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Design and Distribution Obligations (DDO) and Product Intervention Powers (PIP)

Are you DDO and PIP ready?

April 2019

DDO and PIP

What are DDO and PIP?

In November 2014, the Financial System Inquiry (FSI) found the current regulatory framework for financial products to be insufficient for consumer protection because it relies too heavily on disclosure, general advice and financial literacy of consumers. The FSI found that the inherent complexity of financial products and low level of financial literacy of consumers meant that products are not easily understood, even when there is full disclosure.

Following the FSI's recommendations, the Government introduced:

- **Design and Distribution Obligations (DDO)** which necessitate issuers and distributors of financial products (captured under the regime) to be targeted at the right people.
- **Product Intervention Powers (PIP)** which provide ASIC the power to modify products, or if necessary ban the sale of financial products, when there is a risk of significant consumer detriment. ASIC will also have the power to impose **civil and criminal penalties** for any breach of DDO or PIP.

DDO and PIP are contained in the *Treasury Laws Amendment (Design and Distribution Obligations and Product Intervention Powers)* Bill 2019, and have been added respectively as a new Part 7.8A and 7.9A to the Corporations Act 2001 (Cth) (Corporations Act).

The legislation received the Royal Assent on 5 April 2019, and applicable as follows:

- PIP is effective immediately; and
- DDO is applicable to new and existing financial products in 24 months (as of 5 April 2021).

It is also worth noting that, in the Final Report on the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry, Commissioner Hayne recommended authorised deposit-taking institutions (ADI's) that are currently, or soon to be regulated under the Banking Executive and Accountability Regime (BEAR) will need to allocate a new prescribed accountability in Accountability Statements. This is to cover all steps in the design, delivery and maintenance of products offered to customers, and any remediation in relation to those products.

DDO and PIP:

Requires financial products be targeted at the right people so that the products match customers' circumstances

Increases accountability for both issuers and distributors

Gives ASIC powers to enforce the new arrangements, including ability to request information, issue stop orders and to make exemptions and modifications

DDO

What products are captured under DDO?

The products captured by DDO are those for which a prospectus, product disclosure statement (PDS) or disclosure to investors is required under the Corporations Act. These are financial products acquired by **retail clients**. This includes products exempt from disclosure under a mutual recognition scheme (which is currently limited to certain offers of financial products under New Zealand law).

DDO also applies to any financial product prescribed by the Minister in regulations. This means the new regime can apply to any prescribed financial product in any prescribed circumstance, regardless of whether or not the product requires disclosure.

Are credit products captured under DDO?

ASIC indicated that design and distribution obligations should be applied to credit products under the National Consumer Credit Protection Act 2009 (Cth). This is because definition of 'financial product' is broader in the Australian Securities and Investments Commission Act 2001 (Cth), and includes 'credit products'.

Moreover, Commissioner Hayne questioned why the powers should not extend, as ASIC requested, to all financial products and credit products within ASIC's regulatory responsibility.

The amended legislation now captures credit products under DDO.

Financial product	Captured under DDO?	Why?
Insurance	✓	
Asset management	✓	
Derivatives	✓	
Some superannuation products	✓	
Credit products	✓	
Financial products obtained through personal advice	✗	Captured by Future of Financial Advice (FOFA)
MySuper products	✗	Subject to special rules under the Superannuation Industry (Supervision) Act 1993
Margin lending facilities	✗	Subject to product-specific regulations
Ordinary shares, including securities issued under employee share schemes	✗	Regarded as well understood

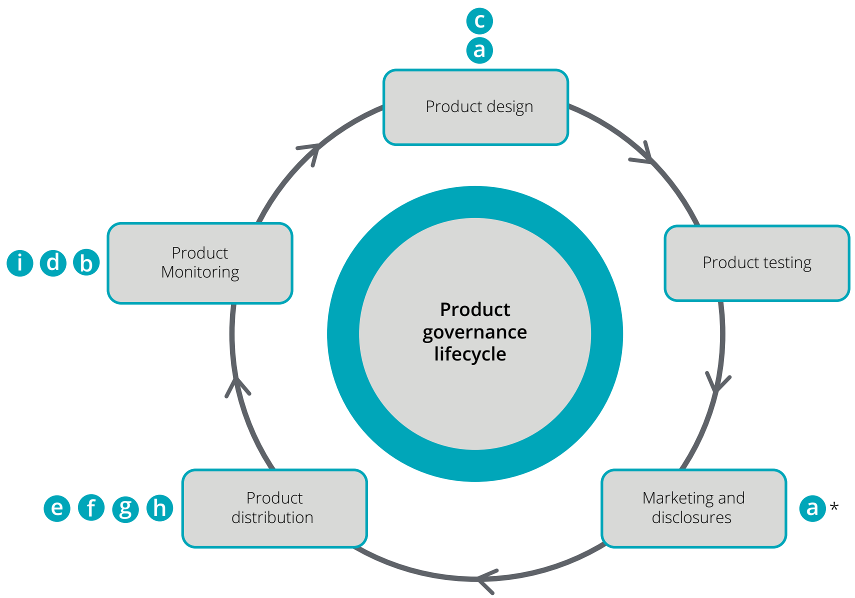
DDO

What are the Obligations?

The Bill introduces four Design Obligations and five Distribution Obligations. Issuers of financial products must meet the Design Obligations. Organisations who sell direct to customers must comply with the Distribution Obligations (excludes personal advice). These obligations are considered against their relevant impact on the product governance lifecycle phases.

Issuer | Distributor(s)

Design obligations	
a	Make a target market determination and identify review triggers
b	Review the target market determination for appropriateness
c	Keep records about the target market determination
d	Notify ASIC about significant dealings in respect of the target market determination



Distribution obligations	
e	Prohibition in retail product distribution without a target market determination
f	Prohibition in retail product distribution where the target market determination may no longer be appropriate
g	Take reasonable steps to ensure distribution is consistent with the target market determination
h	Collect, keep and provide distribution information
i	Notify the issuer of significant dealings not consistent with the target market determination

* As part of the target market determination obligation, issuers are required to state the determination on any product related advertising or promotional material.

Design Obligations

What is the product's target market?

a

Target market determination

Under DDO, issuers are required to make a target market determination in relation to the product they develop. This is the primary obligation under the DDO regime and carries the heaviest penalties for failures in meeting the target market determination in either creation, review or distribution.

The determination must be publicly available, free of charge and in writing. It must set out:

- The class of retail clients comprising the product's target market;
- Any conditions or restrictions on distributing the product;
- Circumstances that reasonably suggest the determination is no longer appropriate ("review triggers");
- Reasonable review and reporting periods; and
- The type of information required to enable the creator of the determination to promptly identify review triggers or other events suggesting the determination is no longer appropriate.

An issuer must take into account all relevant factors to determine whether a product will generally meet the objectives of customers within the target market. Relevant factors issuers could take into account for creating a determination may include:

Key product features	Customer circumstances
Complexity	Understanding of product features
Risk profile (over the product's lifetime)	Capacity to meet financial obligations
Applicable product fees	Capacity to bear losses
Investment objectives the product would be seeking to meet	Investment needs and objectives are the same as those the product seeks to meet

When do you make a target market determination?

In the product governance lifecycle, determining the target market will form part of product design phase, and must be completed before distribution. The issuer must provide the product target market determination to distributors in advance of them entering into selling or providing advice on the product.

Design Obligations

Is the target market appropriate?

b Assessing appropriateness of the target market

A determination is appropriate if it is reasonable to conclude that, if the product were issued or a regulated sale occurred:

- When following the distribution conditions to a retail client, the retail client would be in the target market; and
- To a retail client in the target market, it would be consistent with the retail client's likely objectives, financial situation and needs.

A target market determination will need to be remade when events or circumstances suggest that it may no longer be appropriate.

A target market determination must be reviewed within a **reasonable period**. The review period is the maximum period of time that elapses between completed reviews of a determination. The obligation is designed to encourage an issuer to adopt a risk management approach in determining a reasonable review period. This would require issuers to consider the likelihood and consequences of the risk to investors of a determination becoming inappropriate due to the passage of time.

The validity of the determination is not retrospectively affected by a review finding that the determination is no longer appropriate.

What is a review trigger?

A review trigger is an event or circumstance that would reasonably suggest the target market determination is no longer appropriate for a product.

A review trigger will vary depending on the nature of and the circumstances surrounding a financial product. Examples of review triggers include:

- An event or circumstances that would materially change a factor taken into account when making the target market determination for the product;
- The discovery of a material and relevant defect in the product's disclosure documentation;
- Whether the product is being distributed and purchased as envisaged by its target market determination; and
- The nature and extent of any feedback received from those who distribute or invest in the product.

Design Obligations

Records and significant dealings

c

Record keeping

Records must be kept on:

- Target market determinations;
- Review triggers;
- Review periods;
- Decisions about the target market determinations; and
- The reasons behind those decisions.

These records can be requested by ASIC to support its compliance activities with DDO.

The records must be kept for a period of five as per Chapter 7 of the Corporations Act.

d

ASIC notification

If a product issuer becomes aware of **significant dealings** in a product that are not consistent with the product's target market determination, ASIC must be notified in writing as soon as practicable, and in any case within 10 business days.

Whether a dealing is significant would a case-by-case determination. 'Significant' is given its ordinary meaning in the context of the legislation – being something and worthy of ASIC's attention and its role as the regulator of the new regime so that timely and appropriate decisions are made.

Distribution Obligations

Distributors' role in the target market determination

	Obligation	What should the distributor do?
e	**Prohibition of retail product distribution conduct without the target market determination**	Distributors are prohibited from selling or providing advice on products without a target market determination. A distributor may reasonably rely on the validity of the target market determination made by the issuer. However, where reliance is placed on the determination without having the determination in writing or where it is apparent the determination is inappropriate, the distributor is required to make inquires and cease distribution.
f	**Prohibition of retail product distribution if the target market determination may not be appropriate**	A target market determination may no longer be appropriate if the issuer knows, or should reasonably know, that a review trigger or other event has occurred that caused the determination to no longer be appropriate. Issuers must, as soon as practicable or within 10 business days, take reasonable steps to ensure distributors are informed not to engage in retail product distribution conduct unless the issuer has reviewed the target market determination.
g	**Take reasonable steps to ensure distribution is consistent with the target market determination**	To assess reasonableness, considerations include: • The likelihood of the person getting the product in a way other than the target market determination; and • The nature and degree of harm that might result from the product being distributed outside the target market. If the issuer takes reasonable steps but the retail product distribution conduct of third parties is inconsistent with the determination, the issuer is not in breach.

What is retail product distribution conduct?

A person engages in retail product distribution conduct if they deal with a financial product with a retail client, provide a disclosure document or PDS, provide financial product advice or make a recognised offer.

Distribution Obligations

Information collection and significant dealings

	Obligation	What should the distributor do?
h	**Collect, keep and provide distribution information**	Distributors are required to collect and keep records about the distribution information. This includes: • Information specified by the issuer (e.g. information enabling them to identify review triggers); • Number of complaints received in relation to the product; and • Steps taken to ensure consistency with the determination. Distributors must provide this information to the issuer within 10 business days after the end of the reporting period.
i	**Notify the issuer of significant dealings not consistent with the target market determination**	Distributors are required to notify the issuer of any significant dealings of the product that are not consistent with the determination. They must do so as soon as practicable but at a maximum within 10 business days. This requirement is intended to support the issuers in their ability to make timely and appropriate decision, and to adjust to events that may cause a determination to no longer be appropriate.

ASIC and Ministerial powers

When can the new powers be used?

The new regime gives ASIC further powers to support its regulatory role. The most contentious power is the new product intervention power.

a Information gathering powers

ASIC can request information in relation to:

- Information in relation to the distribution information that regulated person possesses or has access to;
- Access to records the issuer is required to keep under the DDO regime.

Recipient of a request can prepare a response in writing and by the date specified by ASIC or, if no date is provided, within 10 business days after being notified of the request.

b Stop order powers

ASIC can issue stop orders for breaches of the target market determination requirements. They can be issued due to:

- Failures to make a determination;
- Engaging in conduct in relation to a product that does not have a determination; or
- Failures to take reasonable steps to ensure retail product distribution is consistent with the determination.

If a stop order is issued, the recipient must not engage in conduct contrary to the order and must take reasonable steps to ensure others engaged in the conduct are aware of the order.

c Target market determination

ASIC can make exemptions for persons or products from all or specific provisions in DDO. ASIC may:

- Exempt a person or class of persons from all or specified DDO provisions;
- Exempt a financial product or a class of financial products from all or specified DDO provisions; or
- Declare that the new regime applies in relation to a person or financial product (or class of person or products) as if specified DDO provisions were omitted, modified or varied as specified in the declaration.

ASIC currently has these powers under the disclosure regime and have been replicated in the DDO regime.

PIP

What are PIP?

PIP will introduce powers for ASIC to make an intervention order that lasts for up to 18 months and amend intervention orders at any time. It will allow ASIC to proactively prevent or respond to significant consumer detriment from prospective financial products. PIP applies to products regulated under:

- The Corporations Act - financial products that are available for acquisition by retail clients and products in certain anti-avoidance sale situations; and
- The Credit Act - all products that may be provided by a person in the course of engaging in a credit activity or proposed credit activity.

The powers can be extended with Ministerial approval, and include banning classes of products. If ASIC is satisfied that a product or a class of products resulted or is likely to result in significant detriment to the retail clients, it must:

01. Consult the people and/or entities affected by the order and APRA.

02. Publish a public notice about the intervention outlining the significant detriment, date the order takes effect, consultation and why it is an appropriate way of reducing detriment on its website.

A **'significant detriment'** can depend on factors such as the nature, extent or impact of the detriment (actual or potential). 'Significant detriment' is also given its ordinary meaning, covering a range of harm that may flow from the product's features, defective disclosure, poor design or inappropriate distribution.

Commissioner Hayne has recommended ASIC consider whether it should intervene in the sale of certain products if ASIC continues to hold concerns about consumer outcomes.

Preparing for DDO

Are you equipped for DDO?

Now that the legislation has been passed, **you should be thinking about**:

Product design

Whether procedure and governance arrangements adequately provide that products or services meet the financial needs, investment objectives, knowledge and experience of the target market identified by the issuer including:

- Understanding the target market's needs and capabilities;
- Defining consumers by these needs and capabilities;
- Designing products that are aligned with those needs and capabilities; and
- Only designing and bringing to the market products with features, charges, risks and distribution channels that meet the interests, objectives and characteristics of, and are of value to the identified target market?

Product distribution

- Whether your procedures are reasonable designed to ensure an appropriate distributor is chosen at the product approval stage?
- What controls are in place to review whether the distribution channels used are appropriate to the target market and correspond to what was originally envisaged?
- Do your procedures adequately provide appropriate information to distributors to enable them to:
  - Understand and place the product properly on the target market;
  - Identify the target market for which the product is designed; and
  - Provide information that needs to be communicated to the consumer?
- Are procedures in place to assess the nature and complexity of the product to determine the likely training needs and other support required by distributors?

Product monitoring

- What procedures are in place to monitor on an on-going basis that the product continues to meet the interests, objectives and characteristics of the identified target market?
- Does product monitoring consider customer claims, customer complaints, persistency and product usage?
- How often are disclosures reviewed to check that they continue to match the product or service design?
- Whether the monitoring of the product itself and monitoring of product distribution is in accordance with the target market determination?

Record keeping

- What records are currently maintained by the issuer and distributor?
- Are they readily accessible?

Preparing for DDO

How can Deloitte support you?

To get on the front foot, we can support you with conducting a current state analysis of your end-to-end product governance framework including policy, processes and controls. The new regime provides an ideal opportunity to review processes and controls and identify opportunities to enhance existing practices to support fair and suitable outcomes for customers.

This includes considering whether product issuers and/or product distributors:

1 DEFINING YOUR PRODUCT

Have procedures in place to determine:

- If the product will meet the interests, objectives and characteristics of the identified target market; and
- The product will be, and can be sold in accordance with the target market determination.

2 HEALTH CHECK DISTRIBUTION

Procedures are reasonably designed to:

- Consider the appropriate distribution strategy and distributor(s);
- Ensure an adequate and appropriate provision of information to distributors; and
- Assess the nature and complexity of the product to determine the likely training needs and other support required by distributors.

3 CHALLENGE YOUR MONITORING

Frameworks and procedures support the appropriate monitoring of products to make sure they:

- Continue to meet the financial needs, investment objectives, knowledge and experience of the target market; and
- Continue to be distributed in accordance with the target market determination.

4 CONSIDER YOUR RESPONSIVENESS

Business is equipped to:

- Respond to the range of DDO reporting requirements;
- Manage stop orders; and
- Manage any form of product intervention.

5 ONGOING PRODUCT REVIEWS

Take an appropriate data-led approach to product reviews. Product reviews should focus on reviewing the product to make sure it continues to deliver fair and suitable outcomes to the identified target market.

Preparing for DDO

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