

# Design and distribution obligations to be introduced for financial products sold to retail clients

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## Key issues:

- Design and distribution obligations on financial products sold to retail clients will come into force in under two years.
- The Australian Securities and Investments Commission (ASIC) consults on additional bans and foreshadows further use of product intervention power.

## The design and distribution obligations

Following the release of the Final Report on the Banking, Superannuation and Financial Services Royal Commission on 4 February 2019, parliament passed the *Treasury Laws Amendment (Design and Distribution Obligations and Product Intervention Powers) Act 2019* (the **Act**), which came into force on 6 April 2019. The Act provides ASIC with a proactive product intervention power to intervene where a financial or credit product has resulted, or is likely to result in, significant detriment to consumers (See our previous article [here](#) on this intervention power for further information).

In addition to the product intervention power, the Act also introduced design and distribution obligations for financial products. However, unlike the product intervention power, these are not yet in effect. Although the design and distribution obligations will not come into effect until 5 April 2021, it is important for issuers and distributors of financial products to start planning ahead to understand and ensure compliance with these obligations once they do come into force.

The design and distribution obligation regime imposes obligations on both the issuers and the distributors of financial products, fundamentally altering how financial products are distributed to Australian retail clients. These include requirements that:

1. the issuers of certain financial products create and keep under review (both periodically and pursuant to trigger events) a publically available **target market determination** for each product, with a view to ensuring that the product is appropriately distributed to its particular target market;
2. a target market determination must be made for a financial product before any person engages in 'retail product distribution' in relation to that product, which includes:
  - a. dealing in the product in relation to a retail client; and
  - b. giving a disclosure document under part 6D.2 of the *Corporations Act 2001* (Cth) (**Corporations Act**) in relation to an offer of the product to a retail client.
3. issuers and distributors of a financial product take reasonable steps to ensure that the retail distribution of any financial product is in compliance with the relevant target market determination for that product;
4. issuers and distributors must keep records of:
  - a. for **issuers**, certain decisions regarding each target market determination; and
  - b. for **distributors**, any complaints received in relation to each product; and
5. issuers must notify ASIC if they become aware of a significant dealing in relation to a retail client that is not consistent with the relevant target market determination.

There are limited exceptions for certain financial products, such as MySuper products, securities issued under an employee share scheme and most fully paid ordinary shares (but not shares in certain investment companies). Otherwise, the obligations will apply to any financial products for which a disclosure document or product disclosure statement is needed under the Corporations Act or that are regulated under the *Australian Securities and Investments Commission Act 2001* (Cth).

## Penalties

Failure to comply with the design and distribution obligations will give rise to liability under the civil penalty and offence provisions, as well as liability to specific persons who suffer loss due to the non-compliance (through a civil action).

## What should you be doing to prepare?

Whilst the commencement of the design and distribution obligations is still quite a way off, we recommend businesses start to consider whether they offer financial products that would be subject to the design and distribution obligations, and if so, what changes they would need to implement to their systems and processes in order to comply with the obligations once they take effect. We expect further guidance will be provided by ASIC and industry bodies ahead of the commencement of these obligations and also expect to see regulations enacted in support of the design and distribution obligations under the Act.

## Further product intervention orders and bans ahead

ASIC have now formally implemented the first use of its product intervention power, putting in place an industry wide product intervention order restricting a specific short term lending model which benefited from certain short term credit exemptions. We discussed this in a [previous article](#) which you can read here.

On a related note, watch out for further consultations from ASIC on additional uses of its new intervention power.

In ASIC's recently released [Report 622](#) (Consumer credit insurance: Poor value products and harmful sales practices), ASIC noted that they were considering using their product intervention power to limit the sale of consumer credit insurance products to specific classes of consumers.

Further, ASIC have recently released [Consultation Paper 322](#) (Product intervention: OTC binary options and CFDs), under which ASIC is considering a further exercise of its product intervention power to make two market-wide product intervention orders, that will:

1. prohibit the issue and distribution of over the counter (**OTC**) binary options to retail clients – binary options being TC derivatives that allow clients to make 'all or nothing' bets on the occurrence or non-occurrence of a specified event in a defined timeframe (e.g. the price of gold increasing in the next 30 seconds); and
2. imposing certain conditions on the issue and distribution of OTC contracts for difference (**CFD**) to retail clients – CFD being leveraged derivatives that allow clients to speculate on the change in value of an underlying asset.

Comments are due on the consultation paper by 1 October 2019.

ASIC have also recently closed submissions on [Consultation Paper 317](#) (Unsolicited telephone sales of direct life insurance and consumer credit insurance). Consultation Paper 317 sought feedback on a

proposal to ban unsolicited telephone sales of life insurance and consumer credit insurance when only general advice, or no advice, is given. It is anticipated this ban will commence in March 2020 and will be implemented via ASIC's modification power. This allows ASIC to declare that specified provisions of the prohibition on hawking in relation to a financial product set out in the Corporations Act be omitted, modified or varied.

If you have questions about how the product intervention power or design and distribution obligations might affect your business, or if you would like to discuss either matter further, please contact HopgoodGanim Lawyers' [Corporate Advisory and Governance](#) team.

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