



# **NATIONAL AUSTRALIA BANK SUBMISSION**

Design and Distribution Obligations  
and Product Intervention Power

15 March 2017

## I. INTRODUCTION

National Australia Bank (NAB) welcomes the opportunity to respond to the Department of Treasury's Proposals Paper on Design and Distribution Obligations and Product Intervention Power.

NAB supports a competitive, transparent and accountable financial system. NAB agrees with the proposal that product lifecycles should be customer-centric and that reforms be broad, flexible and principles-based. However, measures should not unnecessarily impede innovation or undermine a customer's rights to make financial decisions and access a range of products.

NAB also has in principle support for a product intervention power.

NAB's submission addresses the specific questions contained in the Proposals Paper. It is encouraged that Treasury considers the following suggestions as part of forming any new framework:

- Accommodate (and not duplicate) existing prudential structures, which operate to give effect to these proposals (or requirements refined, if this regime is to take precedence);
- Be guided by a principles based approach, which operates to ensure parity for 'like' products, regardless of structure;
- Ensure appropriate safeguards and protections where issuers and distributors (respectively) have taken reasonable steps to define the target market and suitable distribution mechanisms;
- Ensure the issuer is appropriately protected from liability for a distributor's failure to comply (and vice versa); and
- Recognises the right of consumers, not identified as part of the intended market, to nonetheless acquire the product(s) (including an associated limitation of liability for the issuer and distributor).

As stated in NAB's submission to the final report of the Financial System Inquiry (FSI), a targeted and principles based approach to product design and distribution is a core part of NAB's product development framework. Core banking product design and distribution are managed through the Products@NAB framework, with fundamental principles of customer-centric design, distribution and governance. This approach continues to evolve based on NAB's accumulated insights, with the predominant aim of ensuring that customers are able to make informed choices that best suit their needs.

In considering responses to this consultation, it is important that standards are developed that do not duplicate existing frameworks. NAB encourages Treasury to incorporate and leverage the best practice that exists in industry today.

NAB would be pleased to meet with Treasury to discuss this submission in further detail.

## II. RANGE OF PRODUCTS COVERED BY THE MEASURES

- 1. Do you agree with all financial products except for ordinary shares being subject to both the design and distribution obligations and the product intervention power? Are there any financial products where the existing level of consumer protections means they should be excluded from the measures (for example, default (MySuper) or mass-customised (comprehensive income products for retirement) superannuation products)?*

NAB agrees the proposed obligations should apply to financial products made available to retail clients in Australia (as defined in the Corporations Act). As noted in the FSI Report, these

requirements should be scalable, having regard to the nature of the product to limit the impact of the proposals for simple, low-risk financial products, such as retail banking products and simple superannuation products.

NAB acknowledges the proposed exemption of ordinary shares (so domestic and international shares are excluded). Further, NAB would submit that ordinary shares acquired via other vehicles, such as a 'product' platform ('Wrap') also be excluded.

NAB supports the Australian Securities & Investments Commission (ASIC) having a broad power over specified products to exclude them from the scope of the obligations.

Exemptions may be appropriate for simple deposit products and non-cash payment facilities on the basis that these products are generally widely understood by consumers and respond to the needs of a wide target market. The imposition of additional regulatory requirements for these types of products may increase costs with relatively limited additional benefits given the existing regulatory framework. Alternatively, guidance should be provided to ensure that compliance with this obligation is straightforward for simple products, which are likely to be suitable for most consumers.

### **Listed Instruments**

There is also an argument that a broader exclusion of listed securities on certain financial markets, such as the Australian Stock Exchange (ASX), should apply. While NAB would support additional obligations in defining the target market for complex structures, listed assets – including listed trusts – have some similarities to listed shares and arguably should be afforded parity. As a matter of principle, 'like' financial products should, from a legislative perspective, be treated equivalently regardless of the structures in use for acquisition. Failure to address this issue may result in inconsistent outcomes for some issuers and a level of 'arbitrage', with product design taking advantage of the least regulated from similar product categories.

NAB also suggests that an exemption be granted in relation to ASX-listed hybrid instruments issued by banks. These products are issued under a prospectus, which is subject to ASIC oversight (including powers to issue stop orders where ASIC is satisfied that a disclosure document is misleading or deceptive). Hybrid products are issued in order to manage regulatory capital levels in accordance with the prudential standards prescribed by the Australian Prudential Regulation Authority (APRA). The structure and key features of these hybrid instruments are designed to comply with APRA's standards for Additional Tier 1 or Tier 2 capital. There is little flexibility to change product features to accommodate investor preference. The Proposals Paper does not appear to consider the intersection of these new obligations with existing prudential requirements.

In recent years, the ASX-listed market has been an important source of Additional Tier 1 capital for Australian banks. If a proposed intervention related to a feature that is necessary for a product to qualify as regulatory capital, or to a regulatory capital product in its entirety, the potential impact on Australian banks' capital positions could be significant. Accordingly, these products should be excluded from the scope of the proposed intervention power. NAB also suggests that further consultation, in conjunction with APRA, is undertaken.

### **Margin Lending**

NAB recommends that existing frameworks and protections be taken into account with respect to margin lending facilities. These products are subject to certain consumer protections in the Corporations Act (Part 7.8, Division 4A), which among other things require margin lenders to assess whether a proposed margin lending facility will be unsuitable for a retail client, and prohibit the making of a margin loan which is unsuitable for the retail client.

## Superannuation Products

NAB acknowledges Treasury's comments regarding superannuation products. The design framework for Comprehensive Income Products for Retirement (CIPRs) is incomplete and until further progress is made NAB cannot form a view as to whether further measures should apply to their design and distribution. It is preferred that for 'mass customised' options, which are already the subject of extensive prudential frameworks – such as MySuper – the proposed design and distribution laws either not apply or a shorter form approach be adopted. NAB notes that, in this regard, APRA in effect already has powers like those proposed, in that it has:

- A power to remove a trustee or cancel its RSE licence; and
- A power to cancel the authorisation of a MySuper product.

The development of this framework must have regard to existing prudential architecture to mitigate conflicts and avoid duplicative processes.

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***2. Do you agree with the design and distribution obligations and the product intervention power only applying to products made available to retail clients? If not, please explain why with relevant examples.***

Yes. Design and distribution obligations and the product intervention power should only apply where relevant products are made available to retail clients (as defined in the Corporations Act). To the extent a financial product is available to both retail and wholesale clients, the law should be clear that the product design and distribution obligations, and ASIC's intervention power in relation to these products, only apply to retail clients.

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***3. Do you agree that regulated credit products should be subject to the product intervention power but not the design and distribution obligations? If not, please explain why with relevant examples.***

Yes. Consumer credit products regulated under the National Consumer Credit Protection Act 2009 (Credit Act) should be excluded from the design and distribution obligations. In principle NAB accepts that the product intervention power could be extended to consumer credit products regulated under the Credit Act as an enhancement to the regulatory toolkit.

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***4. Do you consider the product intervention power should be broader than regulated credit products? For example, 'credit facilities' covered by the unconscionable conduct provisions in the ASIC Act. If so, please explain why with relevant examples.***

No. NAB does not support a broader application of the proposed product intervention power.

## III. DESIGN AND DISTRIBUTION OBLIGATIONS

***5. Do you agree with defining issuers as the entity that is responsible for the obligations owed under the terms of the facility that is the product? If not, please explain why with relevant examples. Are there any entities that you consider should be excluded from the definition of issuer?***

NAB agrees in principle with defining an issuer as the entity that is responsible for the obligations owed under the terms of the product. ASIC should also have a broad exemption power to exclude particular entities from the scope of the definition, to ensure it is appropriately targeted and to prevent unintended consequences; such as where more than one party may be deemed to be the issuer of a product.

To assist, NAB would propose that in adopting the definition of ‘issuer’ under the Corporations Act, Treasury should consider providing a clear exclusion for distributors that are not the issuer of the product. This will also provide clarity on how the obligations apply in situations where:

- More than one party may be considered an issuer in a transaction (e.g. m-funds, off-market derivatives, foreign exchange contracts and Wrap Platforms).
- Entities in a corporate group perform different issuer and distributor functions or where an entity may be considered a distributor for some purposes and an issuer for other purposes (e.g. a platform operator to the extent the platform itself is a product and a distributor to the extent that the platform makes other products available for acquisition).
- A product issuer and distributor have entered into a white-labelling arrangement. It should be clear that the actual product issuer, not the distributor, is the issuer in these circumstances.

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**6. Do you agree with defining distributors as entity that arranges for the issue of a product or that:**

***(i) advertise a product, publish a statement that is reasonable likely to induce people as retail clients to acquire the product or make available a product disclosure document for a product; and***

***(ii) receive a benefit from the issuer of the product for engaging in the conduct referred to in (i) or for the issue of the product arising from that conduct (if the entity is not the issuer).***

A precise definition of ‘distributor’ is important to identify entities that will be regulated and to clarify obligations of both issuers and distributors. The proposed definition includes terminology that is not defined at law (such as arrange) and terminology which is defined (such as issuer and benefit). Additionally, the term ‘arrange’ is the subject of comment in regulatory guides and is set at a fairly high threshold. The proposed definition raises a number of questions and issues where refinement or further clarity is needed. For example, the definition should:

- Reflect the exclusion of distributor obligations for personal financial product advisers. Excluding financial product advisers generally from this definition of ‘distributor’ would increase clarity and prevent potential overlaps of regulatory obligations.
- Identify whether a ‘benefit from the issuer’ in item (ii) will have a particular meaning in this context.
- Be subject to a ‘conducting a business’ element, so that incidental referrals or recommendations are not captured, particularly in the light of the broad definition of ‘benefit’ in the Corporations Act.
- More clearly identify an issuer which distributes its own product as a distributor.

Currently, the giver and receiver of the ‘benefit’ are narrowly defined. This may result in some parties seeking to avoid obligations through arrangements using subsidiaries. The definition could alternatively focus on the concepts of facilitation of a sale and/or promotion of the product, in exchange for the receipt of a benefit, which is directly or indirectly paid in consideration for those services to or at the direction of the distributor.

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**7. Are there any situations where an entity (other than the issuer) should be included in the definition of distributor if it engages in the conduct in limb (i) but does not receive a benefit from the issuer?**

Subject to the comments on question six, generally, if an entity (other than the issuer) engages in the conduct of limb (i) but does not receive a benefit from the issuer, then it should not be included in the definition of ‘distributor’.

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**8. Do you agree with excluding personal financial product advisers from the obligations placed on distributors? If not, please explain why with relevant examples. Are there any other entities that you consider should be excluded from the definition of distributor?**

NAB supports excluding personal financial product advisers from the obligations placed on distributors given the regulatory obligations placed on such advisers. Despite this exclusion, the new obligations are likely to impact market practice even where a personal financial product advice distribution model is adopted.

The Proposals Paper also states that personal advice providers would be expected to consider the target market of a product identified by the issuer as part of discharging their existing duties to their clients. Where a personal financial product advice distribution model is adopted, related obligations placed on issuers should also be clarified. For example:

- The means by which an issuer gives notice of the product's intended target and non-target market to the financial advisor, where the parties do not have a direct relationship.
- The extent to which an issuer must consider arrangements a financial advisor has in place to ensure its representatives have sufficient knowledge and understanding of the product. It is not clear if this to be limited to circumstances where a product is complex, as per page 20 of the Proposals Paper. Excluding financial advisers generally from this definition of 'distributor' would increase clarity and prevent potential overlaps of regulatory obligations, including the licensee's own compliance obligations.

Other entities and situations that should be excluded from the definition of distributor include:

- Media companies engaged by the issuer to advertise the product (as contemplated in the Proposals Paper), and more generally, entities which engage in advertising services where they do not also engage in the provision of financial services and related products.
- Situations that involve mere referral arrangements, with the definition of distributor subject to a 'conducting a business' element so incidental referrals are not captured.

*Note:* it is assumed that employers would be excluded from the 'distributor' definition in relation to their employees' superannuation arrangements. Under s68A of the Superannuation Industry (Supervision) Act, superannuation trustees cannot give benefits to employers for putting their employees into a particular fund. NAB believes that such an exclusion is appropriate, both because of s68A and because employers have compulsory superannuation obligations to their employees. Employers should not be subject to another legislative regime, which might impose new requirements that potentially conflict with or complicate existing obligations.

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**9. Do you agree with the obligations applying to both licensed and unlicensed product issuers and distributors? If they do apply to unlicensed issuers and distributors, are there any unlicensed entities that should be excluded from the obligations (for example, entities covered by the regulatory sandbox exemption)? Who should be empowered to grant exemptions and in what circumstances?**

Yes. Obligations should apply to both licensed and unlicensed product issuers and distributors. This would ensure that protections are extended to retail clients comprehensively. ASIC would also benefit from having a broad exemption power, to ensure the obligations are appropriately targeted and to prevent unintended consequences.

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***10. Do you agree with the proposal that issuers should identify appropriate target and non-target markets for their products? What factors should issuers have regard to when determining target markets?***

NAB supports the need for a consistent and transparent decision making process and ongoing governance through the identification of appropriate target and non-target markets. This ensures that the right products are delivered to the right markets, at the right time.

However, caution should be taken against a model which requires consideration of circumstances, risk appetite and personal details that, in effect, results in the introduction of an individual appropriateness test or suggests issuers are – by default – providing personal advice to customers.

NAB also cautions against the inclusion of specific performance predictions based on market conditions or economic forecasting as a formal part of the framework for particular products. This is because conditions can vary, making any prediction unstable and subsequent notifications potentially obsolete – even as they are issued. There is also the risk of a perception of a guarantee where there is none. An alternative may to provide a range of possible outcomes presuming three potential scenarios such as ‘negative’, ‘stable’, ‘positive’ for a type of investment product.

Requirements within NAB's product lifecycle framework already support the recommendation's intent. For example, the NAB framework requires:

- Defining target markets having regard to a range of criteria, such as life stage and financial capacity;
- Understanding the benefits and risks for existing and potential market segments;
- Ensuring that opportunities are driven by consumer needs and feedback; and
- Establishing controls for distribution of the product, including periodic reviews as to whether the product continues to meet the needs of the target markets.

Any legal requirement for an issuer to identify target and non-target markets should be clear about standards required, and not penalise those which make a reasonable and good faith attempt. The requirements should not artificially constrain issuers in what they must or can consider. Any list of considerations would best be non-exclusive allowing an issuer to disregard a particular consideration it reasonably believes is not relevant.

### **Identifying a Target Market**

Issuers should not be restricted to considering whether the product is satisfying the investment or risk management needs of the target market. It is important that the mechanism to define a target market is flexible, with issuers able to include other relevant needs of consumers reasonably considered appropriate. A broader construction of the term ‘need’ would facilitate product innovation and reflect the fact that products may be beneficial to consumers despite not meeting a positive, previously identified consumer need.

Similarly, an issuer should not have to be satisfied that a particular consumer market ‘will’ or ‘would’ benefit from a particular product (suggesting a requirement of certainty). A more appropriate framework would require issuers to be satisfied that there are reasonable grounds to believe that the consumers in the target market ‘may’ benefit. In this context, ‘benefit’ is widely defined. For example, in relation to insurance, both the issuer and consumer hope that the consumer will never have to make a claim for insured benefits, and many consumers in the market may never make a claim, but may still be seen as benefiting from the product.

It is likely that a customer may fit within several possible target markets and may transition between target markets over time.

- Further clarity is required to ensure that the proposed obligations provide flexibility and set out the process for an issuer to redefine the target and non-target markets for their product.
- The obligations need to acknowledge that a potential customer may not specifically sit within a product's target or non-target markets, and that acquisition of the product by this third category of potential customer does not constitute a breach of the proposed issuer or distributor obligations.
- Further clarification about the level of detail required when defining target and non-target markets, and confirmation that a potential customer may not specifically sit within a product's target or non-target markets.
- Issuer obligations must include commercially reasonable 'safe harbour' steps that an issuer may follow in which case they will be deemed to have complied with the proposed obligations.

Regulatory guidance would be appropriate to detail how target market testing, as contemplated by the Proposals Paper, is conducted and how it would interact with current restrictions on advertising financial products. Further detail should be provided in legislation on what constitutes a non-target market, with any regulatory guidance on market definition provided sufficiently prior to the commencement of the obligations. This will allow issuers to have regard to that guidance when reviewing and updating product frameworks. Jurisdictional scope also needs to be considered, for example whether the proposed obligations extend to overseas investors.

NAB also reiterates the point raised in response to question one, that in respect of hybrid capital instruments issued by APRA-regulated financial institutions, the features of these instruments (such as non-viability and capital trigger events and other loss absorption mechanisms) are designed to achieve compliance with APRA's prudential standards.

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***11. For insurance products, do you agree the factors requiring consumers in the target market to benefit from the significant features of the product? What do you think are significant features for different product types (for example, general insurance versus life insurance)?***

This proposal may result in the introduction of an individual appropriateness test, requiring an assessment of some of an individual's personal circumstances before making the product available. NAB does not support the introduction of an individual appropriateness test, where no personal advice is provided, and notes that the FSI Report did not recommend introduction of such a test, instead concluding that it would introduce significant costs for issuers and distributors.

Consumer benefit is an appropriate consideration but, as discussed in question 10, 'benefit' should not be too narrowly construed and the issuer should not have to be satisfied as to certainty of benefit. Insurance offerings often bundle multiple benefits into a product. A consumer may be eligible for, and select a product based on, particular benefits included in that product while being ineligible for another. An appropriate test would require an issuer to believe, on reasonable grounds, that consumers in the target market benefit from at least one or more of the product's features. NAB does not believe it is appropriate that a test require consumers to benefit from each feature or each significant feature.

Requirements should not artificially constrain issuers in what they must or can consider in defining the target market for a product, or unduly narrow the potential target market for a product. For example, in case study one on page 26 of the Proposals Paper, the target market is narrowly defined without a clear rationale about why unemployed consumers would not benefit from the product (as they have been defined as the non-target market), particularly given the product is stated to provide sickness, injury and death cover.

Life insurance provides an example of a product where the benefit to the consumer can greatly differ between consumers and greatly diverge from the cost of the product purchased, depending

on the risk appetite and needs of the individual. Life insurance is priced to ensure it is appropriate on an actuarial basis such that the premiums charged are sufficient to cover the expected claims, cover costs and sustainability of the product. The pooled risk strategy that forms the basis of insurance inherently means that not all consumers are expected to benefit in a financial sense from a product. The premium cost can vary widely from the benefit to the consumer, which includes the peace of mind consumers receive knowing that they will be financially protected.

NAB recommends that the legislation clearly articulates that an individual appropriateness test is not required, and that the design and distribution obligation does not detract from the principle that consumers should ultimately remain responsible for the consequences of their financial decisions and determination of their own risk appetite.

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***12. Do you agree with the proposal that issuers should select distribution channels and marketing approaches for the product that are appropriate for the identified target market? If not, please explain why with relevant examples.***

***13. Do you agree that issuers must have regard to the customers a distribution channel will reach, the risks associated with a distribution channel, steps to mitigate those risks and the complexity of the product when determining an appropriate target market? Are there any other factors that issuers should have regard to when determining appropriate distribution channels and market approach?***

NAB supports a proposal that issuers should select distribution channels for the product that are reasonably appropriate for the identified target market. NAB agrees that when determining whether a distribution channel is appropriate for a product, issuers should have regard to the following:

- The type of customers the distribution channel is likely to reach and whether this is consistent with the identified target market for the product. The requirements should acknowledge that many distribution channels (e.g. digital channels) may reach customers outside the identified target market and this should not constitute a breach of the obligations.
- The complexity of the product and the likely ability of the identified target market to understand the product.
- The level of customer engagement in the product acquisition process.
- Any proposed distributor and distribution activities (without regulatory overlap).

Any legal requirement should be clear about the standard required of issuers and not penalise issuers that take reasonable steps to select appropriate distribution channels. That legal requirement should be inclusive and not exclusive with the issuer able to have discretion regarding factors it reasonably considers relevant.

NAB does not believe that marketing approaches should be included in legislation – as drafted in the current proposal, this requirement is uncertain and may limit an issuer’s ability to utilise a range of reasonable marketing methods. Marketing methodology is also driven by a range of constantly evolving technology that would very quickly date the legislation.

NAB also believes risks in a distribution channel, which may prevent or limit the product being distributed to the identified target market, should not be included in legislative requirements. NAB acknowledges that this is an important commercial consideration. Failing to consider this factor would reduce the commercial effectiveness of distribution activities. It is unclear that this is an appropriate matter for legislation.

On-line applications for financial products present an excellent platform for disclosure and for the customer to absorb information at their own pace. Targeting can be achieved via the site content

but ultimately a customer may proceed with an acquisition for their own reasons regardless of whether they form part of the target market identified for the product.

As noted, the issuer obligations should also include commercially reasonable ‘safe harbour’ steps that an issuer may follow in which case they will be deemed to have complied with the proposed obligations.

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***14. Do you agree with the proposal that issuers must periodically review their products to ensure the identified target market and distribution channel continues to be appropriate and advise ASIC if the review identifies that a distributor is selling the product outside of the intended target market?***

It is prudent for issuers to periodically review their products to ensure the identified target market and distribution channel continue to be appropriate. This is subject to exclusion of after-sale obligations with respect to closed products (which should be defined as products that are not accepting new customers).

Requirements should make it clear that an issuer could undertake periodic reviews of similar products as a class – for example, basic banking products could be treated as a class, with a standard approach to periodic, post-sale review.

To the extent that product reviews require an assessment of the appropriateness of the target market and distribution channels, NAB notes that there are factors which may limit or impact an issuer’s ability to undertake the review. These must be taken into account when drafting this requirement, and include:

- Products where large and varied classes of consumers are considered within the target market, or many distribution channels are considered appropriate;
- The ability of current systems to identify non-target market customers, using relevant customer information and attributes. Uplift of current systems and controls may be required and may be onerous;
- The differing reporting systems and data collection mechanisms used by individual issuers and distributors, including the fact that issuers may receive reporting from multiple distributors;
- Privacy obligations of both issuers and distributors; and
- The ability to identify an underlying customer where the product is held by a custodian in an omnibus account.

The proposed requirement that issuers must advise ASIC if the review identifies that a distributor is selling a product outside of the intended target market needs to be qualified. This contemplates a mandatory reporting regime, even where sales of a product outside of the intended target market are insignificant. This obligation, if implemented, should be subject to a materiality or significance test (e.g. similar to significant breach reporting requirements in CA s.912D). It must acknowledge that a customer may not specifically sit within a product’s target or non-target markets, and that acquisition of the product by this category of potential customer does not constitute a breach of the proposed issuer or distributor obligations, therefore triggering a reporting requirement.

It is also important that the requirement to notify ASIC if a distributor is selling a product outside its intended target market should only apply if a reasonable person, in the issuer’s position, would believe that such sales created a risk of significant consumer detriment to those consumers, or consumers of a similar kind. The rationale for this qualification is that the Proposals Paper implies that all sales outside the target market are a problem and ‘inappropriate’ when this will not necessarily be the case. A product issuer may realise that it defined the target market too narrowly and that the product is suited to a wider group of people than the issuer first thought. In this case,

the issuer should be able to redefine the target market using the same standards. In such an event, making a product issuer report to ASIC would create an unnecessary regulatory burden.

The frequency of periodic review should not be narrowly prescribed because issuers are best placed to consider the appropriate review timeframe. The frequency of periodic reviews may be more appropriately a subject for ASIC guidance rather than legislative prescription.

NAB notes that consideration of claims outcomes will not be relevant for many products and should not be a standard review factor. Additionally, NAB suggests that Treasury clarifies what is required of a distributor if an issuer determines that a market or distribution channel has changed over time. NAB would also propose that legacy business (off sale) be excluded from these reviews and, provided there are not inhibitors to exiting off sale products, only on sale products be subject to review of this mandated nature.

### **Assessing Product Performance**

NAB notes Treasury's comments on page 22 of the Proposals Paper in relation to assessing product performance. NAB strongly opposes legislating review of profit margins as a required matter for review. While consideration of profit margins is, or may be, a commercially relevant factor for an issuer to consider in its product review process, NAB does not believe that the profit margin of an individual product is determinative of whether that product is appropriately targeted. Additionally, there may be operational impediments to using profit margins to monitor a product, as profitability is not always reported at an individual product level, and instead may be aggregated at a product or customer portfolio level.

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#### ***15. In relation to all the proposed issuer obligations, what level of detail should be prescribed in legislation versus being specified in ASIC guidance?***

Legislation should clearly define core requirements (i.e. targeted, principles based obligations). For issuer obligations, legislation should provide commercially reasonable 'safe harbour' steps that an issuer may follow in which case they will be deemed to have complied with the proposed obligations. The legislation should include appropriate protection for an issuer to make it clear they will not be liable for a distributor's failure to comply with its obligations (e.g. a failure to implement reasonable distribution controls).

NAB requests clear guidance from ASIC to address matters such as market definition and how target market testing may be conducted. Any regulatory guidance should be provided sufficiently prior to the commencement of the obligations to allow issuers to have regard to that guidance in reviewing and updating their product frameworks.

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#### ***16. Do you agree with the proposal that distributors must put in place reasonable controls to ensure that products are distributed in accordance with the issuer's expectations?***

In principle NAB supports the proposal that distributors must put in place reasonable controls to ensure products are distributed in accordance with the issuer's expectations. NAB cautions against a model that requires controls which in effect result in the introduction of an individual appropriateness test. It is important that such controls do not constitute the provision of personal advice. Use of customer information, as a reasonable control, should not be mandated but if a distributor (or an issuer undertaking distribution activities) uses existing customer information in its control framework, then the legislation should permit such use.

Any legal requirement concerning the standard required of distributors should be clear and not penalise distributors for a reasonable and good faith attempt to put in place reasonable controls. Legislation needs to also provide a clear delineation of responsibility (i.e. an issuer should not be liable for a distributor's failure to comply with its obligations and a distributor should not be liable for an issuer's failure to comply with its obligations).

Regulatory guidance on what constitutes reasonable controls should reflect existing commercial best practice. This includes explaining how any proposed testing of controls to ensure effectiveness is required to be undertaken. Guidance on the practical development of distributor controls by or in conjunction with issuers, and the delineation of responsibility/liability between issuers and distributors would also be practical. This guidance should also be provided sufficiently prior to the commencement of the obligations to allow issuers and distributors to review and update control frameworks and, if need be, renegotiate commercial arrangements.

Distributor obligations should also include commercially reasonable 'safe harbour' steps that a distributor may follow in which case they will be deemed to have complied with the proposed obligations.

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***17. To what extent should [a] consumer be able to access a product outside of the identified target market?***

***18. What protections should there be for consumers who are aware they are outside the target market but choose to access a product regardless?***

NAB does not support the removal of consumer choice. There should be no express prohibition on a consumer outside the identified target market acquiring a product. This would be an excessive intrusion in a person's rights and create an excessive additional layer of regulation. Requiring an issuer to refuse such a consumer might, in some cases, conflict with anti-discrimination laws or expose the issuer to complaints that it has acted unfairly. Such a consumer would still have cooling-off rights for some products and there are existing remedies if the issuer or distributor has acted unconscionably or in a misleading and deceptive way in the sale of the product.

The absence of an express prohibition against 'non-target market' product issues need not diminish the issuer's obligations in relation to ensuring appropriate distribution channels for the product, or its reporting obligations if a risk of significant consumer detriment appeared.

One likely consequence of requiring issuers to define their target market is that issuers will seek to protect themselves – and consequently also protect consumers – by including warnings directed to consumers who may be outside the target market in product documentation and application forms. This is likely even if the law does not require it, and would be an additional safeguard.

NAB does not think that the fact that a consumer outside the target market applies for a product, and is subsequently issued the product, should of itself give that consumer any new rights against the product issuer; there are already, and will be, adequate safeguards and remedies.

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***19. Do you agree with the proposal that distributors must comply with reasonable requests from the issuer related to the product review and put in place procedures to monitor the performance of products to support the review? Should an equivalent obligation also be imposed on advised distributors?***

NAB agrees with the proposal that distributors must comply with reasonable requests from the issuer related to the product review. However, the proposal requires some further clarification to ensure it does not impose an unreasonable burden on distributors.

Monitoring the performance of products should remain a product issuer obligation. This obligation should be limited to requiring distributors to comply with reasonable requests for information from the issuers relating to product review, putting in place reasonable procedures to collect the necessary data to support the issuer's product review. Distributors should not be required to put in place procedures to generally monitor the performance of products.

The obligation should only apply prospectively, with respect to consumers that have acquired the product after commencement of the relevant issuer and distributor obligations. Distributors should

also be able to discharge the proposed reporting obligation through the provision of aggregated and de-identified information. To the extent that issuers and distributors agreed to a proposed disclosure of personal information, legislation should permit such use and disclosure for these purposes.

NAB does not consider that an equivalent obligation should be imposed on advised distributors (i.e. personal financial product advisers which should be excluded from the distributor obligations).

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***20. In relation to all the proposed distributor obligations, what level of detail should be prescribed in legislation versus being specified in ASIC guidance?***

Legislation needs to clearly define the core requirements (i.e. targeted, principles based obligations). For the distributor obligations, commercially reasonable 'safe harbour' steps are required, to protect distributors where they are deemed to have complied. The legislation should include appropriate protection for a distributor to make it clear they will not be liable for an issuer's failure to comply with its obligations (e.g. a failure to perform periodic reviews).

Legislation needs support by clear ASIC guidance, including examples of reasonable controls that reflect existing commercial best practice and explain how any proposed testing of controls. Regulatory guidance provided sufficiently prior to the commencement of the obligations will allow issuers to have regard to that guidance in reviewing and updating product frameworks.

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***21. Do you agree with the obligations applying 6 months after the reforms receive Royal Assent for products that have not previously been made available to consumers? If not, please explain why with relevant examples.***

Implementation should be subject to a sufficient transitional period, to ensure industry is able to make any necessary changes, particularly with respect to:

- Defining and implementing changes to systems, policies, procedures and control frameworks;
- Updating distribution arrangements, which may require commercial negotiation; and
- Training for relevant staff and parties involved in distribution.

Even for issuers and distributors with robust existing frameworks, a six month period is likely to be insufficient. If imposed, this may adversely impact product development work around the time of implementation. Some issuers and distributors may also need greater than six months to undertake system development in response to the new obligations.

To enable industry to prepare for the new obligations, NAB suggests a transitional period of at least 12 months from Royal Assent. This would be more appropriate for products that have not previously been made available to consumers and will enable changes to be integrated into current frameworks, rather than being bolted on to meet a short timeframe of six months.

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***22. Do you agree with the obligations applying to existing products in the market 2 years after the reforms receive Royal Assent? If not, please explain why with relevant examples and indicate what you consider to be a more appropriate transition period.***

NAB agrees that the obligations should not apply to products available to consumers before Royal Assent, for a period of at least two years. NAB also agrees that closed products (i.e. products that are not accepting new customers) should be also excluded from the obligation to undertake periodic product reviews. The legislation should make it clear that the obligations apply prospectively – i.e. with respect to new customers after commencement of the obligations.

NAB requests clarification about how these obligations are to apply with respect to listed instruments and, in particular, existing hybrid securities that may have a time to maturity of greater

than 2 years. It is unclear what action could be taken in relation to monitoring and reviewing the suitability of outstanding instruments for a group of investors who may have changed over time (through secondary market transactions). In response to a periodic review, an issuer's ability to amend, cancel or redeem an outstanding security would be limited as any such change would require further engagement with, and approval by, APRA, and indeed there is no guarantee that APRA approval would be granted.

#### IV. PRODUCT INTERVENTION POWER

*23. Do you agree that ASIC should be able to make interventions in relation to the product (or product feature), the types of consumers that can access a product or the circumstances in which a consumer can access the product. If not, please explain why with relevant examples.*

NAB agrees in principle with the proposal to introduce a proactive product intervention power that would enhance the regulatory toolkit available where there is risk of significant consumer detriment.

In describing the proposed power, the FSI Report provided a list of potential interventions the power would allow the regulator to intervene to require / impose:

- Amendments to marketing and disclosure materials.
- Warnings to consumers, and labelling or terminology changes.
- Distribution restrictions.
- Product banning.

The Proposals Paper (section 4.1) has expressed the proposed power differently – *ASIC can make interventions in relation to the product (or product feature), the types of consumers that can access the product or the circumstances in which consumers access the product*. The rationale for this change in approach from the FSI Report is to enable ASIC to make interventions related to matters concerning the distribution of products, as well as the types of interventions identified by the FSI. It is unclear whether this change is necessary and it may, arguably, create uncertainty for industry about the nature and extent of the proposed power.

Other practical issues and limitations also need to be addressed. For example, the prospective nature of the power must be clear and legislation should ensure that the type of intervention that may be made is appropriately targeted to address the relevant risk of significant consumer detriment. A proposed intervention to ban a product or change product features should be limited to when the detriment is linked to a failure (or suspected failure) of the issuer or distributor obligations.

NAB's view is that the ASIC's remit be formulated as a precise list of potential interventions the power would allow, consistent with the FSI Report. This would provide greater certainty for industry about the nature and extent of the proposed power, without detracting from ASIC's ability to intervene to address the risk of significant consumer detriment.

Additionally, to the extent the power enables amendments to marketing and disclosure materials, the use, or potential use, of the power should not be used as a mechanism by ASIC to make ad-hoc changes to disclosure requirements. Use of the power should not be a substitute for clear disclosure requirements that industry and consumers can rely upon. Given the nature of the potential interventions, NAB also submits that closed products (defined as products that are not accepting new customers) should be excluded from the scope of the proposed power.

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***24. Are there any other types of interventions ASIC should be able to make (for example, remuneration)?***

The proposed intervention power is broad and has the potential for significant commercial impact. NAB does not support an extension of the proposed product intervention power to allow ASIC to make other types of interventions. To increase certainty for industry, draft legislation should reflect limits to the product intervention power, as described in the Proposals Paper; so that it does not enable interventions that indirectly relate to a product.

NAB notes there are a range of other current regulatory reforms and industry initiatives that seek to improve consumer outcomes, raise industry standards and address related issues. These include the independent Code of Banking Practice Review and independent review of product sales commissions and enhancements to external dispute resolution. An extension of the proposed product intervention power would potentially create an unwarranted overlap with these reviews and other reforms and initiatives underway, increasing the potential regulatory impact for industry.

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***25. Do you agree that the extent of a consumer detriment being determined by reference to the scale of the detriment in the market, the potential scale of the detriment to individual consumers and the class of consumers impacted? Are there any other factors that should be taken into consideration?***

NAB agrees in principle with the following proposed key factors ASIC must consider when evaluating whether a detriment is sufficient to warrant intervention:

- The potential scale of the detriment in the market; and
- The class of consumers likely to be impacted by the detriment.

In principle, use of the power should apply only where there is detriment to a class of consumers. For clarity, 'detriment' should also be assessed with regard to actual or potential financial loss within the impacted class of consumers.

It would be beneficial to have regulatory guidance by ASIC, with appropriate public consultation, detailing what detriment must be evidenced before an intervention is warranted (e.g. how ASIC would determine the size of potential losses, relevant assumptions used and consideration of the likelihood of those assumptions).

As noted in the Proposals Paper, the FSI Report highlighted that the proposed power was not intended to be used where a large number of consumers have incurred a small detriment. NAB is concerned that the proposed reformulation of the test for determining when the power may be used may extend beyond the situations contemplated in the FSI Report. This raises the importance of providing issuers and distributors with appropriate safe harbour defences within any implementing legislation for the product design and distribution obligations and appropriate regulatory guidance for industry.

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***26. Do you agree with ASIC being required to undertake consultation and consider the use of alternative powers before making an intervention? Are there any other steps that should be incorporated?***

NAB agrees with ASIC being required to undertake consultation and consider the use of alternative powers before making an intervention. The use of the power should not be precluded merely because there is an alternative power that could be used, although this should not change the underlying expectation that the power should be used infrequently and with a high level of accountability.

Given the exceptional nature of the power, consultation is a key element to ensure it is exercised in a manner that provides a high level of accountability. Prior to any exercise of the intervention power, consultation requirements should – at a minimum – include the following:

- An obligation for ASIC to conduct reasonable prior consultation with affected issuers and distributors – or a reasonable sample of such persons – before making any intervention order. If this is not possible, an obligation for ASIC to publish written prior notice of any proposed intervention orders (e.g. in State-wide and/or national newspapers) and give persons an opportunity to make submissions before ASIC makes the order. Legislation should specify times for prior ASIC notice and lodging submissions.
- Where prudentially regulated firms may be affected, a requirement for ASIC to consult with both APRA and the potentially impacted firms. ASIC should not have a power to dispense with such consultation.
- If a proposed intervention related to changing market practices for regulatory capital securities (or may impact the risk weighted asset treatment of a particular product or class of products), early, open and constructive consultation with APRA, the banking industry and market participants. This is crucial to ensure that potential implications on bank regulatory capital, financial outcomes and the market itself are able to be appropriately understood.
- As part of its consultation, a requirement for ASIC to provide appropriate evidence of the matters being considered that support the exercise of this power.
- ASIC should provide details of the alternative powers, if any, that could be used to address the issue and the rationale for the use of the product intervention power as opposed to those other powers.

If ASIC is to have the power to make an order without either prior consultation or publication then that power should only be exercisable where ASIC reasonably believes that delay would create a significant risk of imminent significant consumer detriment. Any such action should be an interim order with a short, limited lifespan (e.g. one month).

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***27. Do you agree with ASIC being required to publish information on intervention, the consumer detriment and its consideration of alternative powers? Is there any other information that should be made available?***

ASIC should be required to publish information about use of the intervention power; detailing the significant consumer detriment the intervention is seeking to address and details on why the product intervention power is the most effective means of addressing the issue. This assumes that consultation or publication prior to use of the power has occurred, consistent with the response to question 26. NAB also suggests that where consumer detriment is assessed, the assumptions used to come to that position should be made clear.

Consistent with the FSI Report, ASIC should also issue regulatory guidance (after appropriate public consultation) describing when the power may be used, the process of engagement with affected parties, consultation with other regulators before the use of the power, transparency in its use and public reporting of the review of each use of this power.

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***28. Do you agree with interventions applying for an initial duration of up to 18 months with no ability for extensions? Would a different time frame be more appropriate? Please explain why.***

NAB accepts that a temporary intervention by ASIC may last for up to 18 months. It is reasonable that that a temporary intervention lapses after 18 months, if the Government has not made it permanent. NAB would welcome further discussion about this aspect of the proposals and the control in place to ensure a workable outcome for both ASIC and industry. For example, it is assumed ASIC would issue regulatory guidance (after appropriate public consultation) describing

how an intervention for an initial duration of less than 18 months might be extended up to 18 months.

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***29. What arrangements should apply if an ASIC intervention is subject to administrative or judicial appeal? Should an appeal extend the duration that the Government has to make an intervention permanent?***

ASIC intervention should be subject to normal judicial and administrative appeal and review processes. It is reasonable for an individual intervention by ASIC through an administrative decision or effected by class order to be reviewed in the same manner. A market-wide intervention by ASIC by way of a legislative instrument should be subject to Parliamentary disallowance and be judicially reviewable by the Federal Court as delegated legislation.

The proposed duration of up to 18 months for an ASIC intervention is to provide Government time to decide whether to make the intervention permanent. As the Government will be on notice of the issue of concern, NAB does not consider that an appeal or review should extend the duration of the original ASIC intervention.

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***30. What mechanism should the Government use to make interventions permanent and should be mechanism differ depending on whether it is an individual or market wide intervention? What (if any) appeal mechanisms should apply to a Government decision to make an intervention permanent?***

Treasury has proposed that the mechanism to effect permanent policy change is expected to take the form of a legislative instrument. Potentially, the appropriate mechanism to effect permanent change will depend on the nature of the initial intervention. For example, if a temporary, market-wide intervention is made by way of a legislative instrument, then the mechanism to effect a permanent change of Government policy should be an Act of Parliament, rather than a further legislative instrument which would presumably be subject to Parliamentary disallowance.

This would not appear to be the appropriate mechanism with respect to an individual intervention by ASIC through an administrative decision. In these cases, potentially the mechanism to effect a permanent change could be by way of a legislative instrument, which would be subject to potential Parliamentary disallowance and judicial review.

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***31. Are there any other mechanisms that could be implemented to provide certainty around the use of the product intervention power?***

Given the exceptional nature of the power, it must be implemented in a manner that ensures there is a high level of accountability on ASIC, when exercising the proposed product intervention power. NAB agrees ASIC should, with appropriate public consultation, develop and periodically update detailed regulatory guidance about how and when the proposed intervention power might be exercised.

NAB agrees the proposed intervention power should not be used for pre-approval of products.

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***32. Do you agree with the powers applying from the date of Royal Assent? If not, please explain why with relevant examples.***

The proposed intervention power requires a 12 month implementation period from the date of Royal Assent. This time period would allow development of relevant regulatory guidance about how and when the proposed intervention power might be exercised, and enable industry to consider and respond to potential implementation issues that may not be apparent until detailed legislation and regulatory guidance is available.

## V. ENFORCEMENT AND CONSUMER REDRESS

*33. What enforcement arrangement should apply in relation to a breach of the design and distribution obligations or the requirements in an intervention?*

*34. What consumer rights and redress avenues should apply in relation to a breach of the design and distributions obligations or the requirements of an intervention?*

The penalties and liabilities for breach of design and distribution obligations will differ in some respects from those for breach of an intervention. In principle, penalties and liabilities for breach of the requirements in an intervention might be more substantial compared to breach of the design and distribution obligations.

### **Design and Distribution Obligations**

Administrative actions, civil penalties and injunctive actions are reasonable remedies in relation to the breach the obligation; however the imposition of criminal liability would be excessive as it is covered adequately by existing legislation.

In particular, issuers and distributors should not be liable to penalties merely because, with the benefit of hindsight, their processes were not perfect or particular product risks that eventuated were not foreseen. It should be sufficient if issuers and distributors take reasonable steps, and act in good faith, to carry out the required processes to the standards determined by the legislation (see question 10).

Additionally, the failure to fully perform design and distribution obligations – on its own – should not invalidate a contract or product, or make it voidable at the election of a consumer. Inadequacies in the issuer’s process of defining the target market and appropriate distribution channels do not mean that the product is necessarily unsuitable for those consumers who have acquired it. Before a contract or product is invalidated, NAB recommends there ought to be proof of some other misconduct. This is addressed by existing laws (e.g. rights to rescind contracts where there is misleading and deceptive conduct or investment in unregistered but registrable managed investment schemes).

In principle, it appears reasonable that a consumer has a right to damages from an issuer or distributor if a failure to comply with design and distribution obligations actually causes financial loss to the consumer. However, NAB believes that, in practice, it may be difficult to define a fair test of causation – a simple ‘but for’ test may be unfair in the absence of evidence that the product is defective in some way.

Requiring an issuer to provide a replacement product at no additional cost may potentially be impractical for issuers and unsatisfactory for consumers. This should not be mandated in the reforms.

### **Intervention Order**

Breach of an intervention order would suggest a deliberate disregard of a real and specific ASIC concern for consumer financial safety, and one which should have been reasonably publicised by ASIC. Accordingly, NAB believes that potential penalties for breaches be more substantial and may potentially include criminal liability (in addition to administrative and civil liability). However, ‘mistake of fact’ and ‘reasonable steps’ defences should still be available.

An entitlement for consumers to claim damages for loss caused by breach of an intervention order is reasonable. However, a fair test of causation would be prudent because for some products a consumer might suffer financial loss, even in the absence of a breach of the requirements. Any test of causation needs to require a connection between ASIC’s reasons for imposing the intervention order and the nature of the loss suffered.

Consumers should also be entitled to elect to rescind or void contracts or products issued in breach of an intervention order, without having to prove loss or other detriment; however, these consumer remedies should be subject to appropriate defences. For example, a right to rescind or void the contract or product may be lost if the issuer or distributor proves the breach did not cause the consumer any loss, and is not likely to cause the consumer any future loss; or any loss or possible future loss is not connected to the reasons given by ASIC in making the intervention order.

NAB also notes that there are other current review initiatives that have been, or are being, undertaken by Government, such as the current Enforcement Review and the review of the role, powers and governance of the financial system's external dispute resolution and complaints schemes (Ramsay). The design of enforcement and consumer redress avenues should, to the extent appropriate, have regard to those other review initiatives.