



ASIC
Australian Securities &
Investments Commission

Explanatory Statement

ASIC Corporations (Design and Distribution Obligations—Exchange Traded Products) Instrument 2020/1090

This is the Explanatory Statement for *ASIC Corporations (Design and Distribution Obligations—Exchange Traded Products) Instrument 2020/1090*.

The Explanatory Statement is approved by the Australian Securities and Investments Commission (*ASIC*).

Summary

1. This instrument is intended to provide clarity and consistency in the application of the design and distribution obligations, contained in Part 7.8A of the *Corporation Act 2001* (the *Act*), to exchange traded products (*ETPs*). The instrument applies to issuers of ETPs that are covered by the obligations under s994B(1)(a) or (b) of the Act or reg 7.8A.09 of the *Corporations Regulations 2001* (the *Regulations*), as well as to distributors of ETPs.
2. The instrument notionally modifies certain provisions within Part 7.8A of the Act as well as within the Regulations. These notional modifications clarify that issuers and distributors of ETPs will be subject to the same obligations where their products are acquired on a financial market regardless of whether the relevant issuer utilises an internal market making (*IMM*) or external market making (*EMM*) structure.
3. The instrument clarifies that while issuers of ETPs will be required to review their target market determinations (*TMDs*) as necessary to ensure they remain appropriate, they will not be required to cease distributing while they carry out that review, recognising practical difficulties in doing so where a product is continually issued on a financial market. In addition, distributors of ETPs will be required to comply with certain record keeping and reporting obligations under the regime, recognising that this is necessary to provide issuers with information that will assist them in complying with their review obligations.

Background

4. In April 2019, the *Treasury Laws Amendment (Design and Distribution Obligations and Product Intervention Powers) Act 2019* introduced design and distribution obligations to Chapter 7 of the Act.

-
5. The design and distribution obligations are intended 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.
 6. The *design* obligations require issuers of financial products to:
 - (a) make a publicly available TMD;
 - (b) take reasonable steps so that retail product distribution conduct is consistent with the TMD;
 - (c) review the TMD as required to ensure it remains appropriate; and
 - (d) notify ASIC of any significant dealings in a product that are not consistent with the product's TMD.
 7. The *distribution* obligations require distributors of financial products:
 - (a) not to engage in retail product distribution conduct in relation to a product unless a TMD has been made;
 - (b) not to engage in retail product distribution conduct where a TMD may no longer be appropriate;
 - (c) to take reasonable steps so that retail product distribution conduct is consistent with the TMD;
 - (d) to collect information specified by the issuer and complaints related to a product and provide both to the issuer; and
 - (e) to notify the issuer of a product of any significant dealings in the product that are not consistent with the product's TMD.
 8. The design and distribution obligations generally apply to products for which a Product Disclosure Statement (*PDS*) or disclosure document must be prepared under Parts 7.9 and 6D.2 of the Act, as well as products that are not regulated under Parts 7.9 or 6D.2 but that are 'financial products' under Division 2 of Part 2 of the *Australian Securities and Investments Commission Act 2001*. The [Corporations Amendment \(Design and Distribution Obligations\) Regulations 2019](#) enhance the regime by altering the products and persons in relation to which the design and distribution obligations apply.
 9. The design and distribution obligations cease to apply if the product is no longer available to consumers by way of primary or initial offering. Paragraph 1.45 of the [Revised Explanatory Memorandum for the Treasury Laws Amendment \(Design and Distribution Obligations and Product Intervention Powers\) Bill 2019 \(Revised Explanatory Memorandum\)](#) explains:

‘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.’

10. Unlike closed-ended funds such as listed investment companies (which tend to carry out an initial offering of their product that is then able to be traded on a financial market), ETPs are open-ended, with issuers having the power and approval to continuously issue new products that are quoted.
11. An ETP’s open-ended structure allows the issuer of an ETP to issue and redeem units on a daily basis resulting in the number of units on issue fluctuating depending on investor demand. An ETP issuer may utilise EMM or IMM structures. Under the EMM structure, units are first issued to a wholesale client (a participant in relation to a financial market) prior to being sold on the financial market, including to retail clients. Under the IMM structure, a participant in relation to a financial market is appointed as the issuer’s agent to facilitate the issue of units on the financial market. In some circumstances, issuers of ETPs issue their product to consumers off-market.
12. The Regulations clarify that an issuer of an ETP must make a TMD for an ETP that is designed to be sold to a retail client: see reg 7.8A.09. The [Explanatory Statement for Corporations Amendment \(Design and Distribution Obligations\) Regulations 2019](#) at page 11 explains that reg 7.8A.09:

‘...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.’
13. Despite reg 7.8A.09, there remained uncertainty and inconsistency in application of the design and distribution obligations to these products. In particular there was uncertainty as to whether there was a ‘regulated sale’ as defined in s994A(1) in circumstances where an ETP issuer utilised an EMM structure. Additionally, there was uncertainty for ETP issuers who utilised IMM structures that involve a direct issuance to retail clients, facilitated by the issuer’s agent (as opposed to an on-sale by a wholesale client).
14. The design and distribution obligations do not apply equally in relation to ETPs utilising different market making structures. For ETP issuers utilising IMM structures, and distributors engaging in retail product distribution conduct in relation to these products, the design and distribution obligations would apply in full. However, issuers of ETPs utilising EMM structures would not involve a ‘regulated sale’ as defined in s994A(1), accordingly certain obligations (such as the obligation review a TMD periodically, where a review trigger has occurred, or where an event or circumstance has occurred that would reasonably suggest that the determination is no longer appropriate: see s994C(2)-(4)) would not apply to these issuers. Distributors engaging in retail product distribution

conduct in relation to these products would not be subject to any obligations: see ss994D, 994E(3), and 994F(2).

15. Further, issuers of ETPs faced practical difficulties in complying with certain obligations where a product is continually issued and traded on a financial market – such as the obligation to cease retail product distribution conduct where a review trigger has occurred or where an event or circumstance has occurred that would reasonably suggest that the TMD is no longer appropriate. They also identified difficulties in complying with review obligations in circumstances where distributors were not required to provide them with information regarding consumer outcomes.

Purpose

16. The instrument is intended to provide certainty and consistency in relation to the application of the design and distribution obligations to issuers and distributors of ETPs.

Consultation

17. ASIC consulted on its guidance on the design and distribution obligations in Consultation Paper 325 [*Product design and distribution obligations*](#) in December 2019, with consultation closing on 11 March 2020. During consultation, interested stakeholders raised queries about how the obligations would apply to ETP issuers, as well intermediaries involved in distribution, such as brokers, authorised participants and trading agents appointed by the issuer.
18. Following initial consultation, ASIC carried out further targeted consultation in August 2020 in relation to the application of the regime to ETPs. Specifically, ASIC noted in its consultation that it proposes to exercise its declaration powers under the design and distribution obligations legislation to modify the application of certain provisions to achieve the legislative intent and to provide certainty to issuers and distributors of ETPs, when these products are acquired on a financial market.
19. Having regard to the feedback obtained through consultation, ASIC determined that it would make the instrument, as well as provide further guidance in this area.

Operation of the instrument

20. An “exchange traded fund” means an investment vehicle where:
 - (a) ETPs of the investment vehicle are in a class that are, or will be, able to be traded on a licensed market;
 - (b) the operator has the power and approval to issue ETPs in that class on any day that those financial products are able to be traded on the relevant financial market;
 - (c) the operator allows applications for and redemptions of ETPs in that class;

-
- (d) the price or value of the financial product, index, currency, commodity or other thing that the investment vehicle invests in or tracks is continuously disclosed or can be immediately ascertained.
21. An exchange traded fund could be structured as either a managed investment scheme or a foreign company which has the economic features of a managed investment scheme and is an open-ended investment company registered with the U.S. Securities and Exchange Commission under the *Investment Company Act 1940* of the United States of America.
22. An ETP is defined in the instrument as an interest in an exchange traded fund, a share in an exchange traded fund or a legal or equitable right or interest in such an interest or share.
23. The instrument modifies the application of the design and distribution obligations to issuers and distributors of ETPs.
24. Section 5 of the instrument provides that Part 7.8A of the Act applies in relation to an ETP as if certain provisions were modified or varied as follows.

Target market determinations for financial products

- (a) Paragraph 5(1)(a) of the instrument modifies s994B(8) of the Act, which relates to the requirement for a TMD to be such that it would be reasonable to conclude that if sold to a retail client in accordance with the distribution conditions, it would be likely that the retail client is in the target market, and likely consistent with the likely objectives, financial situation and needs of a retail client in the target market. This modification provides certainty in relation to the application of s994B(8) in circumstances where an ETP issuer is required to make a TMD as a result of reg 7.8A.09. That is where it issues the product to another wholesale client in the first instance.

Target market determinations to be reviewed

- (b) Paragraphs 5(1)(b) and (c) of the instrument modify s994C of the Act, which relates to the requirement to review TMDs. The modification provides certainty that issuers of ETPs are required to review TMDs periodically or when necessary, and ensures that consistent obligations apply where these products are traded on financial markets. However, issuers will not be prohibited from engaging in, or required to take reasonable steps to ensure that others do not engage in retail product distribution conduct when issuers are required to undertake such reviews. This recognises the practical difficulties associated with ceasing distribution in circumstances where a product is being acquired by retail clients on a financial market.
- (c) Similarly, as a result of paragraphs 5(1)(c) and (d) of the instrument, distributors will not be required to cease retail product distribution conduct where a TMD is being reviewed, or where a TMD has not been made (see s994C(3) to (7) and s994D of the Act).

Distribution of financial products

- (d) Section 5(1)(e) of the instrument clarifies that distributors will not be required to comply with the requirement to take reasonable steps (see s994E(3) of the Act).

Record keeping and notification obligations—other regulated persons

- (e) Paragraphs 5(1)(f) to (i) of the instrument clarify that distributors will be required to comply with certain record keeping and notification obligations, specifically, those that require them to keep records and provide information around complaints and specified information to issuers. This reflects that issuers require such information in order to comply with their review obligations.

Regulations

- (f) Subsection 5(2) of the instrument modifies reg 7.8A.09(1)(c) to include the purpose of issuing the product mentioned in subparagraph 707(3)(b)(i) of the Act (sale amounting to indirect issue), in addition to the purpose mentioned in subparagraph 1012C(6)(c)(i). This modification reflects the types of products covered by this regulation, which includes products regulated by Part 6D.2 of the Act.
25. Section 6 of the instrument clarifies that section 5 of the instrument does not apply to an ETP to the extent that it is on offer to retail clients other than on a licensed market. This is in order to ensure that where an ETP is issued directly to a retail client off-market, issuers and distributors of the ETP should be subject to the obligations as they ordinarily apply.
26. The instrument commences on the later of 5 October 2021 and the day after it is registered on the Federal Register of Legislation.

Legislative instrument and primary legislation

27. The subject matter and policy implemented by this instrument is more appropriate for a legislative instrument rather than primary legislation. The design and distribution obligations apply broadly, covering most products across all sectors of the financial services market.
28. The standard 10-year sunset period for legislative instruments provided for under the *Legislation Act 2003* is appropriate for this instrument. The instrument is intended to support the application of the primary legislation, by providing certainty for industry regarding the application of the design and distribution obligations to these products. Industry will be required to implement arrangements in order to comply with the design and distribution obligations. Early sunset of the instrument will likely create uncertainty around compliance and lead to undue burden for industry. ASIC will monitor the operation of the instrument and respond if necessary.

-
29. The instrument uses powers given by Parliament to ASIC, which allow ASIC to modify the operation of the Act as it applies to a specified class of financial product, being ETPs in this circumstance. As such, use of these powers allows ASIC to clarify uncertainties and correct inconsistencies regarding the application of the design and distribution obligations to issuers and distributors of ETPs. Clarification is important to provide certainty to industry about the application of the regime to these products, and to ensure that issuers and distributors of these products are treated consistently.

Legislative authority

30. The instrument is made under subsection 994L(2) of the Act. From 5 October 2021, subsection 994L(2) will provide that ASIC may, by legislative instrument, declare that Part 7.8A of the Act applies in relation to a specified class of financial products as if specified provisions were omitted, modified or varied as specified in the declaration. Even though the section that confers the power to make the instrument has yet to come into operation, ASIC can make the instrument as if it had come into operation: see subsection 4(1) of the *Acts Interpretation Act 1901* (as in force on 1 Jan 2005).
31. Section 994L applies to specified provisions of Part 7.8A, which includes regulations made for the purposes of that Part. Section 761H(1) of the Act states that a reference in a provision of Chapter 7 to a particular group of provisions of the Chapter includes a reference to regulations made for the purposes of those provisions.
32. The instrument is a disallowable legislative instrument.

Statement of Compatibility with Human Rights

33. The Explanatory Statement for a disallowable legislative instrument must contain a Statement of Compatibility with Human Rights under subsection 9(1) of the *Human Rights (Parliamentary Scrutiny) Act 2011*. A Statement of Compatibility with Human Rights is in the [Attachment](#).

Statement of Compatibility with Human Rights

This Statement of Compatibility with Human Rights is prepared in accordance with Part 3 of the *Human Rights (Parliamentary Scrutiny) Act 2011*.

ASIC Corporations (Design and Distribution Obligations—Exchange Traded Products) Instrument 2020/1090

Overview

1. The instrument clarifies uncertainties around the application of the design and distribution obligations, contained in Part 7.8A of the *Corporations Act 2001* and modified by Reg 7.8A.09 of the *Corporations Regulations 2001*, to issuers and distributors of exchange traded products (*ETPs*). These uncertainties arose due to the unique structure of these products, which are traded on a financial market by way of an intermediary. The effect of the modification is to apply the regime to these products in a way that is clear and consistent, for example, with regard to issuers utilising internal and external market making structures.

Assessment of human rights implications

2. This instrument does not engage any of the applicable rights or freedoms.

Conclusion

3. This 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*.