

# EXPLANATORY STATEMENT

## **Issued by authority of the Treasurer**

*Corporations Act 2001*

*Corporations Amendment (Design and Distribution Obligations) Regulations 2019*

Section 1364 of the *Corporations Act 2001* (the Corporations Act) provides that the Governor-General may make regulations prescribing matters required or permitted by the Corporations Act to be prescribed, or necessary or convenient to be prescribed for carrying out or giving effect to the Corporations Act.

The *Corporations Amendment (Design and Distribution Obligations) Regulations 2019* (the Regulations) complement the operation of the *Treasury Laws Amendment (Design and Distribution Obligations and Product Intervention Powers) Act 2019* (the Act). The Act amends the Corporations Act to introduce the design and distribution obligations (the DDO) in relation to financial products. The Act also amends the Corporations Act and the *National Consumer Credit Protection Act 2009* (the Credit Act) to introduce a product intervention power for the Australian Securities and Investments Commission (ASIC) to prevent or respond to significant consumer detriment.

The purpose of the Regulations is to enhance the DDO regime by altering the products and persons in relation to which the DDO regime applies. The amendments extend the DDO to additional persons and products and exclude certain persons and products from its operation.

These Regulations extend the distribution obligations in the DDO to the following persons by prescribing them as regulated persons:

- a person that is exempt under paragraph 926B(1)(a) of the Corporations Act from the requirement in section 911A of the Corporations Act to hold an Australian financial services licence for a financial service;
- product distributors of basic deposit products, general insurance products and bundled consumer credit insurance products;
- credit licensees and credit representatives; and
- issuers of extended operation financial products (i.e. *Australian Securities and Investments Commission Act 2001* (the ASIC Act) financial products that are not financial products within the meaning of the Corporations Act).

These Regulations extend the DDO regime so that it applies in relation to the following products:

- simple corporate bonds depository interests in simple corporate bonds, where the simple corporate bonds are, or are to be, issued under a 2 part simple corporate bonds prospectus;

- debentures of a body that is an authorised deposit-taking institution (ADI) or registered under section 21 of the *Life Insurance Act 1995*;
- basic banking products;
- investor-directed portfolio services;
- exchange traded funds; and
- custodial arrangements that are not already subject to the new regime.

These Regulations exclude the following products from the DDO regime:

- interests in eligible rollover funds;
- defined benefit interests;
- medical indemnity insurance products;
- depository interests in foreign fully paid ordinary shares, if the DDO regime would not otherwise apply to the shares;
- bank drafts (and money orders issued by or for Australia Post);
- financial products not received in this jurisdiction that are not already excluded from the DDO;
- credit facilities not issued in the course of a business of providing credit;
- credit provided for business purposes;
- certain ‘credit facilities’ that do not involve the provision of credit;
- the provision of a mortgage (as distinct from the credit contract secured by the mortgage); and
- credit provided by pawnbrokers.

The Regulations also exempt an employer complying with certain superannuation guarantee obligations from the DDO regime.

The Regulations commence on the latter of the day after registration of these Regulations and the commencement of the DDO amendments in the Act (5 April 2021, the day after the end of the period of two years from when the Act received Royal Assent).

The Corporations Act does not specify any conditions that need to be met before the power to make regulations may be exercised.

Public consultation was undertaken on an earlier version of the Regulations from 23 October 2018 to 13 November 2018. Eleven submissions were received from consumer groups, industry groups and financial services entities.

Public consultation was also undertaken on a revised version of the Regulations from 12 September 2019 to 11 October 2019. The revised version reflected parliamentary amendments incorporated into the Act which extended both the DDO and product intervention powers to cover additional financial products regulated under the ASIC Act. Seventeen submissions were received from consumer groups, industry groups and financial services entities on the revised version of the Regulations. Following this consultation, changes were made to the Regulations to exclude employers from the DDO regime for certain superannuation guarantee obligations and to clarify the operation of DDO for exchange traded products.

The Treasury has undertaken a process equivalent to a Regulation Impact Statement through the Financial System Inquiry. The Financial System Inquiry 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). It is estimated that the increase in annual compliance costs for the industry as a whole associated with the Act and these Regulations will amount to \$193.2 million.

Details of the Regulations are set out in Attachment A.

A Statement of Compatibility with Human Rights is at Attachment B.

**Details of the *Corporations Amendment (Design and Distribution Obligations) Regulations 2019***

**Section 1 – Name of the Regulations**

This section provides that the name of the Regulations is the *Corporations Amendment (Design and Distribution Obligations) Regulations 2019* (the Regulations).

**Section 2 – Commencement**

The Regulations commence on the latter of the day after the Regulations are registered, and the day on which Schedule 1 to the *Treasury Laws Amendment (Design and Distribution Obligations and Product Intervention Powers) Act 2019* (the Act) commences. Schedule 1 to the Act commences on 5 April 2021, being the day after the end of the period of 2 years beginning on the day the Act received the Royal Assent.

**Section 3 – Authority**

The Regulations are made under the Corporations Act. Note that the Regulations have been made prior to the commencement of Schedule 1 to the Act in reliance on section 4 of the *Acts Interpretation Act 1901*.

**Section 4 – Schedules**

This section provides that each instrument that is specified in a Schedule to this instrument is amended or repealed as set out in the applicable items in the Schedule concerned, and any other item in a Schedule to this instrument has effect according to its terms.

**Schedule 1 – Amendments**

**Item 1**

Item 1 of Schedule 1 makes a technical amendment to the *Corporations Regulations 2001* (the Corporations Regulations) to update the definition of ‘overseas student health insurance contract’ in subregulation 7.1.07C(2) of those regulations. Previously, that definition referred to regulation 48 of the repealed *National Health Regulations 1954*.

The new definition provides that ‘overseas student health insurance contract’ has the same meaning as in Private Health Insurance Rules made for the purposes of Part 4-2 of the *Private Health Insurance Act 2007* (which is about health insurance business).

**Item 2**

Item 2 of Schedule 1 makes amendments to the Corporations Regulations. It inserts a new Part 7.8A into the Corporations Regulations which includes provisions that are related to the design and distribution obligations (the DDO) regime in Part 7.8A of the Corporations Act, which will be inserted into the Corporations Act when Schedule 1 to the Act commences.

### **Part 7.8A, Division 1 - Preliminary**

#### Item 2, Regulation 7.8A.01 – Definitions

The Regulations insert new definitions for the purposes of the new Part 7.8A of the Corporations Regulations. They provide that:

- ‘credit’ has the same meaning as in subregulation 2B(3) of the *Australian Securities and Investments Commission Regulations 2001* (the ASIC Regulations);
- ‘credit facility’ has the same meaning as in the ASIC Regulations; and
- ‘extended operation financial product’ means a financial product covered by paragraph 994AA(1)(b) of the Corporations Act.<sup>1</sup> That paragraph extends the DDO beyond financial products regulated under the Corporations Act to those that are regulated under the *Australian Securities and Investments Commission Act 2001* (ASIC Act), including credit products.

#### Item 2, Regulation 7.8A.02 – Definitions – regulated person

The Regulations extend the DDO regime by declaring that certain additional persons are regulated persons for the purposes of paragraph (c) of the definition of regulated person in subsection 994A(1) of the Corporations Act.<sup>2</sup> Regulated persons are subject to the distribution obligations when they engage in ‘retail product distribution conduct’ as defined in subsection 994A of the Corporations Act.<sup>3</sup>

#### *Persons who are exempt from having an Australian financial services licence*

The Regulations declare a person to be a regulated person in relation to a financial product if the person is exempt under paragraphs 926A(2)(a) or 926B(1)(a) of the Corporations Act from the requirement in section 911A of the Corporations Act to hold an Australian financial services licence for a financial service. (Schedule 1, item 2, subregulation 7.8A.02(2))

#### *Product distributors*

The Regulations declare authorised distributors of basic deposit products and risk insurance products (which comprise general insurance and bundled consumer credit insurance<sup>4</sup> products) to be regulated persons for the purposes of the DDO regime. This means that the distribution obligations in the DDO regime will extend to these distributors. (Schedule 1, item 2, subregulation 7.8A.02(3))

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<sup>1</sup> As will be inserted by item 5 of Schedule 1 to the Act.

<sup>2</sup> As will be inserted by item 5 of Schedule 1 to the Act.

<sup>3</sup> As will be inserted by item 5 of Schedule 1 to the Act.

<sup>4</sup> A bundled consumer credit insurance product is defined in the *ASIC Corporations (Basic Deposit and General Insurance Product Distribution) Instrument 2015/682* as a facility that is a consumer credit insurance product, as defined by regulation 7.1.15 of the Corporations Regulations, and constitutes both a general life insurance product and a life risk insurance product. This is consistent with the definition of such products used in ASIC orders.

The term ‘product distributor’ is used in the Regulations to describe the distributors affected by this extension of the DDO regime. ‘Product distributor’ is defined in section 910A of the Corporations Act as modified by the *ASIC Corporations (Basic Deposit and General Insurance Product Distribution) Instrument 2015/682*, as in force from time to time. That instrument provides relief to these distributors, so that they do not need to comply with the administrative requirements of the authorised representative regime.

Because of this relief, the distribution obligations in the DDO regime would not apply to these distributors in the absence of the Regulations. Specifically, the distribution obligations apply to ‘regulated persons’, which is defined to include ‘authorised representatives’.<sup>5</sup> However, ‘product distributors’ are not ‘authorised representatives’ due to the relief provided by the ASIC instrument. As such, the amendments made by the Regulations are necessary to ensure that these distributors are subject to the distribution obligations within the DDO regime.

#### *Credit licensees and credit representatives*

The Regulations extend the definition of regulated person to include credit licensees and credit representatives within the meaning of the *National Consumer Credit Protection Act 2009* (the Credit Act). (Schedule 1, item 2, paragraphs 7.8A.02(4)(a) and (b))

They also extend the definition of regulated person to a person who is exempt from the obligation to hold a credit licence under section 29 of the Credit Act because of an exemption under paragraphs 109(1)(a), 109(3)(a) and 110(a) of the Credit Act. (Schedule 1, item 2, paragraph 7.8A.02(4)(c))

They also extend the definition of regulated person to include persons who engage in credit activity (within the meaning of section 6 of the Credit Act) on their own behalf. (Schedule 1, item 2, paragraphs 7.8A.02(4)(d))

They also extend the definition of regulated person to a person who contravenes section 29 of the Credit Act which prohibits a person from engaging in credit activities without a licence authorising the person to engage in the credit activity. (Schedule 1, item 2, paragraph 7.8A.02(4)(e))

These provisions ensure that equivalent distribution obligations apply to credit licensees and credit representatives as apply to Australian financial services licensees and their authorised representatives.

#### *Issuers and sellers of extended operation financial products*

The Regulations extend the definition of regulated person to include issuers of extended operation financial products and sellers of extended operation financial products under a regulated sale. This means that a person who issues an extended operation financial product and such sellers of ‘extended operation financial products’ must comply with the distribution obligations when engaging in retail product distribution conduct. (Schedule 1, item 2, subregulation 7.8A.02(5))

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<sup>5</sup> See paragraph (d) of the definition of regulated person in section 1011B of the Corporations Act, and paragraph (b) of the definition of regulated person in subsection 994A of the Corporations Act, as will be inserted by item 5 of Schedule 1 to the Act.

## **Part 7.8A, Division 2 - Financial products for which target market determinations are required**

Division 2 of Part 7.8A<sup>6</sup> requires target market determinations to be made for the following products:

- 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 ('depository interests in simple corporate bonds');
- debentures of a body that is an ADI or registered under section 21 of the *Life Insurance Act 1995*;
- basic banking products (as defined in the Corporations Act);
- investor directed portfolio services (IDPS);
- exchange traded funds (ETF); and
- certain custodial arrangements.

This has the effect that these products will be subject to the DDO regime.

This Division is made for the purposes of paragraphs 994B(1)(c) and 994B(2)(b) of the Corporations Act.<sup>7</sup>

### *Jurisdictional scope of Division*

This Division only applies in relation to financial products that are available for acquisition by issue or by regulated sale in this jurisdiction. (Schedule 1, item 2, paragraph 7.8A.04(1)(a))

This ensures that the scope of the subregulation is consistent with that of the obligation to make a target market determination under the Act. Under the Act, a target market determination must be prepared for a financial product where, under Part 6D.2 of the Corporations Act, a person is required to prepare a disclosure document for the product, or, under Part 7.9 of the Corporations Act, the person is required to prepare a Product Disclosure Statement for the product.<sup>8</sup> However, the geographical coverage of these obligations is limited to this jurisdiction by subsection 700(4) and section 1011A of the Corporations Act respectively.

This Division does not apply to securities offered under a recognised offer in relation to a recognised jurisdiction. This ensures that the scope of this Division is consistent with that of the obligation to make a target market determination under the Act. (Schedule 1, item 2, paragraph 7.8A.04(1)(b))

'Recognised jurisdiction', 'recognised offer' and 'securities' have the meanings given by subsection 1200A(1) of the Act. (Schedule 1, item 2, subregulation 7.8A.04(2), definitions of 'recognised jurisdiction', 'recognised offer' and 'securities')

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<sup>6</sup> As will be inserted by item 5 of Schedule 1 to the Act.

<sup>7</sup> As will be inserted by item 5 of Schedule 1 to the Act.

<sup>8</sup> As will be inserted by item 5 of Schedule 1 to the Act.

Recognised offers are exempt from the requirement to make a target market determination under the Act because they are not subject to the requirement in Part 6D.2 of the Corporations Act to prepare a disclosure document or the requirement in Part 7.9 to prepare a Product Disclosure Statement.<sup>9</sup> The exemption applies to recognised offers of shares, debentures, and interests in managed investment schemes (or rights, interests or options in them) where the recognised offer is in relation to a recognised jurisdiction. This reflects that such offers are subject to the mutual recognition scheme in Chapter 8 of the Corporations Act.

### *Simple corporate bonds*

The Regulations apply the DDO regime in Part 7.8A of the Corporations Act to simple corporate bonds depository interests, which are defined in section 9 of the Corporations Act.<sup>10</sup> In particular, the Regulations extend the obligation to make a target market determination under Part 7.8A of the Corporations Act to simple corporate bonds depository interests. The issuer of the depository interest must make the target market determination before any person engages in 'retail product distribution conduct'.<sup>11</sup> (Schedule 1, item 2, regulation 7.8A.05)

Simple corporate bonds are bonds that meet the legislative criteria set out in section 713A of the Corporations Act. A depository interest in a simple corporate bond is a beneficial interest in the bond that is issued by the acquirer of the bond (a 'depository nominee') to a retail client, with the permission of the issuer.

Without the amendments made by the Regulations, depository interests in simple corporate bonds would not be subject to the DDO regime. In relation to securities, the DDO regime generally applies to offers of products that require disclosure under Part 6D.2 of the Corporations Act.<sup>12</sup> However, simple corporate bonds depository interests where the simple corporate bonds were issued under a 2-part simple corporate bonds prospectus are excluded from this disclosure regime by paragraph 700(1)(b) of the Corporations Act.

### *Debentures of certain bodies*

The Regulations extend the target market determination obligation to debentures<sup>13</sup> of a body that is an ADI within the meaning of the *Banking Act 1959* or a body that is registered under section 21 of the *Life Insurance Act 1995*. The issuer<sup>14</sup> of the debenture must make the target market determination before any person engages in 'retail product distribution conduct'.<sup>15</sup> (Schedule 1, item 2, regulation 7.8A.05)

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<sup>9</sup> See subsection 1200F(1) of the Corporations Act.

<sup>10</sup> As will be inserted by item 5 of Schedule 1 to the Act.

<sup>11</sup> Subparagraph 994B(2)(b)(ii) of the Corporations Act, as will be inserted by item 5 of Schedule 1 to the Act, provides that, if there is no time or event specified for a particular financial product that regulations declare a target market determination must be made for, the target market determination must be made before any person engages in retail product distribution conduct in relation to the product.

<sup>12</sup> Section 994B of the Corporations Act, as will be inserted by item 5 of Schedule 1 to the Act.

<sup>13</sup> What constitutes a debenture is defined in section 9 of the Corporations Act.

<sup>14</sup> Issuer has a meaning affected by section 761E of the Corporations Act (see section 761A of the Corporations Act).

<sup>15</sup> Subparagraph 994B(2)(b)(ii) of the Corporations Act, as will be inserted by item 5 of Schedule 1 to the Act, provides that, if there is no time or event specified for a particular financial product that



Without the amendments made by the Regulations, offers of debentures of a body that is an ADI or registered under section 21 of the *Life Insurance Act 1995* would not be subject to the DDO regime. In relation to securities, the DDO regime generally applies to offers of products that require disclosure under Part 6D.2 of the Corporations Act.<sup>16</sup> Offers of these debentures are exempted from needing such disclosure by subsection 708(19) of the Corporations Act.

These obligations are only extended to debentures for which a person would be required to prepare a disclosure document under Part 6D.2 of the Corporations Act if subsection 708(19) of the Corporations Act did not apply.<sup>17</sup> This ensures that the obligations are not extended to wholesale issuances that do not require disclosure to investors. (Schedule 1, item 2, paragraph 7.8A.06(b))

### *Basic banking products*

The Regulations extend the obligation to make a target market determination to a basic banking product within the meaning of section 961F of the Corporations Act. The issuer of the product must make the target market determination before any person engages in ‘retail product distribution conduct’.<sup>18</sup> (Schedule 1, item 2, regulation 7.8A.07)

A basic banking product includes a basic deposit product (which is defined in section 761A of the Corporations Act), a facility for making non-cash payments, a facility for providing traveller’s cheques and any other product prescribed by the Corporations Regulations for the purposes of that definition.

Without the amendments made by the Regulations, basic banking products would not be subject to the DDO regime. In relation to financial products which are not securities but are regulated under the Corporations Act, the DDO regime generally applies in relation to products that require disclosure under Part 7.9 of the Corporations Act.<sup>19</sup> Under regulation 7.9.07FA of the Corporations Regulations, such disclosure is not required for most basic banking products when specified conditions are met.

### *Investor-directed portfolio services (IDPS)*

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regulations declare a target market determination must be made for, the target market determination must be made before any person engages in retail product distribution conduct in relation to the product.

<sup>16</sup> Section 994B of the Corporations Act, as will be inserted by item 5 of Schedule 1 to the Act.

<sup>17</sup> Subsection 708(19) is the carve-out for the requirement to give a disclosure document for ADIs. If it did not apply, wholesale issuances of debentures would avoid the disclosure requirement through other exemptions (e.g. for sophisticated and professional investors), but where the product is issued to retail clients a disclosure document would be required, triggering the requirement to make a target market determination under the Act.

<sup>18</sup> Subparagraph 994B(2)(b)(ii) of the Corporations Act, as will be inserted by item 5 of Schedule 1 to the Act, provides that, if there is no time or event specified for a particular financial product that regulations declare a target market determination must be made for, the target market determination must be made before any person engages in retail product distribution conduct in relation to the product.

<sup>19</sup> Section 994B of the Corporations Act as will be inserted by item 5 of Schedule 1 to the Act.

An IDPS is an unregistered managed investment scheme for holding and dealing with investments selected by investors. In broad terms, it provides custodial, transactional and reporting services where the investor makes all of the investment decisions.

Under regulation 7.8A.08, IDPS operators:

- are not required make a target market determination in relation to financial products offered or available on their platform (unless they are themselves the issuer); however
- they are required to make a target market determination in relation to the platform itself (as the platform is a separate financial product).

Without the amendments made by the Regulations, IDPSs would not generally be subject to DDO regime. In relation to financial products which are not securities but are regulated under the Corporations Act, the DDO regime generally applies in relation to products that require disclosure under Part 7.9 of the Corporations Act.<sup>20</sup> Under ASIC Class Order [CO 13/763], such disclosure is not required in relation to IDPSs when certain conditions are met by IDPS operators.<sup>21</sup>

The Regulations extend the obligation to make a target market determination to a financial product that is an interest in a managed investment scheme, where the interest arises out of participation or proposed participation in an IDPS but is not IDPS property. The operator of the IDPS must make the target market determination before any person engages in ‘retail product distribution conduct’.<sup>22</sup> (Schedule 1, item 2, regulation 7.8A.08)

In this Regulation, an IDPS, IDPS property and an operator of an IDPS are defined by reference to the meanings of those terms as set out in ASIC Class Order [CO 13/763], as in force from time to time.<sup>23</sup> This ensures that the obligation to make a target market determination only extends to IDPSs and operators that are covered by the relief from disclosure given by the order. (Schedule 1, item 2, subregulation 7.8A.08(2), definitions of ‘IDPS’, ‘IDPS property’ and ‘operator’)

#### *Exchange traded products*

Regulation 7.8A.09 provides that an issuer must make a target market determination for an exchange traded product that is designed to be sold to a retail client. The target market determination is to be made by the end of the day on which the product is first issued.

This Regulation applies in circumstances where:

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<sup>20</sup> Section 994B of the Corporations Act as will be inserted by item 5 of Schedule 1 to the Act.

<sup>21</sup> IDPSs that do require disclosure are already subject to the DDO and not captured by the regulation (an IDPS may require disclosure because it does not satisfy the terms of the ASIC relief).

<sup>22</sup> Paragraph 994B(2)(b)(ii) of the Corporations Act, as will be inserted by item 5 of Schedule 1 to the Act, provides that, if there is no time or event specified for a particular financial product that regulations declare a target market determination must be made for, the target market determination must be made before any person engages in retail product distribution conduct in relation to the product.

<sup>23</sup> The definitions of IDPS and IDPS operator are in subsection 912AD(42) of the Corporations Act as modified by that order.

- the product is an interest in a managed investment scheme or a share in certain investment companies registered with the U.S. Securities and Exchange Commission (and related products) that is or will be able to be traded on a licenced market. This is drafted to be consistent with the definition of exchange traded funds used in the *ASIC Corporations (Short Selling) Instrument 2018/745*;
- the issuer issued the product with the purpose of the person to whom it was issued selling or transferring the product, or granting, issuing or transferring interests in or options or warrants over the product (this is the purpose mentioned in subparagraph 1012C(6)(c)(i) of the Act, which is also affected by subsection 1012C(7) of the Act in determining whether the issuer had this purpose); and
- it is reasonably likely that a regulated person will offer to sell the product to a person as a retail client within 12 months of the issue of the product.

This Regulation is intended to address any uncertainty that the issuer is required to make a target market determination in these circumstances, noting issuers of exchange traded products will often issue the product to another wholesale client in the first instance. Issuers of exchange traded products such as exchange traded funds should have the responsibility to issue a target market determination in relation to the product, as they design the product and are therefore well placed to determine the target market for the product.

This Regulation does not apply to a financial product if the issuer issued, or offered to issue, the product to a person as a retail client at or before close of business on the day on which the issuer first issues the product. This is because, if the issuer issues a product directly to a retail client they will be required to issue a Product Disclosure Statement under section 1012B of the Corporations Act, which means that the obligation to issue a target market determination will already apply. (Schedule 1, item 2, subregulation 7.8A.09(3))

#### *Custodial or depository services*

The Regulations extend the obligation to make a target market determination to a financial product that includes a custodial or depository service that is provided to a retail client. The issuer of the product must make the target market determination before any person engages in ‘retail product distribution conduct’.<sup>24</sup> (Schedule 1, item 2, regulation 7.8A.10)

A custodial or depository service is an arrangement where a provider holds financial products or interests on trust or on behalf of a client or the client’s nominee. A financial product that includes such a service may be anything that meets the

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<sup>24</sup> Paragraph 994B(2)(b)(ii) of the Corporations Act, as will be inserted by item 5 of Schedule 1 to the Act, provides that, if there is no time or event specified for a particular financial product that regulations declare a target market determination must be made for, the target market determination must be made before any person engages in retail product distribution conduct in relation to the product.

definition of a financial product in Division 3 of Part 7.1 of Chapter 7 of the Corporations Act and also includes the provision of those services.

An example of such a product is an arrangement where a provider manages a client's portfolio of assets on behalf of a retail client on an individual basis at the provider's discretion. The arrangement would be a financial product as it would fall within the definition of a financial investment in section 763B of the Corporations Act by virtue of the provider using the arrangement to generate a return for the investor; and would include the provision of a custodial or depository services through the terms of the arrangement which allow the provider to hold the assets on the client's behalf.

The amendments made by the Regulations only extend the DDO regime to financial products that include a custodial or depository service where those products would not otherwise be subject to DDO regime. Such a product would generally not be subject to the DDO regime if it does not require disclosure under Part 7.9 of the Corporations Act, for example, because of ASIC relief from the relevant disclosure obligations.

### **Part 7.8A, Division 3 - Exemptions**

Division 3 of new Part 7.8A of the Corporations Regulations excludes the following financial products from the requirement to make a target market determination under Part 7.8A of the Corporations Act<sup>25</sup> in relation to a financial product (Schedule 1, item 2, subregulation 7.8A.20(1)). This has the effect that the DDO regime will not apply to these products.

This Division prescribes financial products for the purposes of paragraph 994B(3)(f) of the Corporations Act.<sup>26</sup>

#### *Superannuation – Eligible rollover funds (ERF)*

The Regulations exempt interests in ERF, as defined in the *Superannuation Industry (Supervision) Act 1993*, from the requirement to make a target market determination in Part 7.8A of the Corporations Act.<sup>27</sup> (Schedule 1, item 2, subregulation 7.8A.20(2))

Superannuation funds are required by law to nominate an ERF to hold the balances of their lost or ineligible members. ERF are intended to be a temporary repository for transferred super benefits, with the expectation that members will find their lost superannuation and transfer their balances to their main super account. ERF are regulated and tend to rely on passive investment strategies with no fees.

Given that ERF are required by law and operate in circumstances such as where contact has been lost with the account holder (e.g. inactive accounts), it is not necessary to apply the DDO regime in relation to them.

#### *Superannuation - defined benefit interests*

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<sup>25</sup> As will be inserted by item 5 of Schedule 1 to the Act.

<sup>26</sup> As will be inserted by item 5 of Schedule 1 to the Act.

<sup>27</sup> See subsections 994B(1) and (2) of the Corporations Act as will be inserted by item 5 of Schedule 1 to the Act.

The Regulations exempt defined benefit interests, as defined in the *Superannuation Industry (Supervision) Regulations 1994*, from the requirement to provide a target market determination under Part 7.8A of the Corporations Act.<sup>28</sup> This exemption applies in relation to superannuation interests that are defined benefit in nature only. Where a superannuation fund issues both defined benefit interests and other interests, the exemption only applies with respect to the defined benefit interests. (Schedule 1, item 2, subregulation 7.8A.20(3))

A defined benefit interest is defined in regulation 1.03AA of the *Superannuation Industry (Supervision) Regulations 1994* as: a superannuation interest where benefits are payable by reference to salary, specified amounts or specified factors; or an unfunded public sector superannuation scheme with at least one defined benefit member.

Offers of defined benefit interests are only available through employer arrangements. As such, it is unlikely that such interests are inappropriately distributed. It is not necessary to apply the DDO in relation to those interests.

#### *Insurance products - medical indemnity insurance*

The Regulations exempt medical indemnity insurance products from the requirement to provide a target market determination in Part 7.8A of the Corporations Act.<sup>29</sup> (Schedule 1, item 2, subregulation 7.8A.20(4))

A ‘medical indemnity insurance product’ is currently defined in regulation 1.0.02 of the Corporations Regulations. That regulation defines medical indemnity insurance product to mean an arrangement to which the *Medical Indemnity (Prudential Supervision and Product Standards) Act 2003* applies, under which medical indemnity cover is provided to a medical practitioner as defined in section 4 of that Act or to a registered health professional prescribed under that Act.

Medical indemnity insurance is already subject to an existing regulatory regime and has a target market that is obliged to purchase the product. Therefore, it is not necessary to apply the DDO regime to medical indemnity insurance.

#### *Depository interests in foreign fully paid ordinary shares*

The Regulations exempt depository interests in foreign fully paid ordinary shares from the requirement to make a target market determination under Part 7.8A of the Corporations Act.<sup>30</sup> However, the exemption only operates where the requirement (and Part 7.8A of the Corporations Act more generally) would not apply if the shares were offered directly to retail clients. (Schedule 1, item 2, subregulation 7.8A.20(5))

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<sup>28</sup> See subsections 994B(1) and (2) of the Corporations Act as will be inserted by item 5 of Schedule 1 to the Act.

<sup>29</sup> See subsections 994B(1) and (2) of the Corporations Act as will be inserted by item 5 of Schedule 1 to the Act.

<sup>30</sup> See subsections 994B(1) and (2) of the Corporations Act as will be inserted by item 5 of Schedule 1 to the Act.

Foreign fully paid ordinary shares are already exempt from the DDO regime, except in circumstances described in subsection 994B(4) of the Corporations Act. Depository interests covers interests or units of beneficial ownership in fully paid ordinary shares in a foreign company that is listed on a licensed market, where the interests or units are issued for the purpose of enabling the ordinary shares to be recorded and transferred in accordance with the operating rules of the licensed market. Depository interests in those shares are a means by which foreign shares are held and traded, and so are exempted on the same basis.

*Money products - bank drafts and Australia Post money orders*

The Regulations exempt bank drafts, including (but not limited to) a cheque drawn by a financial institution on itself or a cheque drawn by a financial institution on a financial institution other than itself, from the DDO regime. Similarly, a money order issued as a money order by or for Australia Post is carved out of the DDO regime. (Schedule 1, item 2, subregulations 7.8A.20(6) and (7))

*Extended operation financial products not received in this jurisdiction*

The Regulations also ensure that the DDO regime only applies to products if the offer to issue or sell the product is received in this jurisdiction. The regime excludes extended operation financial products where offers are not received in this jurisdiction. This limit already applies to other financial products covered by the DDO regime, being financial products requiring disclosure under Chapter 6D.2 and Part 7.9 of the Corporations Act (see subsection 700(4) and section 1011A of the Corporations Act). (Schedule 1, item 2, subregulation 7.8A.20(8))

*Credit facilities - provision of credit not issued in the course of a business of providing credit*

The Regulations exempt a credit facility that is not issued in the course of a business that is wholly or partly a business of providing credit. This excludes from the operation of the DDO regime individuals that provide credit for social or family reasons (for example, a parent that lends money to a child) and credit that is merely incidental to the operation of a non-credit business.

This is necessary given the breadth of the arrangements in the definition of credit facility in the ASIC Regulations. (Schedule 1, item 2, paragraph 7.8A.20(9)(a))

*Credit provided for business purposes*

The Regulations exempt from the scope of the DDO regime a credit facility (within the meaning of the ASIC Regulations) under the terms of which the credit is, or must be, applied wholly or predominantly for business purposes. This means that business loans and other credit provided for business purposes are outside of the scope of the DDO regime. Business purpose does not include lending for personal, domestic or household purposes. (Schedule 1, item 2, paragraph 7.8A.20(9)(b))

*Credit facilities that do not involve the provision of credit*

Paragraph (b) of the definition of credit in the ASIC Regulations (see subregulation 2B(1)) lists a number of arrangements that fall within the definition of credit and

therefore within the definition of a financial product for the purposes of the ASIC Act. This item ensures that these arrangements will only be covered by the DDO regime when they also fall within paragraph (a) of the definition of credit. That is, the arrangements listed in paragraph (b) must also involve the incurring of a deferred debt or payment of a deferred debt to fall within the scope of the DDO regime. This is necessary given the breadth of the arrangements listed in paragraph (b) of the definition of credit facility in subregulation 2B(1) of the ASIC Regulations. (Schedule 1, item 2, paragraph 7.8A.20(9)(c))

#### *Credit facilities - the provision of a mortgage*

The Regulations exclude the provision of mortgages from the scope of the DDO regime. This carve out only extends to the provision of the mortgage itself. For example, where a loan is secured by a mortgage over a property, the loan itself may still be subject to the DDO regime, however, the mortgage will not be, noting that the mortgage is generally provided by the person taking out the credit (as opposed to the credit provider). (Schedule 1, item 2, paragraph 7.8A.20(9)(d))

#### *Credit facilities - pawnbroking*

The Regulations exclude pawnbroking from the scope of the DDO regime on the basis that the regulation of pawnbroking is the responsibility of States and Territories.

Pawnbroking is defined as a credit facility (within the meaning of the ASIC Regulations) that involves the provision of credit by a pawnbroker in the ordinary course of a pawnbroker's business (being a business which is being lawfully conducted by the pawnbroker). (Schedule 1, item 2, paragraph 7.8A.20(9)(e))

#### *Exemption from Part 7.8A – Employers complying with certain superannuation guarantee obligations*

The Regulations exempt employers from Part 7.8A<sup>31</sup> where the employer is complying with certain superannuation guarantee obligations.

Regulation 7.8A.25 provides that an employer is not subject to the design and distribution obligations in engaging in a transaction that involves specified retail product distribution conduct that relates to a financial product that is, or will be, an interest in the chosen fund of the employee or the employer's default fund (i.e. an interest in a fund to which paragraph 32C(2)(ba) of the *Superannuation Guarantee (Administration) Act 1992* applies).

The exempted conduct is:

- an employer giving the employee a Product Disclosure Statement for a product that is a default fund product for the employer and employee;
- an employer paying contributions on behalf of the employee into a product that is a default fund product for the employer and employee or a chosen fund product for the employee; and

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<sup>31</sup> As will be inserted by item 5 of Schedule 1 to the Act.

- a dealing in a financial product that consists only of the employer arranging for the issue to the employee of a product that is a default fund product for the employer and employee or a chosen fund product for the employee.

In this regulation, chosen fund product and default fund product are defined by reference to the *Superannuation Guarantee (Administration) Act 1992*.

Absent this Regulation, employers would be brought into the DDO regime as a regulated person because the definition of regulated person (see section 994A<sup>32</sup> and section 1011B of the Corporations Act) includes a person who is exempt from the obligation to hold an Australian financial services licence because of paragraph 911A(2)(k) of the Corporations Act. Employers utilise exemptions made under paragraph 911A(2)(k) in relation to dealings with their employees superannuation arrangements.<sup>33</sup>

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<sup>32</sup> As will be inserted by item 5 of Schedule 1 to the Act.

<sup>33</sup> In particular, see paragraphs 7.6.01(1)(h) and 7.6.01(1)(hc) of the Corporations Regulations.



**Statement of Compatibility with Human Rights**

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

***Corporations Amendment (Design and Distribution Obligations) Regulations 2019***

This Legislative Instrument 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 of the Legislative Instrument**

The Regulations complement the operation of the *Treasury Laws Amendment (Design and Distribution Obligations and Product Intervention Powers) Act 2019* (the Act).

The purpose of the Regulations is to enhance the DDO regime by altering the products and persons in relation to which the DDO regime applies. The amendments extend the DDO to additional persons and products and exclude certain persons and products from its operation.

These Regulations extend the distribution obligations in the DDO to the following persons by prescribing them as regulated persons:

- a person that is exempt under paragraph 926B(1)(a) of the Corporations Act from the requirement in section 911A of the Corporations Act to hold an Australian financial services licence for a financial service;
- product distributors of basic deposit products, general insurance products and bundled consumer credit insurance products;
- credit licensees and credit representatives; and
- issuers of extended operation financial products (i.e. ASIC Act financial products that are not financial products within the meaning of the Corporations Act).

These Regulations extend the DDO regime so that it applies in relation to the following products:

- simple corporate bonds depository interests in simple corporate bonds, where the simple corporate bonds are, or are to be, issued under a 2 part simple corporate bonds prospectus;
- debentures of a body that is an ADI or registered under section 21 of the *Life Insurance Act 1995*;
- basic banking products;
- investor-directed portfolio services;
- exchange traded funds; and

- custodial arrangements that are not already subject to the new regime.

These Regulations exclude the following products from the DDO regime:

- interests in eligible rollover funds;
- defined benefit interests;
- medical indemnity insurance products;
- depository interests in foreign fully paid ordinary shares, if the DDO regime would not otherwise apply to the shares;
- bank drafts (and money orders issued by or for Australia Post);
- financial products not received in this jurisdiction that are not already excluded from the DDO;
- credit facilities not issued in the course of a business of providing credit;
- credit provided for business purposes;
- certain ‘credit facilities’ that do not involve the provision of credit;
- the provision of a mortgage (as distinct from the credit contract secured by the mortgage); and
- credit provided by pawnbrokers.

The Regulations also exempt an employer complying with certain superannuation guarantee obligations from the DDO regime.

The Regulations commence on the latter of the day after registration of these Regulations and the commencement of the DDO amendments in the Act (5 April 2021, the day after the end of the period of two years from when the Act received Royal Assent).

### **Human rights implications**

The human rights implications of this legislative instrument are the same as those in the Act. Those implications are the same because this instrument merely extends and restricts the application of the obligations in that Act with respect to specified people and specified financial products. The implications are therefore also discussed in the Statement of Compatibility with Human Rights prepared for the *Treasury Laws Amendment (Design and Distribution Obligations and Product Intervention Powers) Bill 2018*.

Therefore, as with the Act, this legislative instrument 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**

Paragraph 2 of Article 14 of the International Covenant 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>34</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*

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

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>35</sup>, offence specific defences in the Act are made explicit through words of exception and exemption.

The evidential burden in those defences has been reversed in the Act 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.

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.

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.

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*

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

The Act allows ASIC to request information from offerors and distributors for the purposes of administering the regime. This includes information related to the

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<sup>34</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>35</sup> Attorney-General’s Department, September 2011 edition.

person's decisions in relation to key obligations in the Act, 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.

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.

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.

The Act 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 Act engages the right against self-incrimination.

#### Engagement of the right to privacy

Article 17 of the 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.
- The Act 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.

Each of these aspects of the Act is directed at ensuring information about how products are distributed can be used to improve product design. The Act 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.

As such, it is unlikely that the Act, and, by extension, this Legislative Instrument engages the right to privacy.

## **Conclusion**

This Legislative Instrument is compatible with human rights. It engages, or may engage the presumption of innocence and the right to privacy. However, to the extent the regime 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.