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Financial Services Unit
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The Treasury
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PARKES ACT 2600

By email: ProductRegulation@treasury.gov.au

DESIGN AND DISTRIBUTION OBLIGATIONS AND PRODUCT INTERVENTION POWER

Thank you for the opportunity to comment on the Government's proposals to enhance the existing obligations placed on issuers and distributors of financial products as well as providing ASIC with greater product intervention powers to deliver improved consumer protection.

The policy objective that issuers and distributors of products should be "more accountable for ensuring that products are designed with consumer needs in mind and are marketed at appropriate sections of the population" is supported by the principles which underpin the intent of the product design, distribution and intervention requirements.

The scope of ASX's submission is confined to how the proposed new obligations interact with existing obligations applying to financial products listed or quoted on a licensed market. Extensive and well-tested obligations are in place for these products today. New obligations need to pass the cost benefit test of providing a material increase in the degree of consumer protection so that there is not simply an additional compliance burden, a cost that will inevitably be passed to the consumer. In the area of market traded products ASX's assessment is that ASIC's existing powers appear sufficient to ensure the effective protection of consumers. The details of these existing protections are set out below.

The consultation paper does not make it clear if licensed financial markets are considered to fall within the definition of issuers or distributors of financial products.

One reading of the criteria that define a product distributor (i.e. an entity that "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") could capture a licensed financial market which offers products for trading and which provides information and education about those products.

However, in practice financial markets merely provide a platform on which products offered by issuers can be traded. The products are distributed to consumers by brokers or financial planners who accept orders from their clients to buy and sell these products. The market operator has no direct business relationship with the client, and therefore should not be defined as a distributor for the purposes of these new obligations. A market operator does have specific licence obligations which go to some of these matters (see below).

The Corporations Act recognises that a market operator is not the issuer of derivatives traded on a licensed market through a broker who is a financial services licensee (see s761E(6)). We note the comment in the consultation paper that “For the purposes of the design and distribution obligations, it is proposed that the obligations will apply to anyone that meets the definition of issuer under the Corporations Act.” We agree that this is the correct approach and think it would be useful to confirm that the issuer obligations do not apply to market operators.

Products to be covered by these measures

The obligations are proposed to be imposed on all financial products except ordinary shares. ASX agrees that ordinary shares should be excluded from the scope of the proposals.

Other products traded on licensed financial markets should also be excluded from the measures. These include exchange traded funds (ETFs), warrants and other structured products, exchange traded options (ETOs) and futures. These products are already subject to a range of controls under the Corporations Act and to ASIC’s regulatory oversight.

These controls have been developed over a number of years through consultation between regulators, markets and the financial services industry and operate very effectively. As new types of products evolve, market operators and ASIC have the ability to introduce new controls if required. Imposing any further controls on market traded products would result in regulatory duplication, which may cause product offerors to prefer the unlisted market. This is not a desirable outcome as the licensed markets function well to provide customers access to products within a well-regulated and transparent framework.

Product design measures

Existing requirements relating to the design of market traded products are set out in the Operating Rules of the licensed market. For example, the ASX Operating Rules set requirements for the design of ETFs, warrants and ETOs. Under the Corporations Act the rules require regulatory clearance from the Minister (or ASIC as the Minister’s delegate) before they come into effect.

Matters which are considered in the regulatory clearance process include:

- the nature of the financial product being offered,
- the participants in the market and whether the products are to be made available to retail and/or wholesale clients; and
- whether the rule amendments that facilitate the listing, quoting and trading of the product are in the public interest (Corporations Act ss 793D, 793E and 798A).

The rules are reviewed by ASIC as part of the regulatory clearance process and ASIC has the opportunity to shape the design of new market traded products through this process, particularly if the products are designed to be made available to retail clients.

The market operator also has an obligation to enforce the operating rules, and it is a condition of its licence that it has in place adequate arrangements to monitor and enforce the operating rules (Corporations Act s792A).

Product distribution measures

In relation to distribution of market traded products, market participants (brokers) who are responsible for distributing these products to end customers are subject to the ASX Operating Rules. These rules include requirements concerning:

- who can access to the market; and
- how trading (the purchase and sale of financial products) is conducted.

If a broker breaches the rules ASX can take enforcement action against it.

In addition, brokers are also subject to the ASIC Market Integrity Rules (MIRs), including rules which:

- require best execution for clients (i.e. the best possible price);
- govern the broker-client relationship; and
- manage a client's trading experience (e.g. client order priority and prohibition on manipulative trading).

If a broker breaches the MIRs ASIC can take action against it.

For certain, more complex, products, such as futures, options and warrants, there are obligations under the MIRs that provide an additional layer of protection to ensure that clients are not able to trade in products deemed unsuitable given their financial knowledge and experience. These include:

- Brokers must provide a retail client with an information booklet which explains the features of a particular class of product.
- Clients enter into a client agreement with the broker which acknowledges the risks of the product and that the client has read the product information.
- Any broker giving advice on these products must have undertaken specialist accreditation before they are permitted to offer them to a retail client.

Also, products offered on ASX's mFund managed fund settlement service are subject to protections to ensure that clients are aware the service provides settlement but products are not traded on a market. The protections include a requirement that the broker give the client a copy of the PDS and Investor Fact Sheet and advise the client or prominently display a message (for online trading) that the service does not involve trading (ASX Operating Rule 4655).

Product intervention measures

ASIC has an existing power to direct a market licensee to suspend dealings in a financial product or class of financial product or give some other direction if ASIC is of the opinion that this is necessary or in the public interest to protect people dealing in those products. The direction is enforceable by a court (Corporations Act s794D).

ASIC has a similar power to direct any other entity to suspend dealings in a financial product or class of financial products or give some other direction if ASIC is of the opinion that this is necessary or in the public interest to protect people dealing in those products. The direction is also enforceable by a court (Corporations Act s798J).

These existing intervention powers over products traded on a licenced market provide ASIC with sufficient ability to intervene where they deem it necessary. ASX is of the view that no additional powers are necessary.

If you have any queries in relation to these matters please contact Sally Palmer (ph: 9227 0920; email: sally.palmer@asx.com.au) or Gary Hobourn (ph: 9227 0930; email: gary.hobourn@asx.com.au).

Yours sincerely,

A handwritten signature in black ink, appearing to read 'Sally Palmer', written in a cursive style.

Sally Palmer
Deputy General Counsel, Trading

A handwritten signature in black ink, appearing to read 'Gary Hobourn', written in a cursive style.

Gary Hobourn
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