

17 March 2017

Manager  
Financial Services Unit  
Financial System Division  
The Treasury  
PARKES ACT 2600

[ProductRegulation@treasury.gov.au](mailto:ProductRegulation@treasury.gov.au)

Dear Sir/Madam

**Design and Distribution Obligations and Product Intervention Power: Proposals Paper, December 2016**

On behalf of the customer owned banking sector and its 4 million customers, COBA appreciates the opportunity to comment on this consultation paper.

Customer-owned banking institutions - mutual banks, credit unions and building societies – have \$104 billion in total assets and 10 per cent of the household deposits market.

COBA endorses the Government's commitment, expressed in the consultation paper, to ensuring that all Australians are treated fairly and ethically by the financial system. We see value in carefully designed reforms to introduce:

- new design and distribution obligations for financial products, and
- a product intervention power for ASIC.

These reforms are more likely to strike the right balance between consumer protection and regulatory costs if:

- basic banking products are, like ordinary shares, exempt from the design and distribution obligation, and
- ASIC's consultation requirements in relation to the product intervention power are clearly defined.

COBA recognises that the proposed design and distribution obligations aim to reduce the number of consumers buying products that do not match their needs. We note however that the problem the recommendation seeks to address is primarily a result of large scale financial investment failures, and poor advice, associated with complex, 'Tier 1' financial products. Basic banking products are the simplest, safest and best understood of all financial products and it is highly unlikely that adding these obligations to basic banking products will lead to a meaningful increase in consumer protection relative to the regulatory costs.

Increasing the regulatory compliance burden harms competition because the biggest players have much greater capacity to handle the costs. The fixed costs of regulatory compliance, particularly staff costs, can be spread over a much larger asset base by larger entities. Higher costs for customer owned banking institutions means they have to shift resources away from customer service, product innovation and competitive pricing.

In terms of the product intervention power, COBA wants to ensure that the capacity of customer owned banking institutions to issue new capital instruments is not unduly inhibited by this new power.

COBA is currently engaging with APRA about increasing options for customer owned banking institutions to raise regulatory capital by issuing new instruments. Due to APRA's regulatory capital rules and our mutual model, these instruments may be considered novel and/or complex. It is important that our sector has the flexibility to target both retail and wholesale investor markets for these instruments. Customer owned banking institutions planning to issue such instruments need as much certainty as possible about the regulatory environment, including the scope of the production intervention power and associated consultation requirements.

For more detail on our concerns, please see the included attachment.

Please contact me ([llawler@coba.asn.au](mailto:llawler@coba.asn.au) or 02 8035 8449) or my colleague Mark Nguyen ([mnguyen@coba.asn.au](mailto:mnguyen@coba.asn.au) or 02 8035 8443) if you wish to discuss this submission.

Yours sincerely



**LUKE LAWLER**  
**Head of Public Affairs**

## ATTACHMENT

### Product Design and Distribution Obligations

#### Question 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)?

COBA's view is that "basic banking products" as defined under the *Corporations Act 2001* should be exempt from the product design and distribution obligations.

Basic banking products are defined under section 961F of the Corporations Act and include basic deposit products (such as transaction accounts), non-cash payment facilities, and travellers cheque facilities.

We note that ordinary shares and credit cards are to be exempt from the new obligations so it would be unreasonable and excessive to impose the obligations on issuers of basic banking products.

Basic banking products are the best understood products in the financial system. They are simple, safe and subject to a government guarantee for deposits of up to \$250,000.

COBA recognises that the proposed new obligations aim to reduce the number of consumers buying products that do not match their needs. We note however that the problem the recommendation seeks to address is primarily a result of large scale financial investment failures, and poor advice, associated with complex, 'Tier 1' financial products.

The FSI Final Report identifies the difference in risk of consumer detriment between complex and simple products, and states "simple low-risk products such as basic banking products would not require extensive consideration, and may be treated as a class with a standard approach to their design and distribution."<sup>1</sup>

However, even a "standard approach" will involve new regulatory compliance costs for issuers and possible unintended consequences.

The proposal will require issuers to:

- identify appropriate target and non-target markets for their products
- select distribution channels that are likely to result in products being marketed to the identified target market, and
- review arrangements with reasonable frequency to ensure arrangements continue to be appropriate.

It is unreasonable to impose these costs on issuers of basic banking products when it is considered inappropriate to impose the same costs on issuers of ordinary shares or issuers of credit cards or home loans.

The FSI's rationale for extending these new obligations to simpler products is based on concerns about general insurance and debentures rather than basic banking products.

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<sup>1</sup> Financial System Inquiry Final Report, November 2014, page 199

COBA is unaware of any significant consumer detriment associated with the design or distribution of basic banking products.

It is highly unlikely that adding these obligations will lead to a meaningful increase in consumer protection relative to the regulatory costs. The Government should go further than the FSI's proposed class treatment and exempt basic banking products from these requirements.

### **Basic banking products compared to ordinary shares**

Basic banking products are far simpler and far less risky than ordinary shares. Basic banking products are better understood by consumers than ordinary shares.

In canvassing the proposed exemption for ordinary shares, the consultation paper concedes that the new obligations will have regulatory costs:

“...these products are widely understood by consumers, and it would reduce the regulatory costs associated with companies undertaking capital raisings”<sup>2</sup>

The main ‘product’ covered by the basic banking product definition is a basic deposit product. The simple, safe and well-understood nature of basic deposit products is already well recognised in the regulatory framework and policymakers have taken considerable care to reduce as far as possible the regulatory burden on issuers of these products. This reflects the critical ‘everyday’ importance of these products for all consumers and as the chief source of funding for the banking system.

Basic deposit products (BDPs) are subject to much less onerous regulatory requirements than those applying under the Corporations Act to most other financial products, including ordinary shares. In particular:

- AFS licensees are not required to provide a Product Disclosure Statement [PDS] when recommending or issuing a BDP or other Basic Banking Product [BBP], as long as certain disclosures are made.
- Licensees are not required to provide a Statement of Advice [SOA] when providing personal advice about a BDP or other BBP.
- The current Tier 1 training requirements under *ASIC Regulatory Guide 146: Licensing: Training of Financial Product Advisers* do not apply in relation to advice on BDPs and other BBPs.
- The ban on conflicted remuneration under the Act does not apply in relation to BDPs and other BBPs.
- In relation to the Act's ‘best interests’ duty, advisers on BDPs and other BBPs only need to follow the ‘modified’ steps set out in the legislation to obtain the benefit of its safe harbour regime.
- Staff and representatives who only provide personal advice in relation to BDPs and other BBPs are not required to be registered on ASIC's Financial Adviser Register.

Exempting basic banking products from the proposed new design and distribution obligations would be consistent with this treatment.

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<sup>2</sup> Design and Distribution Obligations and Product Intervention Power: Proposals Paper, December 106, Page 11

## Product Intervention Powers

### Question 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?

COBA supports the requirement for ASIC to consult and consider alternatives before making an intervention. In order to do this, the legislative framework should clarify what is appropriate consultation to meet this requirement.

Adequate consultation will reduce the likelihood that the product intervention power will stifle innovation and competition.

COBA is sensitive to the risk that the proposed new power could affect our sector's capacity to issue instruments that meet APRA's requirements to qualify as Common Equity Tier 1 (CET1), Additional Tier 1 or Tier 2 regulatory capital.

COBA is currently discussing with APRA amendments to the prudential regulatory regime to allow customer owned banking institutions to directly issue CET1 instruments. APRA's framework is based on international banking rules set by the Basel Committee on Banking Supervision and these rules are designed for internationally active listed banks. There is a degree of complexity in aligning the prudential framework with the customer owned business model that is subject to ASIC Regulatory Guide 147 *Mutuality – Financial institutions*.

In Australia, listed banks regularly issue CET1 capital instruments, and it is important that customer owned banking institutions also have the capacity to do so while preserving their mutual model. Having the option to raise capital in addition to retained earnings allows for more ambitious growth targets, diversifies funding options and provides capacity to take acquisition opportunities and invest in technology and innovation.

Prior to the Basel III changes to definitions of regulatory capital in the prudential framework in 2012, customer owned banking institutions did have capacity to issue the highest quality capital instruments and did issue such instruments.

APRA's prudential framework has fallen behind comparable jurisdictions, i.e. Europe and the UK, where mutual banking institutions have been given capacity to issue CET1 instruments. Canada is also taking steps to deliver this capacity.

APRA is currently engaging positively with our sector on possible amendments to the prudential framework to allow for direct issue of CET1 instruments by COBA members.

In the UK, ASIC's counterpart, the Financial Conduct Authority (FCA), used its product intervention power to restrict distribution to retail investors of certain regulatory capital instruments issued by the banking sector.

In the case of CET1 instruments issued by mutual banking institutions, the FCA did not prevent distribution of the securities to retail investors but did impose some additional disclosure and conduct requirements.<sup>3</sup>

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<sup>3</sup> Financial Conduct Authority, Restrictions on the retail distribution of regulatory capital instruments: Feedback to CP14/23 and final rules, June 2015, page 8

The FCA's approach to these mutual instruments highlights the importance of consultation in reaching outcomes acceptable to all stakeholders and accommodating different business models and relatively novel financial products:

"...we are mindful that mutual societies, particularly the smaller societies, may have little or no access to institutional markets to raise regulatory capital. We also recognise that the concept of mutuality entails ownership by members; some consumers may genuinely wish to support mutual societies of which they are members by providing core capital."<sup>4</sup>

COBA supports the consultation paper's view that there should be a high degree of transparency around ASIC's use of the power and that this could include ASIC making publicly available details of any intervention, details of the risk of significant consumer detriment and details on why the product intervention power is the most effective means of addressing the issue.

We also agree with the proposals that procedural steps based around consultation, consideration of alternative powers and post-intervention transparency best meets the principle of ensuring there is sufficient due process before an intervention is made.

We support the proposed requirement that ASIC must consult with APRA prior to using this power when it may affect an APRA-regulated body.

**17 March 2017**

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<sup>4</sup> FCA, Feedback to CP14/23 and final rules, June 2015, page 7