financial Services, the Hon Kelly O'Dwyer MP, released a proposals paper on the implementation of the obligations.<sup>4</sup>

1.5 These obligations are designed to assist consumers to obtain appropriate financial products by requiring issuers and distributors to have a customer-centric approach to designing, marketing and distributing financial products.

1.6 The Department of the Treasury has considered the compliance costs associated with implementing the new design and distribution obligations. The department's analysis is in Chapter 3.

## **Summary of new law**

1.7 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 have a customer-centric approach to making initial offerings of products to consumers.

1.8 The obligations generally apply to offers of financial products about which the offeror must make disclosure under the Corporations Act. This consists of products that require a disclosure document, such as a product disclosure statement or prospectus. There are, however, exceptions for products and distribution methods where there are existing similar regimes or other competing policy priorities. The obligations also apply to financial products that are not regulated under the Corporations Act, but are regulated under the ASIC Act (which includes credit).

1.9 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.

1.10 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 certain 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.

## 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 financial products that are not regulated under the Corporations Act, but are regulated under the ASIC Act.	No equivalent.
Offerors must make target market determinations available to the public free of charge.	No equivalent.
Offerors must develop a plan for reviewing target market determinations and abide by that plan.	No equivalent.
Offerors must specify distribution information that distributors must collect, keep and provide back to the offeror.	No equivalent.
Distributors are prohibited from distributing a product unless a current target market determination is in place.	No equivalent.
Offerors and distributors must take reasonable steps so that distribution is consistent with the most recent 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.
Distributors must provide to offerors numbers of complaints about the product and distribution information relating to the product that offerors have specified.	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.
ASIC is given powers to enforce the new arrangements, including: the	ASIC has similar powers to support its enforcement of the current

<i>New law</i>	<i>Current law</i>
ability to request necessary information; issue stop orders; and, make necessary exemptions and modifications to the new arrangements.	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

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

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

1.13 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 applies;
- 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?

1.14 The obligations generally apply to offers of financial products that require disclosure under the Corporations Act. 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; or
- require disclosure to investors under Chapter 6D (Fundraising) of the Corporations Act; and

*[Schedule 1, item 5, subparagraphs 994B(1)(a)-(b) of the Corporations Act]*

1.15 What is a financial product is determined according to the existing provisions of Division 3 of Part 7.1 of the Corporations Act and applicable definitions in Chapter 7.<sup>5</sup> *[Schedule 1, item 5, paragraphs 994AA(a) of the Corporations Act]*

1.16 Some products requiring disclosure are exempt from the new regime: MySuper products, margin lending facilities, securities issued under an employee share scheme and fully-paid ordinary shares. The regulations may also apply the new regime to additional financial products or provide additional exemptions from its operation. In addition, the new regime does not apply to financial products offered by an exempt body or an exempt public authority. *[Schedule 1, item 5, section 994A, paragraph 994B(1)(c) and subsection 994B(3) of the Corporations Act]*

1.17 The obligations also have an extended application in relation to financial products that are not regulated under the Corporations Act, but are regulated under the ASIC Act. *[Schedule 1, item 5, paragraphs 994AA(b) and 994B(1)(ba) of the Corporations Act]*

## **Financial products requiring a PDS**

1.18 The new design and distribution regime generally applies to a financial product<sup>6</sup> if a disclosure document in the form of a PDS must be prepared for it. Under Subdivision C of Division 2 of Part 7.9 of the Corporations Act a PDS has to be prepared where one is required to be given under Subdivision B of the same division and part of the Act. 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 to a retail client. *[Schedule 1, item 5, paragraph 994B(1)(b) of the Corporations Act]*

1.19 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

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<sup>5</sup> In addition to the definition of a financial product in Division 3, this includes, for example: when two or more arrangements are together treated as a single arrangement: see section 761B; when a financial product is part of a broader facility: see section 762B; and, when a financial product is 'incidental': see section 763E. ASIC has exemption and modification powers to address situations where the application of disclosure rules to the myriad of financial products results in unintended consequences: exemption and modification powers are discussed further below.

<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 license 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.

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. The term ‘regulated sale’ is used to describe these sale situations in the new regime. [*Schedule 1, item 5, section 994A, paragraph 994B(1)(b) of the Corporations Act*]

1.20 There are several benefits of linking the new design and distribution 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>

1.21 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 are also aimed at ensuring that firms provide appropriate products to consumers.<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 5, subsection 994B(3) of the Corporations Act*]

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<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 and issuances not in the course of business; and, has appropriate anti-avoidance provisions and rules for products (such as derivatives, bundled products, co-issued products, managed investment schemes, and products that are periodically renewed or rolled over) and custodial arrangements. Note that some of the rules applying to these products and arrangements are provided for by instruments made the purposes of the disclosure regime.

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

<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.

## **Securities requiring disclosure**

1.22 The new design and distribution regime also applies to financial products for which a disclosure document must be prepared under Part 6D.2 of the Corporations Act. Under Division 4 of Part 6D.2 a disclosure document must be prepared for offers of securities that require disclosure. *[Schedule 1, item 5, paragraph 994B(1)(a) of the Corporations Act]*

1.23 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>

1.24 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. Again, the term ‘regulated sale’ is defined in the new regime to cover these sale situations.

1.25 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;<sup>14</sup>
- 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;
- offers relating to takeovers, exempt bodies (non-companies incorporated under state law<sup>15</sup>) and exempt public authorities; and

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

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

<sup>14</sup> These include rules relating to offers of fully-paid shares under a dividend reinvestment plan or bonus share plan. In addition, existing section 708AA provides for rights issues that do not need disclosure.

- offers relating to debentures in ADIs or life insurers.

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

1.27 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.

1.28 There are some securities that require disclosure under Part 6D.2 that are not subject to the new design and distribution regime. These are fully paid ordinary shares in a company or foreign company and securities issued under an employee share scheme.

1.29 Fully paid ordinary shares are excluded as they are fundamental to corporate fundraising.<sup>16</sup> ‘Fully paid share’ is defined in section 9 of the Corporations Act to mean a share on which no amount remains unpaid. The exception therefore only applies in relation to ordinary shares where no amount remains unpaid. In such situations the full extent of the investor’s exposure to loss is represented by the paid-up amount on the shares. [*Schedule 1, item 5, paragraph 994B(3)(d) of the Corporations Act*]

1.30 Securities issued only under employee share schemes are excluded because they are a mechanism by which employees can become part owners in the company for which they work.<sup>17</sup> 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>18</sup> [*Schedule 1, item 5, paragraph 994B(3)(c) of the Corporations Act*]

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

1.32 The first anti-avoidance provision ensures that the new regime applies to issues of ordinary shares where the company intended that those shares be converted into preference shares within 12 months after issue.<sup>19</sup>

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<sup>15</sup> See section 66A of the Corporations Act.

<sup>16</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>17</sup> Where a security is issued both under an employee scheme as well as in other circumstances, only the securities issued under the scheme are exempt from the regime.

<sup>18</sup> See the definition of Employee Share Scheme in section 9 of the Corporations Act.

<sup>19</sup> Section 254G provides that a company may convert an ordinary share into a preference share (except a redeemable preference share) in certain circumstances.



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 5, paragraph 994B(4)(a) of the Corporations Act]*

1.33 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 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 5, paragraph 994B(4)(b) of the Corporations Act]*

### **Extended application to ASIC Act products**

1.34 The obligations also apply to products that are not regulated under the Corporations Act, but are regulated under Division 2 of Part 2 of the ASIC Act, which includes credit. Associated amendments are made to ensure that the new regime can operate effectively in relation to those ASIC Act products to which it now also applies, given that the regime is enacted within the Corporations Act. *[Schedule 1, item 5, Section 994AA and paragraph 994B(1)(ba) of the Corporations Act]*

### **Products prescribed by the regulations**

1.35 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. Any regulations would be subject to parliamentary scrutiny through the disallowance procedures of the *Legislation Act 2003*. *[Schedule 1, item 5, paragraph 994B(1)(c) and paragraph 994B(2)(b) of the Corporations Act]*

1.36 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

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

1.37 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 5, paragraph 994B(3)(f) of the Corporations Act]*

1.38 At the outset, the Government proposes to make regulations that would exclude a number of products from the regime. These products are:

- depository interests in fully paid foreign ordinary shares that would, if offered directly to retail clients, be excluded from the regime;
- medical indemnity insurance;
- interests in defined benefit superannuation funds; and
- interests in eligible rollover funds.

1.39 In addition, the new regime does not apply to financial products offered by an exempt body or an exempt public authority. An exempt body is a non-company body corporate that is incorporated by or under a law of a state or territory.<sup>20</sup> An exempt public authority is a body corporate that is incorporated within Australia or an external Territory that is a public authority or an instrumentality or agency of the crown in right of the Commonwealth, a state, or a territory.<sup>21</sup> *[Schedule 1, item 5, section 994A, paragraph 994B(3)(e) of the Corporations Act]*

1.40 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?**

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

1.42 The design obligations are:

- to make a publicly available target market determination;
- to review the target market determination as required to ensure it remains appropriate;

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<sup>20</sup> ‘Exempt bodies’ is presently defined in section 66A of the Corporations Act.

<sup>21</sup> ‘Exempt public authority’ is presently defined in section 9 of the Corporations Act.

- to 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.

1.43 The distribution<sup>22</sup> obligations are:

- not to engage in 'retail product distribution conduct' in relation to a product unless a target market determination has been made;
  - 'retail product distribution conduct' is, in relation to a product, dealing in relation to a retail client, providing financial product advice to a retail client, or giving a disclosure document or PDS to a retail client;
- not to engage in retail product distribution conduct where a target market determination may no longer be appropriate;
- to take reasonable steps so that retail product distribution conduct is consistent with the target market determination;
- to collect information specified by the issuer and complaints related to a product and provide both to the issuer; and
- to notify the issuer of a product of any significant dealings in the product that are not consistent with the products target market determination.

1.44 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 6 and 7, subparagraphs 1018A(1)(ca) and 1018A(2)(ca) of the Corporations Act]*

1.45 The new obligations only apply to primary or initial offerings of financial products to retail clients. They do not apply to sales of products on secondary markets unless such sales are made in circumstances that could otherwise be used to avoid the obligations. These situations are those already discussed in paragraphs 1.19 and 1.24 of this memorandum. This means that the obligations cease to apply if the product is no longer available to consumers by way of primary or initial offering.<sup>23</sup>

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<sup>22</sup> Note that the issuer of a financial product may also be a distributor of the product.

<sup>23</sup> While the obligations relating to collecting information cease to apply after the product is no longer available to consumers by way of initial offering, information that has been collected must still be kept for the prescribed period.

## Design obligations

1.46 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>24</sup> for the product.<sup>25</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 5, subsection 994B(1) of the Corporations Act*]

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

1.47 The first design obligation requires an issuer to make a ‘target market determination’ for their product. There are a number of requirements that must be met for such a determination to be validly made. In particular, the target market determination must:

- be in writing
- describe the class of retail clients that comprise the target market for the product (the target market);<sup>26</sup>
- specify any conditions and restrictions on retail product distribution conduct (the distribution conditions);<sup>27</sup>
- specify events and circumstances that would reasonably suggest the determination is no longer appropriate (review triggers);
- specify maximum review periods (review periods); and
- specify reporting periods for when complaints about the product should be provided from the distributor to the issuer;
- specify kinds of information needed to promptly determine that a determination may no longer be appropriate, along with;

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<sup>24</sup> The disclosure document may be required by Part 7.9 or Chapter 6D of the Corporations Act

<sup>25</sup> Under the new regime as enacted, the person required to make a target market determination for a financial product is the issuer of the product (except in regulated sale situations, in which case it is the seller). 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 made for the purposes of subsection 994B(1)(c) to impose the obligation on someone other than the legal issuer of a product, if necessary

<sup>26</sup> The target market is to be described according to the ordinary meaning of the term. A separate requirement (discussed below) requires the target market to be appropriate.

<sup>27</sup> Subsection 994B(5)(c) provides that the distribution conditions do not include any such conditions or restrictions imposed by or under the Corporations Act.

- which distributors should provide those kinds of information; and
- reporting periods for when that information should be provided by the distributors to the issuer.

*[Schedule 1, item 5, section 994A, subsection 994B(5) of the Corporations Act]*

1.48 The purpose of these requirements is to ensure issuers design products for which an appropriate target market can be defined, or conversely to consider whether the planned target market for products under development is appropriate; and whether there are distribution channels to that market which are feasible and appropriate.

1.49 The target market determination must be made available to the public free of charge. This is to mitigate evidential difficulties with substantiating non-compliance with target market determinations. It also enables consumers to access a target market determination should they wish to do so. The requirement applies to both past and present determinations in relation to the product. *[Schedule 1, item 5, subsection 994B(9) of the Corporations Act]*

1.50 The new regime also provides for when the target determination must be made. In particular, the determination must be made before distribution occurs, or in the case where regulations require the determination be made – before the time or event specified in those regulations (or before distribution occurs if no such time or event is specified). *[Schedule 1, item 5, paragraph 994B(2)(b) of the Corporations Act]*

*Determinations must be in writing*

1.51 The new law provides that a target market determination must be in writing. However, it does not prescribe any particular form for the written determination. This allows issuers to determine the most effective and efficient form for a determination given the particular product involved and their existing systems and processes. *[Schedule 1, item 5, paragraph 994B(5)(a) of the Corporations Act]*

*Target market and distribution conditions*

1.52 A target market determination must detail the product's target market and distribution conditions. The determination must also be appropriate having regard to the target market and distribution conditions. *[Schedule 1, item 5, paragraphs 994B(5)(b) and (c) and subsection 994B(8) of the Corporations Act]*

1.53 The new regime sets out when a target market determination is appropriate. In particular, for the determination to be appropriate it must satisfy two requirements. These requirements are that it be reasonable to conclude that if the product were to be issued, or sold in a regulated sale:

- to a retail client in accordance with the distribution conditions – it would be likely that the retail client is in the target market; and
- to a retail client in the target market – it would likely be consistent with the likely objectives, financial situation and needs of the retail client.

*[Schedule 1, item 5, subsection 994B(8) of the Corporations Act]*

1.54 These requirements are objective. They do not require an issuer to have knowledge about individual consumers.

1.55 The first requirement focuses on the likelihood of a retail client being in the target market for a product given the distribution conditions proposed by the issuer. This requirement enables an issuer to determine a wide range of distribution conditions applicable to a product, provided they are likely to direct distribution to consumers in the target market.

*[Schedule 1, item 5, paragraph 994B(8)(a) of the Corporations Act]*

1.56 An issuer must consider a wide range of factors in determining whether their selected distribution conditions are appropriate. Factors may include known diligence, capabilities and the integrity of existing and prospective distribution methods. For example, an issuer may consider previous instances where a product was issued through a specific distribution method as part of its assessment to determine the appropriateness of that distribution method.

1.57 The second requirement focuses on the likelihood of a product being appropriate for the retail clients in the target market. Whether a product is appropriate is determined by reference to whether it is likely to be consistent with the likely objectives, financial situation and needs of the retail clients. Again, this formulation provides flexibility to an issuer in determining the appropriate target market for a product. For example, it would enable an issuer to conclude that it is appropriate for a product to be issued to an investor as part of balanced portfolio, even if it would not otherwise be appropriate for the investor. *[Schedule 1, item 5, paragraph 994B(8)(b) of the Corporations Act]*

1.58 The amendments use language similar to that currently used in the Corporations Act in the context of personal advice. In particular, it must be reasonable to conclude that if the product were issued or sold it would “likely be consistent with 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 this language does not reflect a requirement to take into account the personal circumstances of any particular person or to provide personal advice.

1.59 An issuer must take into account all relevant factors in determining whether a product is likely to be consistent with the likely 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.

1.60 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 into account.

*Review triggers and review periods*

1.61 As part of making the target market determination the maker must:

- 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 5, section 994A and paragraphs 994B(5)(d), (e) and (f) of the Corporations Act*]

1.62 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 may 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 circumstance that would materially change a factor taken into account in making the target market determination for the product;
- 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 acquire the product.

1.63 Issuers must also determine review periods for a target market determination. The review periods are: the maximum period of time that elapses between the making of the determination and finishing the first review; and the maximum period between completed reviews of a determination. These periods must be reasonable in the circumstances to ensure that a determination does not become inappropriate over time.

*[Schedule 1, item 5, section 994A and paragraphs 994B(5)(d)(e) and (f) and subsection 994B(6) of the Corporations Act]*

1.64 What a reasonable period is in the circumstances will vary from product to product. However, in determining what is reasonable for this purpose, regard must be had to:

- the need to identify promptly whether a review trigger or other event or circumstances would reasonably suggest the determination is no longer appropriate; and
- the likelihood, nature and extent of detriment to consumers that may result if a review trigger or another event or circumstance that would reasonably suggest that the target market determination is no longer appropriate, has occurred, and the target market determination is not promptly reviewed. *[Schedule 1, item 5, section 994A and subsection 994B(7) of the Corporations Act]*

1.65 The requirement that review periods be reasonable is designed to encourage an issuer to adopt a risk management approach in determining a reasonable review period. Under such an approach the review periods applicable to a product would generally shorten as its complexity and risk profile increases. Similarly, the maximum period between reviews would generally be shorter where an issuer has limited experience issuing similar products or is yet to establish a proven distribution network.

#### *Information requirements*

1.66 Issuers must also specify in the target market determination:

- kinds of information needed to enable the issuer to promptly identify review triggers or other events and circumstances that have occurred which would reasonably suggest the determination is no longer appropriate;
- for each kind of information specified above, the distributors that should be required to provide that information to the issuer and the corresponding reporting periods; and



- reporting periods for reporting information about the number of complaints about a product. *[Schedule 1, item 5, paragraphs 994B(5)(g) and 994B(5)(h) of the Corporations Act]*

1.67 The reporting periods specified by the issuers must be reasonable in the circumstances. The test for determining the reasonableness of the reporting periods is the same as that described in paragraph 1.64 in relation to determining the reasonableness of the periods applicable to reviewing the target market determination. *[Schedule 1, item 5, section 994A and subsections 994B(6) and 994B(7) of the Corporations Act]*

1.68 Together, these requirements create a flow of information from the distributor to the issuer that will facilitate the issuer's review obligations relating to target market determinations. This process is designed to help issuers ensure that reviews of target market determinations can be conducted effectively, efficiently and with appropriate distribution information.

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

1.69 The second design obligation requires an issuer to review a target market determination for a financial product:

- during a review period; and
- when a review trigger occurs, or an event or circumstance occurs that would reasonably suggest that the target market determination is no longer appropriate. *[Schedule 1, item 5, subsections 994C(2) and (3) of the Corporations Act]*

1.70 The first mentioned review obligation relates to periodic reviews. In effect, it requires issues to complete a periodic review of a target market determination, where a review has not otherwise been undertaken during a review period. The obligation applies to all financial products with a target market determination, but is particularly pertinent for complex products and products that are likely to be issued over an extended period of time. The obligation does not apply where a product is no longer on offer for acquisition by issue, or regulated sale, to retail clients. *[Schedule 1, item 5, subsection 994C(2) of the Corporations Act]*

1.71 This requirement to review the target market determination during the review period ensures there is a periodic assessment of whether the target market determination remains appropriate. In particular, that the target market, distribution conditions, information requirements and review arrangements for the product remain appropriate.

1.72 The second review obligation provides for triggered reviews. Under the obligation a review could be triggered by a pre-determined event or circumstance identified in the target market determination or by any other events or circumstances that suggest the target market determination is no longer appropriate. This requirement ensures, for

example, that an assessment of whether the product is being distributed appropriately may be required in response to information about distribution the issuer receives over time. In practice, the issuer will be acting on:

- information specified by the issuer in the target market determination that is provided by distributors; and
- any other relevant information the issuer receives as part of its business activity or is otherwise aware of. [*Schedule 1, item 5, subsection 994C(3) of the Corporations Act*]

1.73 As with periodic reviews, the obligation to conduct triggered reviews does not apply where a product is no longer on offer for acquisition by issue, or regulated sale, to retail clients. [*Schedule 1, item 5, subsection 994C(3) of the Corporations Act*]

1.74 Notwithstanding the above arrangements, an issuer may review a target market determination and make a new determination at any time. [*Schedule 1, item 5, subsection 994C(1) of the Corporations Act*]

1.75 The validity of a target market determination is not retrospectively affected by a review finding that it is no longer appropriate. Similarly, that a review finds a determination no longer appropriate is not in itself evidence that the determination may have been invalid at an earlier time. Provided such a determination complied with the requirements of the new regime, it would remain valid until it was found, on review, to no longer be appropriate. This is a natural consequence of the new regime, which includes the review obligations for the very reason that an appropriate determination may subsequently become inappropriate.

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

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

- a product's target market determination, review triggers, review periods, and other decisions relating to requirements for making target market determinations; and
- the reasons for those decisions. [*Schedule 1, item 5, subsection 994F(1) of the Corporations Act*]

1.77 These record keeping provisions support the effectiveness of the new regime. In particular, they ensure 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 5, section 994H of the Corporations Act*]

1.78 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>28</sup> In addition, the Corporations Act currently provides that records required to be kept by a provision of Chapter 7 must be preserved for 5 years.<sup>29</sup> These provisions apply in relation to the new regime.

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

1.79 The fourth (and final) design obligation requires issuers to notify ASIC of significant dealings (except certain dealings connected to personal advice) 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 5, section 994G of the Corporations Act]*

1.80 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.

1.81 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**

1.82 The distribution obligations apply to those people that engage with a potential investor in relation to a product. These are the people responsible for making offers, or giving advice or disclosure documents, to potential investors. They will generally be the issuer of the product (where the issuer distributes their own product) or be person carrying on a financial services business in Australia. All references to 'regulated person' are references to a person responsible for the distribution

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<sup>28</sup> See sections 1101C, 1101E and 1101F of the Corporations Act, respectively.

<sup>29</sup> See section 1101C of the Corporations Act.

obligations.<sup>30</sup> *[Schedule 1, item 5, the definition of regulated person, section 994A of the Corporations Act]*

1.83 Not all conduct of regulated persons is subject to the new distribution obligations. The new obligations only apply to where a regulated person engages in ‘retail product distribution conduct’. What constitutes retail product distribution conduct is defined for the purposes of the new regime. In particular, a regulated person engages in such conduct<sup>31</sup> if they:

- issue or arrange to issue a financial product<sup>32</sup>;
- provide financial product advice; or
- give a PDS or disclosure document;

*[Schedule 1, item 5, the definition of ‘retail product distribution conduct’ in subsection 994A of the Corporations Act]*

1.84 While retail product distribution conduct includes providing financial product advice, the new regime excludes personal advice and associated conduct from most of the new distribution obligations. This reflects that such conduct already involves consideration of the client’s individual circumstances and is subject to the best interest obligations under Part 7.7A of the Corporations Act.<sup>33</sup> However, conduct related to personal advice is subject to the record keeping and notification obligations to ensure the effective operation of those obligations. *[Schedule 1, item 5, the definitions of ‘retail product distribution conduct’, ‘dealing’, excluded conduct’, and ‘excluded dealing’, subsection 994A of the Corporations Act]*

***Obligation not to engage in retail product distribution conduct unless a target market determination has been made***

1.85 The first distribution obligation prohibits retail product distribution conduct in relation to a financial product if the issuer has failed to make a target market determination for the product. *[Schedule 1, item 5, subsection 994D of the Corporations Act]*

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<sup>30</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.

<sup>31</sup> Those engaging in retail product distribution conduct are generally the people responsible for giving disclosure documents to potential acquirers of the product.

<sup>32</sup> Or equivalent secondary sale activity that requires disclosure: see the definition of regulated sale in section 994A.

<sup>33</sup> Personal advice and closely related conduct is defined in the new regime as ‘excluded conduct’. Excluded conduct, in turn, includes ‘excluded dealings’ which is defined as arranging for the issue of a product for the purpose of implementing the personal advice, whether by the advisor or their associate: see section 994A.

1.86 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.

1.87 For the purposes of the obligation, there is a defence if a regulated person (except the issuer) makes all inquiries (if any) that are reasonable in the circumstances and believes on reasonable grounds that the determination has been validly made or that a determination does not need to be made. *[Schedule 1, item 5, paragraph 994D(c) of the Corporations Act]*

1.88 This defence ensures that a regulated person does not need to make undue inquiries as to whether or not an issuer has complied with their design obligation to make a target market determination. However, where reliance on a determination (or lack thereof) is not reasonable, for example, because it is not in writing or appears obviously inappropriate, the regulated person must make further necessary inquiries or not distribute the product.

1.89 The first distribution obligation does not apply where the distribution conduct consists of personal advice or associated conduct. This associated conduct consists of any dealings engaged in by the personal advisor, or an associate of the advisor, for the purposes of implementing the personal advice. *[Schedule 1, item 5, paragraph 994D(d) of the Corporations Act]*

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

1.90 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: 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 5, subsections 994C(3), 994C(4), and 994C(5) of the Corporations Act]*

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

- Issuers are prohibited from engaging in retail product distribution conduct in relation to the product, from as soon as practicable (but no later than 10 business days) after they knew or ought to have known that the determination may be inappropriate, until they have reviewed the determination and, if necessary, made a new determination.
- Issuers must, as soon as practicable but within 10 business days, take reasonable steps to ensure regulated persons are

informed not to engage in retail product distribution conduct in relation to the product unless the issuer has reviewed the determination and, if necessary, made a new determination.

- A regulated person must, as soon as practicable but within 10 business days, cease to engage in retail product distribution conduct when such steps have been taken by the issuer unless, after making all inquiries (if any) that are reasonable in the circumstances, the person believes on reasonable grounds the determination has been reviewed and remade (if necessary). [*Schedule 1, item 5, subsections 994C(3), 994C(4), 994C(5), 994C(6) and 994C(7) of the Corporations Act*]

1.92 The second distribution obligation does not apply where the distribution conduct consists of personal advice or associated conduct. This associated conduct consists of any dealings engaged in by the personal advisor, or an associate of the advisor, for the purposes of implementing the personal advice. [*Schedule 1, item 5, paragraphs 994C(3)(e), 994C(4)(e), 994C(5)(e), 994C(6)(e) and 994C(7)(c) of the Corporations Act*]

***Obligation to take reasonable steps so that distribution is consistent with the target market determination***

1.93 The third distribution obligation requires:

- issuers to take reasonable steps aimed at making retail product distribution conduct consistent with the target market; and,
- regulated persons to take reasonable steps to distribute a product in accordance with its target market determination. [*Schedule 1, item 5, section 994E of the Corporations Act*]

1.94 The first requirement focuses on the interaction between the issuer of a product and the distributors of that product. In particular, an issuer must take reasonable steps that will, or are reasonably likely to, result in retail product distribution conduct in relation to the product being consistent with the product's target market determination. It involves the issuer taking reasonable steps directed at any retail product distribution conduct engaged in by themselves or any another distributor. [*Schedule 1, item 5, subsection 994E(1) of the Corporations Act*]

1.95 The second requirement is directed at interactions between distributors of financial products and their clients. It provides that a regulated person must take reasonable steps that would result in, or would be reasonably likely to result in, retail product distribution conduct that they engage in being consistent with the target market determination. As noted above, retail product distribution conduct, in essence, consists of the distributor's interactions with their clients with respect to the relevant product. [*Schedule 1, item 5, subsection 994E(3) of the Corporations Act*]

1.96 Whether these requirements are met is determined objectively. This means that an issuer or distributor (as the case may be) must meet the standard of behaviour expected of a reasonable person in their position that is offering the same product and is subject to the same legal obligations.

1.97 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 so that retail product distribution conduct in relation to the product is consistent with the product’s target market determination. In making this assessment, issuers and distributors (as the case may be) are to take into account all relevant matters, including:

- the likelihood of their conduct being inconsistent with the 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 practically 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 5, subsection 994E(5) of the Corporations Act*]

1.98 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, where a distributor’s previous conduct indicates that they may be at higher risk of engaging in conduct that is not consistent with the target market determination, issuers will need to take reasonable steps to address the risk. This could include: having systems that enable distributors to be alerted to updates of target market determinations; assisting distributors to address concerns; or, in extreme cases, ceasing to distribute the product through the distributor where doing so is possible. Other relevant factors include the complexity and risk profile of the product, and the nature of any relationship between an issuer and a distributor of a product.<sup>34</sup>

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<sup>34</sup> The obligations do not require any formal relationship (for example, contract or other arrangement) to exist between an issuer and a distributor. However, the existence or non-existence of any such relationship may be relevant in determining whether or not an issuer has met its obligation to take ‘reasonable steps’. In addition, it may be a ‘reasonable step’

However, what constitutes ‘reasonable steps’ will ultimately depend upon the circumstances of each case.

1.99 As noted above, the new law sets out four relevant factors that must be considered in order to establish the desired risk management approach. It is anticipated that in most instances the relevant factors that must be considered would not extend beyond those listed or, if they did, would be of a similar nature. However, where necessary an issuer is to consider any other matter that is relevant for this purpose.

1.100 As the determination of what are reasonable steps depends on the application of a risk management approach to the individual circumstances of each case, it is possible that a retail client outside of the target market will still acquire the product. To reflect this, the amendments specifically confirm that a regulated person is not taken to have failed to take reasonable merely because this occurs. [*Schedule 1, item 5, subsection 994E(4) of the Corporations Act*]

1.101 Likewise, the requirement for issuers to take reasonable steps is not to be mistaken for a requirement to ensure distributors comply with a target market determination. If the issuer takes reasonable steps but retail product distribution conduct of third parties is still inconsistent with the target market determination, the issuer would not breach the requirement. [*Schedule 1, item 5, paragraph 994E(2) of the Corporations Act*]

1.102 Each reasonable step contemplated by the new law need not itself fall within the definition of retail product distribution conduct. However, the steps would generally relate to reducing the risk of such conduct resulting in inappropriate distributions, namely retail product distribution conduct that is not consistent with the product’s target market determination. For example, this would include steps aimed at reducing the risk of distributing the product to persons that are not in the product’s target market.

1.103 The new regime includes amendments to clarify that conduct required to meet the above mentioned obligations does not (by itself) constitute personal advice. This clarification is required because taking reasonable steps to meet the above mentioned obligations may require a regulated person to: ask a retail client for information to determine whether or not they are in a target market (which includes making that determination); and, inform the client of the result of that determination. Either of these acts could constitute personal advice under subsection 766B(3) of the Corporations Act as they may require a

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for an issuer to formalise its relationship with a distributor or vary such a relationship where doing so is reasonably practicable and would promote distribution being consistent with a product’s target market determination.



regulated person to consider the client's personal circumstances or lead to an expectation that those circumstances have been considered. As such, the definition of personal advice has been amended to clarify that the acts of asking for information solely to determine whether a person is in the target market, and informing them of the result, do not, of themselves, constitute personal advice. *[Schedule 1, items 3 and 4, section 761A and subsection 766B(3A) of the Corporations Act]*

1.104 The third distribution obligation does not apply where distribution conduct consists of personal advice or associated conduct. This associated conduct consists of any dealings engaged in by the personal advisor, or an associate of the advisor, for the purposes of implementing the personal advice. *[Schedule 1, item 5, subsection 994E(1) and 994E(3) of the Corporations Act]*

1.105 In addition, the new regime includes a provision aimed at facilitating the implementation of personal advice by distributors who are not associated with the adviser. In particular, any distribution conduct necessary to implement personal advice, which relates to a particular product, is taken to amount to reasonable steps for the purposes of the above mentioned obligations. For conduct to be "necessary" to implement personal advice, the distributor must be satisfied of all relevant matters including: that the particular retail client has received personal advice in relation to a particular product; that the advice remains current; and, that the distributor's proposed conduct would be consistent with that advice as it relates to the particular product they would be distributing. *[Schedule 1, item 5, subsection 994E(6) of the Corporations Act]*

***Obligation to collect, keep and provide distribution information***

1.106 The fourth distribution obligation requires a distributor to collect and keep complete and accurate records of 'distribution information' and provide certain distribution information to the issuer. *[Schedule 1, item 5, section 994A and subsections 994F(2), 994F(4) and 994F(5) of the Corporations Act]*

1.107 'Distribution information' is defined as:

- the information specified by the issuer in the target market determination in relation to specified distributors (being information which is determined on the basis that it enables the issuer to promptly identify review triggers or other events or circumstances that suggest the determination is no longer appropriate);
- where the distributor is specified in relation to the information above – the dates on which the distributor provided the required information to the issuer;
- the number of complaints the distributor receives to which internal or external dispute resolution procedures apply (including where the number of complaints received is zero);

- where the distributor is not the issuer – the dates that the distributor informed the issuer of the number of complaints that they have received;
- where the distributor is not the issuer – the dates that the distributor reported any significant dealings to the issuer; and
- the steps taken to ensure consistency with the product’s target market determination (that is, the steps to comply with the third distribution obligation). [*Schedule 1, item 5, section 994A and subsection 994F(3) of the Corporations Act*]

1.108 The amendments provide for the timeframes in which distribution information must be provided to the issuer. In particular, a distributor who is required to provide information must do so as soon as practicable, and in any case within 10 business days, after the end of the reporting period specified in the target market determination. This applies whether the information relates to a reporting requirement specified in the determination or to the number of complaints the distributor has received. [*Schedule 1, item 5, subsection 994F(4) and 994F(5) of the Corporations Act*]

1.109 The new law clarifies that these obligations only apply to a product where it remains on offer for issue (or regulated sale) to retail clients. That is, when the financial product is no longer being issued, distribution information does not need to continue to be collected and provided. [*Schedule 1, item 5, paragraph 994F(2)(b) of the Corporations Act*]

1.110 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 and provided to issuers. The provisions also support compliance with the other distribution obligations by ensuring distributors have visibility of their activities with respect to the product. To achieve these ends, the record keeping provisions apply to all regulated persons engaging in retail product distribution conduct, including those providing personal advice or engaging in conduct associated with such advice.

1.111 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>35</sup> In addition, the Act presently provides that records required to be kept by a provision of Chapter 7 must be preserved for 5 years.<sup>36</sup> These provisions apply to the new record keeping provisions, as the provisions are inserted into Chapter 7 of the Act.

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<sup>35</sup> See sections 1101C, 1101E and 1101F of the Corporations Act, respectively.

<sup>36</sup> See section 1101C of the Corporations Act.

1.112 The regulations can impose requirements in relation to the new record keeping obligations. This power ensures that the information required to be collected and kept by regulated persons can be adjusted if necessary to support the effective operation of the new regime.<sup>37</sup> [*Schedule 1, item 5, subsections 994F(7) and (8) of the Corporations Act*]

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

1.113 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 5, subsection 994F(6) of the Corporations Act*]

1.114 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.

1.115 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.

1.116 This obligation applies in relation to regulated persons that provide personal advice, or engage in conduct associated with such advice, in relation to the product. It is possible that such persons may engage in conduct in relation to a significant dealing that is not consistent with the product's target market determination. As such, it is necessary for the obligation to apply to them to ensure that all significant dealings are appropriately notified.

1.117 This distribution obligation only applies where the product is on offer for issue (or regulated sale) to retail clients. That is, when the financial product is no longer being issued, notifications are not required. [*Schedule 1, item 5, paragraph 994F(5)(b) of the Corporations Act*]

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<sup>37</sup> This ability to make regulations also applies in relation to the record keeping obligations imposed on issuer by the new regime.

## **Promotional material must refer to target market**

1.118 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.

1.119 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 target market determination is available. [*Schedule 1, item 6, 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 7, paragraph 1018A(2)(ca) of the Corporations Act*]

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

1.121 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>38</sup>

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

1.122 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;

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<sup>38</sup> There are limited exceptions and ASIC has provided some relief in relation to this prohibition, see ASIC Regulatory Guide 254.

- issue stop orders in relation to suspected contraventions of the new regime; and
- make exemptions and modifications to the new regime.

## Information gathering power

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

- distribution information that a regulated person possesses or has access to (see paragraph 1.107); and
- records the issuer must keep under the new regime (see paragraph 1.76). [*Schedule 1, item 5, subsections 994H(1) and 994H(2) of the Corporations Act*]

1.124 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 is notified of the request. [*Schedule 1, item 3, section 994H(3) of the Corporations Act*]

## Stop orders power

1.125 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, review, or make public a target market determination;
- engaging in retail product distribution conduct in relation to a product without a determination or with a determination that is no longer appropriate; and
- failing to take reasonable steps so that retail product distribution conduct is consistent with the target market determination. [*Schedule 1, item 5, subsection 994J(1) of the Corporations Act*]

1.126 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. The intent of stop orders in relation to the new regime is to protect retail clients from breaches of the design and distribution regime. As such, any conduct specified in a stop

order must be conducted in relation to a retail client with respect to a financial product. In addition, a stop order cannot operate in relation to personal advice or associated conduct and a copy of any order must be served on the issuer of the product to which the order relates. *[Schedule 1, item 5, subsections 994J(2) and 994J(7) of the Corporations Act]*

1.127 There are two 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; 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 5, subsections 994J(2) and 994J(7) of the Corporations Act]*

1.128 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 5, subsections 994J(3), 994J(4) and 994J(5) of the Corporations Act]*

1.129 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>39</sup> The amendments are based on these existing provisions. 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.

1.130 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>40</sup> *[Schedule 1, item 3, subsection 994J(2) of the Corporations Act]*

## **Exemption and modification powers**

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

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<sup>39</sup> See sections 739 and 1020E of the Corporations Act.

<sup>40</sup> See section 5 of the *Legislative Instruments Act 2003*.

- 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 5, sections 994K and 994L of the Corporations Act*]

1.132 ASIC presently has exemption and modification powers concerning the disclosure regime for financial products.<sup>41</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.

1.133 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.

1.134 The regulations may also provide for exemptions to the new regime. Existing section 1368 provides that the regulations may make exemptions to provisions in Chapter 6D or 7. As this new regime is part of Chapter 7, the power in section 1368 applies to it.

## **Consequences of breaching the new provisions**

1.135 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.

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<sup>41</sup> See sections 741 and 1020F of the Corporations Act.

## Civil and criminal penalties

1.136 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.

1.137 The maximum penalties applicable to each obligation in the Bill are detailed in the following tables. The new law gives effect to the penalties by making the necessary amendments to existing section 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 8 and 9, subsection 1317E(1) and Schedule 3 of the Corporations Act*]

**Table 1.1 Penalties concerning obligations**

<i>Obligation</i>	<i>Maximum 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 corporate.
Failure to make a determination available to the public free of charge	Criminal – 50 penalty units or imprisonment for 12 months, or both. Civil penalty – \$200,000 for an individual; or 1 million for a body corporate.
Keeping records of decisions and reasons for target market determination	Criminal – 50 penalty units or imprisonment for 12 months, or both. Civil penalty – \$200,000 for an individual; or 1 million for a body corporate.
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 corporate.
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 corporate.
Failure to inform distributors not to distribute a product where the target market determination may no longer	Criminal: 200 penalty units or imprisonment for 5 years, or both.



<b><i>Obligation</i></b>	<b><i>Maximum penalty</i></b>
be appropriate	Civil penalty – \$200,000 for an individual; or 1 million for a body corporate.
Notifying ASIC of significant dealings outside target market	Criminal – 100 penalty units or imprisonment for 2 years, or both. Civil penalty – \$200,000 for an individual; or 1 million for a body corporate.
<b><i>Distribution obligations</i></b>	
Distributing a financial product without 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 corporate.
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 corporate.
Failure of distributor to comply with a notification 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 corporate.
Failing to take reasonable steps so that distribution is consistent 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 corporate.
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 corporate.
Failing to notify the issuer of 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 corporate.
Failing to notify issuer of significant distributions that are not consistent with a product's target market determination.	Criminal – 50 penalty units or imprisonment for 12 months, or both Civil penalty – \$200,000 for an individual; or 1 million for a body corporate.

<b><i>Obligation</i></b>	<b><i>Maximum penalty</i></b>
<b><i>Failure to provide records to ASIC and stop orders</i></b>	
Failure to provide information to ASIC on request	Criminal: 100 penalty units or imprisonment for 2 years, or both. Civil penalty – \$200,000 for an individual; or 1 million for a body corporate.
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 corporate.
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 corporate.

*[Schedule 1, items 5, 8 and 9, sections 994B, 994C, 994D, 994E, 994F, 994G, 994H, and 99J, table items 40A to 40AN in subsection 1317(1), and table items 290CAA to 290CAJ in the table to Schedule 3 of the Corporations Act]*

1.138 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>42</sup> were also considered in determining the applicable penalties.

## **Civil liability**

1.139 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:

- failing to review the target market as required and associated obligations;
- failing to make a target market determination or distributing a product without a determination; and,
- failing to take reasonable steps to comply with a target market determination.

More detail in relation to each of these situations is below.

<sup>42</sup> Attorney-General's Department, September 2011 edition.

1.140 The first situation arises if any of the following contraventions take place and a person suffers loss because of the contravention:

- the issuer fails to review the target market determination during a review period;
- the issuer engages in retail product distribution conduct after failing to review the determination in response to a review trigger, or other events or circumstances that indicate the target market determination may no longer be appropriate;
- the issuer fails to take reasonable steps to notify regulated persons not to distribute when a review trigger, or other relevant event or circumstance has occurred; or
- a regulated person distributes a product after being notified by issuers not to do so.

*[Schedule 1, item 5, subsections 994M(1)(a) and 994M(1)(b) of the Corporations Act]*

1.141 However, it should be noted that civil liability does not arise where the defences to these contraventions are available. In particular:

- in relation to the issuer, this is where the review has already been conducted and the target market determination has been re-made (if necessary); and
- in relation to the regulated person, this is where all reasonable inquiries have been made and the regulated person believed on reasonable grounds that the determination had been reviewed and re-made (if necessary).

1.142 The second situation arises where a target market determination is not made for a product which requires such a determination or where a product is distributed without a target market determination. In particular, the amendments provide a person with a cause of action if:

- an issuer fails to make a target market determination as required by the regime or a regulated person engages in retail product distribution conduct in relation to a product that does not have a target market determination; and
- the person suffers loss or damage because of that conduct.

*[Schedule 1, item 5, subsection 994M(1)(a) and 994M(1)(b) of the Corporations Act]*

1.143 Again, this cause of action does not arise when a defence to the contravention is available. In particular, the cause of action would not arise if a regulated person (except the issuer) made all inquiries that were reasonable in the circumstances and after doing so, believed on reasonable grounds that the target market determination had been validly 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.

1.144 The third situation arises where a person suffers loss or damage because of a failure to take reasonable steps so that distribution is consistent with the target market determination. In particular, the amendments provide a cause of action if any of the following contraventions take place and the person suffers loss because of the contravention:

- an issuer fails to take reasonable steps that would, or would reasonably be likely to result in retail product distribution conduct being consistent with the target market determination;
- a regulated person fails to take reasonable steps that would have resulted in, or would reasonably likely have resulted in retail product distribution conduct being consistent with the target market determination.

*[Schedule 1, item 5, subsection 994M(1)(a) and 994M(1)(b) of the Corporations Act]*

1.145 The new cause of action does 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, paragraphs 993DM(1)(c), (d) and (e), and subsection 994M(3)]*

1.146 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 1, item 5, subsection 994M(2)]*

1.147 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.

*[Schedule 1, item 5, subsection 994N(1) of the Corporations Act]*

1.148 There are a variety of other orders that a court may make where it has declared a contract void. These include, 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 5, subsection 994N(2) of the Corporations Act]*

1.149 The new regime also provides ASIC with standing to seek orders to redress loss or damage for affected consumers who are non-parties to legal proceedings that relate to a contravention of the DDO regime for which a person may bring a private action. The new law specifies the kind of orders that may be made by the court to redress loss or damage suffered by non-party consumers. The new provisions are consistent with existing provisions of the ASIC Act that apply in relation to certain contraventions of that Act. *[Schedule 1, item 5, sections 994P and 994Q of the Corporations Act]*

## **Consequential amendments**

1.150 The new law makes a consequential amendment to existing section 760B of the Corporations Act. The amendment updates the table in that section so that it refers to the new law. This 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**

1.151 The new design and distribution regime applies 24 months after this Bill receives the Royal Assent. *[Section 2 of the Bill]*



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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 Corporations Act relies heavily on disclosure to assist consumers understand and select 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.

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>43</sup> The FSI found that early intervention by ASIC could be more effective in reducing harm

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<sup>43</sup> Financial System Inquiry (Final Report), November 2014, at p 207 and 208.

to consumers compared with waiting for a breach to occur. It recommended providing ASIC with a proactive intervention power that would enhance the regulatory toolkit available where there is risk of significant consumer detriment.<sup>44</sup>

2.6 The Government accepted the FSI recommendation to introduce an intervention power on 20 October 2015.<sup>45</sup> On 13 December 2016, the Minister for Revenue and Financial Services released a proposals paper on the implementation of the obligations.<sup>46</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.

2.8 The Department of the Treasury has considered the compliance costs associated with implementing the product intervention power. The department's analysis is in Chapter 3.

## **Summary of new law**

2.9 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 and the ASIC Act. The intervention power allows ASIC to proactively reduce the risk of consumers suffering significant detriment from financial and credit products.

2.10 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.

2.11 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

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<sup>44</sup> Financial System Inquiry (Final Report), November 2014, at p.206.

<sup>45</sup> Improving Australia's financial system, Government response to the Financial System Inquiry, December 2016, at pp.7 and 19.

<sup>46</sup> Design and Distribution Obligations and Product Intervention Powers, Proposals Paper, December 2016.



or damage because of a contravention of the new obligations may recover that loss by civil action.

2.12 ASIC may only intervene in relation to products that are made available for acquisition after the commencement of the new power. In addition, an order cannot apply to a product that has already been acquired or where a contract for the acquisition of the product has already been entered into. This ensures that the new power cannot interfere with existing arrangements between consumers and providers.

## 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.	Similar causes of action currently exist in relation to loss or damage caused by several breaches of the Corporations Act, for example, defective disclosure.

## Detailed explanation of new law

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

2.14 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 7 and 13, section 1023A of the Corporations Act and section 301A of the Credit Act*]

2.15 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?**

2.16 The intervention power applies to products regulated under the ASIC Act, Corporations Act, and Credit Act.

- In the case of ASIC Act and Corporations Act financial products, 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 7 and 13, section 1023B and paragraphs 1023D(1)(a) and 1023D(3)(a) of the Corporations Act, and paragraphs 301D(1)(a) and 301D(3)(a) of the Credit Act]*

#### ***Financial products***

2.17 There are two main limitations on the types of financial products that can be subject to the intervention power under the Corporations Act (noting that the regime under the Corporations Act has an extended operation in relation to all ASIC Act financial products within the meaning of Division 2 of Part 2 of the ASIC 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’.

2.18 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 2 of Part 2 of the ASIC 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, superannuation products and credit products (including credit products not covered by the Credit Act). *[Schedule 2, item 7, section 1023B and paragraphs 1023D(1)(a) and 1023D(3)(a) of the Corporations Act]*

2.19 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>47</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>48</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.

2.20 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 ('regulated sales') detailed in sections 707 and 1012C of the Corporations Act. *[Schedule 2, item 7, section 1023B and paragraphs 1023D(1)(a) and 1023D(3)(a) of the Corporations Act]*

2.21 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.

2.22 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.

2.23 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 7, section 1023B and subsection 1023C(3) of the Corporations Act]*

2.24 To support the efficient operation of the new regimes, and financial market regulation more generally, the Bill also includes an enhanced ability to prescribe financial products for the purposes of Chapter 7 (Financial services and markets) of the Corporations Act. In

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<sup>47</sup> See section 1010C of the Corporations Act.

<sup>48</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.

particular, the Bill will enable the regulations to declare anything to be, or to not be, a financial product for specified provisions of Chapter 7. Currently, the regulations may only declare something to be, or not to be, a financial product for all Chapter 7 purposes. A provision is also inserted into existing section 765A to clarify that regulations made under that section have precedent (to the extent of any inconsistency) over an inconsistent ASIC declarations. *[Schedule 2, items 4 and 6, subsections 764A(3), 765A(3) and 765A(4) of the Corporations Act]*

### ***Credit products***

2.25 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 ‘credit activity’ to include a broad range of activities in relation to credit products. *[Schedule 2, item 13, paragraphs 301D(1)(a) and 301D(3)(a) of the Credit Act]*

2.26 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>49</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>50</sup>

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<sup>49</sup> See sections 4 and 5 of the Code.

<sup>50</sup> See sections 169 and 170 of the Code.

- A mortgage or guarantee is regulated where it is granted by a consumer and secures or guarantees obligations under a credit contract.<sup>51</sup>

2.27 The new intervention power only applies prospectively. An intervention cannot apply in relation to any product that has 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. *[Schedule 2, item 7 and 13, subsection 1023C(1) of the Corporations Act and subsection 301C(1) of the Credit Act]*

2.28 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?**

2.29 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 Corporations 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 7 and 13, subsections 1023D(1) and 1023D(3) of the Corporations Act and subsections 301D(1) and 301D(3) of the Credit Act]*

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

2.31 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

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<sup>51</sup> See sections 7 and 8 of the Code.

- any other matter prescribed by the regulations. *[Schedule 2, items 7 and 13, section 1023E of the Corporations Act and section 301E of the Credit Act]*

2.32 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 7 and 13, subsection 1023E(2) of the Corporations Act and subsection 301E(2) of the Credit Act]*

2.33 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.

2.34 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 7 and 7, subsection 1023E(3) of the Corporations Act and subsection 301E(3) of the Credit Act]*

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

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

### ***Intervention orders***

2.36 The new power allows ASIC to make intervention orders. Under an intervention order, ASIC can order, in relation to a product or class of product, that conduct must not be engaged in in relation to a retail client, either entirely or except in accordance with any conditions in specified in the order. *[Schedule 2, items 7 and 13, subsections 1023D(1) and 1023D(3) of the Corporations Act and subsections 301D(1) and 301D(3) of the Credit Act]*

2.37 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 classes of persons in relation to which an intervention order cannot be made. *[Schedule 2, items 7 and 13, subsections 1023C(2) and 1023C(3) of the Corporations Act and subsections 301C(2) and 301C(3) of the Credit Act]*

2.38 The range of orders that ASIC can make under an 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.

2.39 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;
- 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 7 and 13, subsection 1023D(4) of the Corporations Act and subsection 301D(4) of the Credit Act]*

2.40 An intervention order with respect to the above matters would not be appropriate. 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, the arrangement could promote adverse consumer outcomes.

2.41 The conduct covered by an intervention order must be limited to conduct in relation to a consumer. For example, an intervention order cannot limit the offering or distribution of products to wholesale clients. This limitation flows from the purpose of the new regime, which is directed at reducing the risk of significant detriment to consumers. For similar reasons, it is envisaged that an intervention order would generally be directed at addressing the significant consumer detriment identified by

ASIC. *[Schedule 2, items 7 and 13, subsection 1023D(5) of the Corporations Act and subsection 301D(5) of the Credit Act]*

2.42 ASIC and the Minister may delegate their functions and powers under the regime in line with existing delegations in relation to comparable matters. ASIC may delegate its functions and power with respect to intervention orders to an ASIC commissioner, or a senior executive staff member of ASIC. The Minister must not delegate the Minister's powers to a person other than ASIC and ASIC must not further delegate any such powers that have been delegated to it. *[Schedule 2, items 15 to 17, subsection 337(1A) of the Credit Act and subsections 102(2C) and 102(2D) of the Australian Securities and Investments Commission Act 2001]*

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

2.43 An intervention order made by ASIC may continue for up to 18 months (the prescribed period) unless the period is extended by ASIC with the approval of the Minister, following a report to the Minister from ASIC on whether the extension should be made. In addition, if a court makes an order staying or otherwise 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 7 and 13, subsection 1023G(2) of the Corporations Act and subsection 301B of the Credit Act]*

2.44 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 ASIC extends it by declaration for a set period of time or permanently (subject to any later revocation) after receiving approval from the Minister to do so. *[Schedule 2, items 7 and 13, section 1023H of the Corporations Act and section 301H of the Credit Act]*

2.45 There are strict rules relating to remaking an intervention order. In particular, if an order ceases to be in force or is revoked, ASIC may not remake the order, or make an 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 7 and 13, section 1023M of the Corporations Act and section 301M of the Credit Act]*

2.46 An intervention order can only be extended by a declaration made in the above mentioned circumstances. While more than one declaration extending the order can be made, each extension requires the approval of the Minister after considering a report on the matter from ASIC. All such declarations must be published on ASIC's website and have precedent over any previously specified timeframe in relation to the duration of the order. *[Schedule 2, items 7 and 13, subsections 1023H(1), 1023H(1), 1023H(3), 1023H(4), 1023J(4) and 1023L(4) of the Corporations Act and section 301H(1), 301H(2), 301H(3), 301H(4), 301J(4) and 301L(4) of the Credit Act]*



2.47 It should be noted that any declarations must be published alongside the intervention order. This requirement assists those affected by an order by ensuring that documents relevant to the order are located together or near each other on ASIC's website. The same applies to other documents associated with an order, in particular the public notice in relation to the order and any amendments to the order.

### ***Procedural requirements***

2.48 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***

2.49 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.

2.50 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, items 7 and 13, subsection 1023F(1) of the Corporations Act and subsection 301F(1) of the Credit Act]*

2.51 The requirement is for ASIC to consult with persons likely to be affected by the proposed order. 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 7 and 13, subsection 1023F(2) of the Corporations Act and subsection 301F(2) of the Credit Act]*

2.52 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 7 and 13, paragraph 1023F(1)(b) of the Corporations Act and paragraph 301F(1)(b) of the Credit Act]*

2.53 Finally, ASIC must also comply with any further consultation requirements prescribed by the regulations. *[Schedule 2, items 7 and 13, paragraph 1023F(1)(c) of the Corporations Act and paragraph 301F(1)(c) of the Credit Act]*

2.54 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 7, 13, and 18, subsection 1023F(3) of the Corporations Act, subsection 301F(3) of the Credit Act and subsection 136(1)(ca) of the Australian Securities and Investments Commission Act 2001]*

2.55 The law clarifies that section 17 of the *Legislation Act 2003* does not apply to the making of an intervention order. Section 17 sets out the general consultation requirements for legislative instruments. That provision applies to all legislation instruments made under the new regime except for the making of an intervention order. The exception of section 17 in the case of making an order reflects specific needs for consultation when making an intervention order, for example, to consult with APRA where relevant. *[Schedule 2, items 7 and 13, subsection 1023F(4) of the Corporations Act and subsection 301F(4) of the Credit Act]*

*Public notice of intervention orders*

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

- describe the significant detriment to consumers in relation to which the intervention is made;
- if the order takes effect later than the day it is published, specify the date the order is to take effect;
- describe the consultation ASIC has undertaken on the order;
- set out why the order is an appropriate way of reducing the significant detriment. *[Schedule 2, items 7 and 13, subsections 1023L(2) and 1023L(3) of the Corporations Act and subsections 301L(2) and 301L(3) of the Credit Act]*

2.57 ASIC must make a similar public notice if an intervention order is amended. 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 7 and 13, subsections 1023L(5) and 1023L(6) of the Corporations Act and subsections 301L(5) and 301L(6) of the Credit Act]*

2.58 In the case of a revocation of an intervention order, ASIC need only publish the notice of the revocation on its website. *[Schedule 2, items 7 and 13, subsection 1023L(7) of the Corporations Act and subsection 301L(7) of the Credit Act]*

2.59 For intervention orders and amendments to orders that are not legislative instruments, ASIC must also serve a copy of the order or amendment on any person to whom ASIC considers the order applies. This ensures that individuals who are directly affected by orders in relation to individual products know that they must comply with such orders. *[Schedule 2, items 7 and 13, subsections 1023L(1) and 1023L(4) of the Corporations Act and subsections 301L(1) and 301L(4) of the Credit Act]*

### ***Commencement of intervention orders***

2.60 The commencement date of an intervention order depends on whether it is a legislative instrument or not. In particular:

- 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 it is published or from the date specified in the public notice related to the intervention. *[Schedule 2, items 7 and 13, subsection 1023G(1) of the Corporations Act and 301G(1) of the Credit Act]*

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

2.61 ASIC can revoke or amend an intervention order that has not been extended at any time. Where an intervention order has been extended, ASIC can only revoke or amend the order with the Minister's approval, given after considering a report from ASIC. However, an intervention order can never be amended so as to extend the duration of its operation. The duration of an intervention order can only be extended by the declaration process that has already been outlined above. *[Schedule 2, items 7 and 13, sections 1023J and 1023K of the Corporations Act and sections 301J and 301K of the Credit Act]*

2.62 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) and are subjects to the requirements of the *Legislation Act 2003*, including disallowance.
- Orders that are not legislative instruments must be amended or revoked 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*

*7 and 13, subsections 1023G(1), 1023J(5) and (6) and 1023K(4) of the Corporations Act and subsections 301G(1), 301J(5) and 301K(4) of the Credit Act]*

2.63 All amendments to, and revocations of, interventions orders must be published on ASIC's website. In the case of an amendment, ASIC must also publish on its website a notice that: sets out why the amendment is appropriate; and describes the consultation that ASIC undertook in relation to the amendment. In the case of a revocation, ASIC need only publish a notice of the revocation on its website. *[Schedule 2, items 7 and 13, subsections 1023L(6), 1023L(7) and 1023L(8) the Corporations Act and subsections 301L(6), 301L(7) and 301L(8) of the Credit Act]*

***Obligations associated with intervention orders***

2.64 There are three obligations associated with intervention orders.

2.65 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 7 and 13, subsection 1023P(1) of the Corporations Act and subsections 301P(1) of the Credit Act]*

2.66 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>52</sup> *[Schedule 2, items 7 and 13, subsection 1023P(4) of the Corporations Act and subsections 301P(6) and 301P(7) of the Credit Act]*

2.67 Service 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 7 and 13, subsection 1023P(1) of the Corporations Act and subsection 301P(1) of the Credit Act]*

2.68 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 7 and 13, subsection 1023N(1) and subsection 1023P(2) of the Corporations Act and section 301N and subsections 301P(3) and (4) of the Credit Act]*

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<sup>52</sup> See, for example, existing section 1020E of the Corporations Act.

2.69 The notice ASIC provides to the person may specify the way in which the person is to notify their customers. If the intervention order 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 7 and 13, paragraph 1023N1(b) of the Corporations Act and paragraph 301N(1)(b) of the Credit Act]*

### ***Review of intervention orders***

2.70 Section 1317 of the Corporations Act provides a general right to apply to the Administrative Appeals Tribunal for merit review of a decision made under the Act by ASIC and certain other bodies. Section 327 of the Credit Act provides an equivalent right of review for decisions made by ASIC under that Act. These rights of review apply to all decisions made by ASIC under the new product intervention order regime, except those made by legislative instrument. Decisions made by legislative instrument are subject to the processes applicable to such instruments, including parliamentary oversight via the disallowance process, rather than merits review.<sup>53</sup> *[Schedule 2, items 10 and 14, paragraph 1317(gdl) of the Corporations Act and subparagraphs 327(1)(d)(iii) to 327(1)(d)(v) of the Credit Act]*

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

2.71 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***

2.72 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.

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

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<sup>53</sup> See the *Legislation Act 2003*.

**Table 2.1 Penalties concerning obligations**

<i>Obligation</i>	<i>Maximum 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 corporate
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 corporate
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 corporate

2.73 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>54</sup> were also considered in determining the applicable penalties.

2.74 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, 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 7, 11, 12 13, sections 1023N and 1023P, table items 40P to 40R in subsection 1317E(1) and table item 309AG in Schedule 3 of the Corporations Act, and sections 301N and 301P of the Credit Act]*

<sup>54</sup> Attorney-General's Department, September 2011 edition

### ***Civil liability***

2.75 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 7, subsection 1023Q(1)]*

2.76 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 7, subsection 1023Q(3) of the Corporations Act]*

2.77 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 7, subsection 1023Q(2) of the Corporations Act]*

2.78 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.

2.79 There are a range of orders that a court may make where it has declared a contract void. These include, 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 7, section 1023R of the Corporations Act]*

2.80 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**

2.81 The new law makes a consequential amendment to existing section 760B of the Corporations Act. The amendment updates the table in that section so that it refers to the new law. This 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]*

2.82 The Bill also inserts a new heading into existing section 765A of the Corporations Act to enhance the readability of the provision as amended by the new law. *[Schedule 2, item 5, subsection 765A(2) of the Corporations Act]*

## **Application and commencement provisions**

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

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



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## **Chapter 3**

# ***Regulatory Impact of Design and Distribution Obligations and Product Intervention Power***

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### **Outline of reforms**

3.1 On 20 October 2015, as part of its response to the Financial System Inquiry (FSI), the Government agreed with the recommendation that the Government should introduce targeted and principles based product design and distribution obligations and a product intervention power. In committing to these recommendations 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 consultation with industry stakeholders.<sup>55</sup>

3.2 The Australian Government Guide to Regulation identifies seven questions that a Regulatory Impact Statement (RIS) should address. The following is the analysis of these questions that occurred as part of the FSI and stakeholder consultation process.

### **Consultation**

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

3.4 A range of relevant industry and consumer group stakeholders have participated in the consultation process. The December 2016 consultation paper and December 2017 exposure draft each received 38 submissions, four of which were confidential. The July 2018 exposure draft received 34 submissions, four of which were confidential.

3.5 Treasury also met with key industry stakeholders and consumer groups as a part of these consultation processes.

3.6 As a result of these consultation processes, the regulation impact costing for the design and distribution obligations was adjusted to reflect stakeholder feedback on the expected system changes and number of

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<sup>55</sup> The Treasury has undertaken a process equivalent to a Regulation Impact Statement through the FSI. The link to the FSI Final Report can be found here:  
[http://fsi.gov.au/files/2014/12/FSI\\_Final\\_Report\\_Consolidated20141210.pdf](http://fsi.gov.au/files/2014/12/FSI_Final_Report_Consolidated20141210.pdf).

affected businesses; and policy changes were made to allow the desired outcomes to be achieved in a more efficient manner.

## **Design and distribution obligations**

### **The problem**

3.7 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.

3.8 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 asymmetries played a significant role.

3.9 The quality of product design and distribution controls was found to be variable. The Australian Securities and Investments Commission's (ASIC) 2014 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.

3.10 The FSI was also concerned that certain less complex add-on insurance products may not meet the needs of some consumers. For example, a 2013 ASIC report revealed that Consumer Credit Insurance (CCI) products were being bought by consumers whose situation made them ineligible to claim under the policy.

3.11 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 their products to the end consumer.

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

3.12 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.

3.13 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.

3.14 Implementing a new obligation through a self-regulatory approach would build on the work of AFMA, relying on the financial services industry to monitor how standards are applied and taking 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.

3.15 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. The FSI found that, 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**

3.16 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.

3.17 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.

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

3.19 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.

3.20 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 nature and scalable in line with the nature of the product.

3.21 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.

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

3.23 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.

3.24 The costs also include 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.

3.25 It is estimated that the increase in annual compliance costs for the industry as a whole will amount to \$94.7 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>\$94.7</i>	<i>\$0</i>	<i>\$0</i>	<i>\$94.7</i>

## Product Intervention Power

### The problem

3.26 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.

3.27 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 – a much safer product than unlisted debentures. 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.

3.28 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.

3.29 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 involved 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.

3.30 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.

3.31 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.

3.32 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 asymmetries or behavioural biases hard to overcome. Some current product distribution strategies also hamper understanding.

3.33 The FSI's recommendation also took into account the Senate Economics References Committee's 2014 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**

3.34 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.

3.35 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. The FSI thought that widening the pool of default products may risk significantly limiting innovation and reducing competition.

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

3.37 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**

3.38 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.

3.39 This power can be used as a last resort or pre-emptive measure where there is a 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.

3.40 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.

3.41 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.

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

3.43 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.

3.44 It is not expected that the introduction of the product intervention power will result in an increase in annual compliance costs for industry. Any intervention made by ASIC as a result of it taking enforcement action will be subject to its own regulatory impact assessment.

**Table 3.2: Regulatory burden estimate table**

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

## **Implementation and evaluation**

3.45 This Bill will introduce a targeted and principles-based product design and distribution regime and a product intervention power.

3.46 It makes amendments to legislation including the *Corporations Act 2001* and the *National Consumer Credit Protection Act 2009*.



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## **Chapter 4**

# ***Statement of compatibility with human rights***

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**Prepared in accordance with Part 3 of the *Human Rights (Parliamentary Scrutiny) Act 2011***

***Treasury Laws Amendment (Design and Distribution Obligations and Product Intervention Powers) Bill 2018***

4.1 This Bill is compatible with the human rights and freedoms recognised or declared in the international instruments listed in section 3 of the *Human Rights (Parliamentary Scrutiny) Act 2011*.

### **Overview**

4.2 The Bill contains measures to:

- strengthen product issuer and distributor accountability by implementing design and distribution obligations; and
- introduce a financial product intervention power for the Australian Securities and Investments Commission (ASIC).

4.3 The design and distribution obligations will apply to most issuances of financial products and securities for which a disclosure document is required as well as financial products that are not regulated under the Corporations Act, but are regulated under the ASIC Act.

4.4 The design and distribution obligations regime will:

- ensure that offerors make a target market determination for each product to which the new regime applies, including specifying the target market for the product and other relevant matters such as any conditions and restrictions on the distribution of the product;
- ensure that offerors develop a plan for reviewing that determination and abide by that plan. The plan must provide for triggered reviews (reviews that must be undertaken upon the occurrence of an event or circumstance that would suggest that the determination is no longer appropriate) and periodic reviews (reviews that must be undertaken if the determination has not otherwise been reviewed during a period specified by the issuer that must be reasonable);

- ensure that offerors specify what information distributors must collect and keep, and when that information must be provided to offerors. In particular, the offeror must specify any information that the offeror needs to identify whether the target market determination should be reviewed and specify reasonable reporting periods for the provision of this information;
- ensure that offerors make their target market determinations available to the public free of charge;
- prohibit distributors from distributing a product to which the regime applies unless a current target market determination is in place;
- ensure that offerors and distributors take reasonable steps so that distribution is consistent with the most recent target market determination;
- ensure that distributors and offerors maintain necessary records in support of the new regime. Offerors must collect and keep complete records of their decisions in relation to key aspects of the new regime (e.g. the target market determination for the product and plan for reviewing the determination) and the reasons for those decisions. Distributors must collect and keep records of distribution information (being numbers of complaints and distribution information specified by offerors) and information relating to their obligations under the new regime;
- ensure that distributors must provide to offerors numbers of complaints about the product and any distribution information relating to the product which the offeror has specified in its target market determination;
- ensure that 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;
- ensure that 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 regime;
- ensure that a person who suffers loss or damage because of a contravention of the design and distribution obligations may recover that loss by civil action and that the court dealing with the action can make appropriate orders;

- ensure that ASIC may ask the court to make orders to benefit non-party consumers who have suffered loss or damage because of a contravention of the DDO regime for which a private action could be commenced; and
- ensure that advertisements and promotional material in relation to the product describes the target market for the product or specifies where the determination is available.

4.5 The design and distribution obligations will become effective two years after the legislation receives Royal Assent.

4.6 The product intervention power will allow ASIC to intervene in relation to financial and credit products, that may be acquired by consumers, by making orders to prohibit specified conduct related to the product. However, such an order may only be made where ASIC is satisfied that the product has resulted in, or will or is likely to result in, significant detriment to consumers. In addition, an order cannot apply to a product held by a person if the person acquired, or entered into a contract for the acquisition of, the product before the order comes into force.

4.7 Under a product intervention order, ASIC may prohibit a broad range of conduct in relation to a product either entirely or subject to conditions. However, such conditions may not require that a person holds a financial service licence, meets a training or professional standard, or becomes a member of an external dispute resolution scheme (where the law does not otherwise require these things) or be related to a person's remuneration (except so much of the person's remuneration as is conditional on the achievement of objectives related to the product). Similarly, the order may apply in relation to a broad range of persons expect consumers or a person who is in a class of persons specified in the regulations.

4.8 A product intervention order may only last for up to 18 months (or such shorter period prescribed by regulations) unless the Minister provides approval for the duration of the order to be extended. Before providing such approval, ASIC must provide the Minister with a report relating to the extension and the Minister must consider that report.

4.9 The new product intervention regime also:

- ensures that a product intervention order may be made in relation to an individual product or, by legislative instrument, in relation to a class of products;
- ensures ASIC consults affected parties and APRA (where necessary) prior to making an intervention order and makes all orders and related matters public;
- ensures that ASIC may amend and revoke intervention orders where necessary – noting that the Minister must approve

such an amendment or revocation after consider a report from ASIC if the Minister has previously approved an extension of the order;

- ensures it is an offence: for a person to fail to comply with an intervention order (including an order to take reasonable steps to notify past customers of the terms of an order); and, for a person who has been served with an intervention order to fail to take reasonable steps to ensure that other persons who engage in conduct to which the order applies are aware of the order;
- ensures that a person who suffers loss or damage because of a contravention of an intervention order may recover that loss by civil action and that the court dealing with the action can make appropriate orders; and
- ensures that ASIC and the Minister may delegate their functions and powers under the regime in line with existing delegations in relation to comparable matters.

4.10 The product intervention power legislation will commence upon receiving Royal Assent.

4.11 The design and distribution and product intervention regimes generally impose both civil and criminal penalties in relation to each obligation under the regimes. This will allow ASIC or the prosecutor (as the case may be) to take a proportionate approach to the enforcement of the new regime. Applicable penalties are broadly consistent with those applying to similar offences that currently apply under the Corporations Act.

## **Human rights implications**

4.12 The Bill engages, or may engage, the following human rights:

- the right to the presumption of innocence; and
- the right to privacy.

### ***Engagement of the presumption of innocence***

4.13 Paragraph 2 of Article 14 of the International Convention on Civil and Political Rights (ICCPR) protects the right of a person charged with a criminal offence to be presumed innocent until proven guilty according to law. The presumption of innocence is also a fundamental principle of the common law. As the Parliamentary Joint Committee on Human Rights has observed, the presumption of innocence ‘imposes on the prosecution the burden of proving the charge, guarantees that no guilt can be presumed until the charge has been proved beyond reasonable

doubt, ensures that the accused has the benefit of doubt, and requires that persons accused of a criminal act must be treated in accordance with this principle'.<sup>56</sup> The presumption of innocence generally requires the prosecution to prove each element of a criminal offence beyond reasonable doubt.

*Offence provisions that carry an evidential burden*

4.14 An offence provision that requires a defendant to carry an evidential burden may be considered to engage the right to the presumption of innocence.

4.15 A number of offences in the design and distribution obligations and the product intervention power regimes contain offence specific defences for which the defendant carries an evidential burden. In accordance with the *Criminal Code Act 1995* and the *Guide to Framing Commonwealth Offences, Infringement Notices and Enforcement Powers*<sup>57</sup>, offence specific defences in the Bill are made explicit through words of exception and exemption.

4.16 The evidential burden in those defences has been reversed because the subject matter of the defence is:

- peculiarly within the knowledge of the defendant; and,
- significantly more difficult and costly for the prosecution to disprove than for the defendant to establish.

4.17 Details of each defence and the relevant subject matter are in the following table.

**Table 4.1 Offence Specific Defences**

<i>Offence</i>	<i>Defence</i>	<i>Explanation</i>
<b><i>Design and Distribution Obligations</i></b>		
Distribution by the offeror when a target market determination should be reviewed	There are two defences to both of these offences.	Determining that a new target market is not required involves judgment based on information available to the issuer at various points in time.
Failing to tell distributors that	1. The offeror has determined that a new target market determination is not	Whether personal advice has been provided concerns the interaction between the

<sup>56</sup> Parliamentary Joint Committee on Human Rights, *General Comment No 43 Article 14: Right to equality before courts and tribunals and to a fair trial*, CCPR/C/CG/32, 23 August 2007, [30].

<sup>57</sup> Attorney-General's Department, September 2011 edition.

<i>Offence</i>	<i>Defence</i>	<i>Explanation</i>
they should cease distribution because a determination should be reviewed	<p>required or made a new target market determination.</p> <p>2. The distribution conduct is excluded conduct. Excluded conduct is the provision of personal advice or implementation of personal advice by the advisor or an associate.</p>	<p>defendant and its customer.</p> <p>Both are peculiarly within the knowledge of the defendant and would be significantly more difficult for the prosecution to disprove than for the defendant to establish.</p>
Distribution a product that does not have a target market determination	<p>There are two defences to this offence</p> <p>1. Making all reasonable inquiries and believing on reasonable grounds that a determination had been made or was not required.</p> <p>2. The distribution conduct is excluded conduct.</p>	<p>What inquiries have been made and what belief was formed by the defendant are both peculiarly within the knowledge of the defendant and would be significantly more difficult for the prosecution to disprove than for the defendant to establish.</p> <p>As above, the same is true for whether personal advice has been provided because it concerns the interaction between the defendant and its customer.</p>
<p>Taking reasonable steps so that distribution is consistent with the target market determination</p> <p>Failure to notify ASIC of significant dealings that are not consistent with the target market determination</p>	The distribution conduct is excluded conduct.	<p>Whether personal advice has been provided is peculiarly within the knowledge of the defendant and would be significantly more difficult for the prosecution to disprove than for the defendant to establish.</p> <p>This is because whether or not personal advice has been provided concerns the interaction between the defendant and its customer.</p>
<b><i>Product Intervention Power</i></b>		
Failure to comply with a product	There are three defences to this	Both the details of when a product was acquired by a client



<i>Offence</i>	<i>Defence</i>	<i>Explanation</i>
intervention order	<p>offence</p> <p>1. The person engages in conduct prohibited by the order in relation to a financial product that has already been acquired;</p> <p>2. The person engages in conduct prohibited by the order in the capacity of a retail client</p> <p>3. The order is not a legislative instrument and the person was not aware, and could not reasonably have been aware, of the order.</p>	<p>and the capacity in which the defendant is acting are peculiarly within the knowledge of the defendant and would be significantly more difficult for the prosecution to disprove than for the defendant to establish.</p> <p>Whether the person could have been reasonably aware of an individual order in their circumstances is also peculiarly within the knowledge of the defendant and would be significantly more difficult for the prosecution to disprove than for the defendant to establish.</p>

4.18 The offences are critical to the operation of the regime. The imposition of an evidential burden for the defences achieves a legitimate object because it ensures that the offences are prosecutable, thereby allowing effective enforcement of the new regime.

4.19 The burden of proof on the defendant is an evidential burden. The effect of the imposition is therefore that the defendant must merely adduce or point to evidence of the defence. Once this is done, the prosecution bears the burden of proof.

4.20 Because of the low evidential burden on the defendant, to the extent that imposing that burden is a limitation on the right to be presumed innocent, it is proportionate and reasonable in the circumstances.

#### *Self-incrimination*

4.21 Related to the presumption of innocence is the right to be free from self-incrimination under article 14(3)(g) of the ICCPR.

4.22 The Bill allows ASIC to request information from offerors and distributors for the purposes of administering the regime. This includes information related to the person's decisions in relation to key obligations in the Bill, including criminal penalty provisions. This potentially engages the right against self-incrimination because the person who ASIC requests the information from must provide it to ASIC.

4.23 Record-keeping obligations apply to the two key aspects of the regime that ensure products are targeted at consumers for whom they are appropriate. Offerors are required to keep records of decisions relating to the making and review of target market determinations and the reasons for their decisions. Distributors are required to keep records of the actions they take to ensure products are distributed in accordance with the target market determination (that is, the reasonable steps they took). ASIC may require offerors and distributors to provide these records to ASIC.

4.24 The purpose of the record keeping obligations is to assist offerors and distributors in complying with the regime. A requirement to keep records formalises the decision-making framework for offerors and distributors and will aid their approach to compliance with the regime. The requirement to provide these records to ASIC on request will ensure ASIC is able to effectively monitor the regime. On this basis, engaging the right against self-incrimination in this way is necessary and justified to ensure the regime operates effectively.

4.25 The Bill also requires that distributors notify issuers of significant dealings outside the target market (and issuers must notify ASIC of the same), however, dealing outside the target market is not of itself an offence or an element of an offence. The notification of a significant dealing therefore does not indicate that a person was involved in an offence. As such it is not considered that this aspect of the Bill engages the right against self-incrimination.

### ***Engagement of the right to privacy***

4.26 Article 17 of the International Covenant on Civil and Political Rights (ICCPR) requires parties to the ICCPR to uphold the individual right not to have one's private, family and home life or correspondence unlawfully or arbitrarily interfered with. It also includes the right to protection by law of one's reputation. According to the Parliamentary Joint Committee on Human Rights' *Guide to Human Rights*, the right to privacy includes:

- the right of respect for confidential and private information, particularly the storing, use and sharing of such information; and
- the right to control dissemination of information about one's private life.

4.27 The Bill may engage the right to privacy because:

- offerors can specify information about the distribution of products that distributors must then collect and provide back to the issuer. This information is needed so offerors can

identify whether the target market determination should be reviewed;

- distributors must provide numbers of complaints about an offeror's product to the offerors (no other information about the complaints has to be provided);
- distributors must notify offerors and offerors must notify ASIC of significant dealings outside the target market; and
- ASIC can require that the above information be provide to it.

4.28 Each of these aspects of the Bill is directed at ensuring information about how products are distributed can be used to improve product design. The Bill does not contain requirements that personal information be shared as part of these obligations for that purpose. In addition, the *Privacy Act 1988* provides for the protection for personal information, including setting out Privacy Principles that apply to many private sector organisations subject to these obligations.

4.29 As such, it is unlikely that the Bill engages the right to privacy.

## **Conclusion**

4.30 The Bill is compatible with human rights. It engages, or may engage the presumption of innocence and the right to privacy. However, to the extent the Bill places limitations on these rights, these limitations can be considered legitimate, rational and necessary in light of the objectives they aim to achieve, and reasonable and proportionate in their extent.