



# Australian Banking Association

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Dear Ms Moore

## Design and Distribution Obligations and Product Intervention Powers

The Australian Banking Association (**ABA**) appreciates the opportunity to provide Treasury with comments regarding the exposure draft *Treasury Laws Amendment (Design and Distribution Obligations and Product Intervention Powers) Bill 2017 (the Bill)*.

With the active participation of its 24 members, the ABA provides analysis, advice and advocacy for the banking industry and contributes to the development of public policy on banking and other financial services. The ABA works with government, regulators and other stakeholders to improve public awareness and understanding of the industry's contribution to the economy and the community to ensure Australia's banking customers continue to benefit from a stable, competitive and accessible banking industry.

### 1. Introductory comments

The banking industry supports the intent of the Design and Distribution Obligation (**DDO**) to assist "consumers to select appropriate financial products by requiring issuers and distributors to appropriately market and distribute financial products."<sup>1</sup> We believe that in the context of complex financial products and/or products that carry investment risk, disclosure in isolation can be ineffective and we support the Financial Systems Inquiry Final Report (**FSI Final Report**) observation that "these issues have contributed to consumer detriment from financial investment failures, such as Storm Financial, Opes Prime, Westpoint, agribusiness schemes and unlisted debentures."<sup>2</sup>

We make the below comments on applying the DDO to Basic Banking Products (**Basic Products**).<sup>3</sup>

### 2. Applying DDO to Basic Banking Products

Basic Products include savings accounts, transactions accounts, term deposits and traveller's cheques. These products are integral to everyday living and spending activities of consumers. They are essential to financial inclusion, and many customers benefit from having a wide variety of Basic Products that are tailored to their needs, such as student savings accounts or term deposits of varying duration.

Basic Products by their nature are simple, low risk products that, notwithstanding the tailored design of some products in the interests of customers, are generally suitable for a wide range of consumers.

For the reasons explained in this submission, we believe that applying the DDO to Basic Products will reduce customer choice, impact competition and limit investment and innovation in the design and distribution of Basic Products.

**Recommendation:** *Basic Products should not be brought into the DDO regime.*

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<sup>1</sup> p5, Explanatory Memorandum.

<sup>2</sup> *Financial System Inquiry Final Report*, <http://fsi.gov.au/publications/final-report/chapter-4/accountability/>

<sup>3</sup> s961F, *Corporations Act* (Cth) 2001. Each of the following is a basic banking product: (a) a basic deposit product; (b) a facility for making non-cash payments (see section 763D); (d) a facility for providing traveller's cheques; (e) any other product prescribed by regulations for the purposes of this paragraph. For consistency with the FOFA legislation and in recognition of the simple and low risk nature of Basic Banking Products, all Basic Banking Products, including Basic Deposit products, should not be brought with in the DDO regime.



## 2.1 Policy intent

The policy intent of the DDO is to overcome the identified deficiencies of disclosure, such as “consumer disengagement, complexity of documents and products, behavioural biases, misaligned interests and low financial literacy.” It also intends to reduce the likelihood of failures such as Storm Financial or Opes Prime.<sup>4</sup>

It is not clear what the policy objective is for including Basic Products, nor what the expected benefits for consumer will be. In our view, the inclusion of Basic Products in the DDO regime does not further the policy intentions of the regime and has the effect of complicating the provision of Basic Products without providing useful consumer protection.

Basic Products are simple, low risk products, generally suitable for most consumers. Where there are potential adverse outcomes for consumers they relate to not obtaining the full benefit of the product’s features, paying relatively higher fees, or selecting a product with less features and benefits.

However, impacts do not include investment risks or losses or financial hardship. In virtually all cases, the consumer will receive value from the product.

The FSI Final Report noted that “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”. However, as it is currently drafted, the Bill requires the full suite of DDO obligations to apply to Basic Products, without providing clarity on how the obligation can be scaled, and without relief from the substantial and ongoing record keeping and reporting obligations.

## 2.2 Current treatment of Basic Banking Products

Because of their nature, Basic Products, and in particular Basic Deposit Products, are covered by a range of disclosure and conduct exemptions including:

- Basic Products are subject to the modified best interests duty<sup>5</sup> recognising that these products are simple in nature and are more widely understood by consumers, and that there is a lower risk of consumer detriment in relation these products.<sup>6</sup> In designing the modified best interest duty, the Government expressly took into account appropriately balancing the benefits to consumers with the compliance costs to providers.<sup>7</sup>
- Basic Products are exempt from the requirements of a Statement of Advice when personal advice is provided.
- ADI staff and representatives who only provide personal advice in relation to Basic Products are not required to be registered on ASIC’s Financial Adviser Register.
- Basic Deposit Products are subject to specific exemptions from the disclosure obligations set out under part 7.9 of the Corporations Act, reflecting the established public policy position that these products are simpler and lower risk and require appropriately limited safeguards.

Despite these established regulatory settings, it is proposed that regulations are made to bring Basic Deposit Products “back” into the regime. The proposed regulations are inconsistent with the established treatment of Basic Products and Basic Deposit Products, which was designed considering the low risk and simple nature of these products.

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<sup>4</sup> *Financial System Inquiry Final Report*, <http://fsi.gov.au/publications/final-report/chapter-4/accountability/>

<sup>5</sup> s961B(3), *Corporations Act* (Cth) 2001. Advice given by Australian ADIs—best interests duty satisfied if certain steps are taken.

<sup>6</sup> para1.53, <https://www.legislation.gov.au/Details/C2011B00265/Revised%20Explanatory%20Memorandum/Text>

<sup>7</sup> *Ibid.*



### 3. Adverse impacts

#### 3.1 Impact on investment and innovation

Including Basic Products in the regime may have adverse impacts on investment and innovation in the design and distribution of these products. Feedback from our members indicates that banks may tend towards designing “vanilla” products that do not have specific or unique features. A move to standardised, vanilla product offerings would be a way to manage potential legal risks given the uncertainty of the operation of the DDO, and to reduce complexity of the target market determination and consequential data gathering and record keeping and reporting.

However, this approach would reduce consumer choice and competition between product offerings, and leave consumers with less access to products that are targeted to their needs. Further, allocating resources to implementing the obligations for Basic Products will divert resources and investment away from other product and channel developments. Existing investment in product differentiation and competition between banks means that fees have been kept low.

#### 3.2 Impact on customer experience

It is likely that to comply with the DDO obligations, additional information will be collected at point of sale, and an assessment made about whether the customer fits the target market. This will slow down customer interactions and could affect the ability of banks to offer certain products through online or other channels, reducing accessibility and customer choice.

To manage operational risks arising from extensive branch and call centre networks, it is likely that some banks will remove staff discretion to sell Basic Products to customers where that customer cannot demonstrate that they are in the target market. This will result in slower systems as overriding assessments are carried out, or a restriction on consumer choice.

Government policy, including the design of the FOFA reforms, supports the provision of General Advice so that consumers can access innovative and lower cost products. The effect of requiring more investigation at point of sale will be to slow down these models and necessarily add cost to the sale of these simple financial products.

#### 3.3 Impact on competition

As described above, banks have indicated that applying the DDO to Basic Products could see a more standardised product set, which would reduce customer choice, and affect competition. Our non-major bank members have also provided feedback that there will be a significant impact on smaller ADIs in setting up compliance arrangements to meet the DDO. An extension of time for smaller ADIs will not lessen this compliance and costs impact.

It is also possible that banks will need to limit their distribution channels or take products “off line” while digital and online systems are rebuilt to capture the relevant information. This would impact the accessibility of services to consumers in regional areas and who access services online.

Banks that do not have extensive branch networks are likely to be most impacted by these issues.

### 4. Other arrangements to manage risks for consumers

The FSI Final Report proposed, as a matter of principle, that the DDO be universal in its nature and scalable in line with the nature of the product, thus including Basic Products. It claimed this approach would deliver benefits to industry, including strengthening internal risk management for product design, which may mitigate future problems, as well as signalling a higher level of customer focus.<sup>8</sup>

However, the DDO comes at a time where the risks of misselling are trending downward, due to the industry’s action on remuneration structures, and other industry led and government led reforms,

<sup>8</sup> *Financial System Inquiry Final Report*, <http://fsi.gov.au/publications/final-report/chapter-4/accountability/>



including improved background checking, enhanced whistleblowing procedures and the Banking Executive Accountability Regime.

Risks of misselling are also managed through banks' rigorous internal assurance and audit processes.

## 4.1 Remuneration

Banks are currently implementing the recommendations of the Retail Banking Remuneration Review (Sedgwick Review)<sup>9</sup> and removing remuneration structures that could promote behaviour which is inconsistent with customer interests. Changes to remuneration practices which will apply to retail bank staff include:

- No longer paying retail bank employees incentives based directly or solely on sales.
- Where incentives are paid, they should be based on a range of measures of which financial measures is not the dominant component.
- Incentives paid should be product neutral and no longer include payments related to additional products or cross-selling products.
- Examining workplace culture and leadership frameworks to ensure they are aligned with good customer outcomes.

These remuneration changes will substantially lessen misselling risks and promote good customer outcomes and sound banking practices.

## 4.2 Bank assurance and audit processes

Banks operate substantial assurance and audit programs, to identify systemic issues and continuously improve product offering and client experience. These programs are driven by emerging risks and issues, outcomes of IDR and EDR and ongoing quality assurance processes. These programs are intended to prevent future issues, as well as managing current issues.

## 4.3 Evidence of inquiries and reviews

Following regulatory action against Wells Fargo in the U.S., ASIC undertook audits of Australian Banks' processes in relation to three common consumer banking products: basic deposit products, credit cards and CCI from 2014 to 2016. As noted by ASIC in its media release outlining the findings of the audits:

*"All of the audits found that the systemic misconduct that occurred at Wells Fargo had not been occurring in the banks and that, overall, controls were adequate to prevent and identify misconduct."<sup>10</sup>*

These findings of this review do not support the need for further reforms to the distribution of Basic Banking Products.

## 5. Compliance impacts

Despite the DDO being framed as flexible and scalable, we believe that operationalising compliance with the DDO for Basic Products will require substantial change and investment by banks that will have an adverse impact on investment and innovation, consumer experience and choice, and competition.

The FSI Final Report noted that "industry concerns about implementation costs can be dealt with by ensuring the obligation builds on good practice, is principles-based and is applied on a scaled basis, allowing scope for firms to adapt their existing practices. Thus, the new obligation would impose minimal costs on firms with existing good practices."<sup>11</sup>

<sup>9</sup> [https://www.betterbanking.net.au/wp-content/uploads/2018/01/FINAL\\_Rem-Review-Report.pdf](https://www.betterbanking.net.au/wp-content/uploads/2018/01/FINAL_Rem-Review-Report.pdf)

<sup>10</sup> <http://asic.gov.au/about-asic/media-centre/find-a-media-release/2017-releases/17-254mr-asic-reports-on-australian-bank-audits-following-wells-fargo-misconduct/>

<sup>11</sup> *Financial System Inquiry Final Report*, <http://fsi.gov.au/publications/final-report/chapter-4/accountability/>



## 5.1 Target market determination

It is unclear what factors will need to be considered when describing the class of persons who comprise the target market for a Basic Product. These products are suitable, and many of them, such as transaction accounts and savings accounts, are essential, for most Australians. Defining a target market around dominant and readily ascertainable characteristics such as age or employment status is unlikely to yield a defined target market for Basic Products. A more granular target market that considers client characteristics, such as behaviour will be complex to implement and prompt personal advice risks (as outlined below).

For example, it is likely that determining a target market for a bonus saver account could require prediction of future saving / deposit behaviours. The Bank would need to design data collection and record keeping processes to collect and capture information about the customer's savings habits and intentions. This would require new data points, adding to the costs and complexity of record keeping, and in any case, likely be relatively ineffective at predicting behaviour.

## 5.2 Point of sale data capture, record keeping and reporting

Once the target market and relevant customer characteristics are determined, compliance in retail banks is likely to be operationalised by capturing relevant (and likely new) data points at point of sale. This may require new client conversations and call centre scripts, new staff training, system changes to accommodate the data capture and system, and reporting changes to monitor client data to detect significant dealings outside the target market. While there are complexities in managing the target market determination obligations, by far the biggest operational impacts will be in relation to data collection, record keeping and ongoing reporting. Extrapolated data across the major banks, indicates that those banks issue around 5 million basic deposit products per year and the DDO will affect each of those transactions.

## 5.3 Regulatory risks – personal advice

Banks already manage substantial regulatory risks relating to the unauthorised provision of personal advice by frontline bankers. The industry makes significant investments in training staff, embedding controls to limit interactions to factual information and / or general advice and monitoring and supervising against those controls.

Introducing complexity in customer conversations that requires collection of specific target market data is likely to be confusing for customers, and will, despite the most committed training and compliance efforts of banks, heighten risks around providing unauthorised personal advice.

## 5.4 Costs

### 5.4.1 Compliance costs

We believe that the compliance costs to implement the DDO across the industry will substantially exceed the estimated annual compliance costs of \$232.1 million. Extrapolated data from our members estimates that the compliance costs related to implementing the DDO in relation to Basic Products will be around \$200 million per year.

### 5.4.2 Cost to the consumer

The substantial compliance costs related to Basic Products have the potential to affect fees paid by consumers. Possible increases in fees are at odds with the industry's financial inclusion objectives and at odds with consumer expectations that they should obtain these products for free or at very low costs.



## 6. Personal advice – technical changes

If, when determining whether a customer fits within the target market, the institution needs to collect and consider granular personal information, it could trigger personal advice obligations through s766B(3), which sets out that a provider is taken to be providing personal advice when:

- a) They have considered one or more of the person's objectives, financial situation and needs (other than for compliance with the anti-money laundering laws); or
- b) A reasonable person might expect the provider to have considered one or more of those matters.

**Recommendation:** *The current carve-out in section 766B(3)(a) (relating to compliance with AML laws) is amended so that a provider in complying the DDO is not taken, to have considered one or more of the individual's objectives, financial situations or needs.*

## 7. Timeframes

In considering the scope of changes required to ensure compliance with this regime, and the necessity of further regulations and ASIC guidance, the ABA proposes that a more appropriate implementation timeframe would be an effective date 12 months from the beginning of the financial year following the year in which final legislation, including regulations, is made and ASIC guidance issued.

A further 12 months transition before the provisions are mandatory is recommended to allow finalisation of guidance including addressing unanticipated issues. This would reflect the timeframes for similar international regimes, such as the MiFID II Regime which came into effect in the European Union on 3 January 2018, following consultation from 2014 onwards and also the approach to Future of Financial Advice reforms.

**Recommendation:** *The effective date of the DDO legislation is 12 months from the beginning of the financial year following the year in which final legislation, including regulations, is made and ASIC guidance issued, or 1 July 2019, whichever is later.*

*A further 12 months transition before the provisions are mandatory is recommended to allow finalisation of guidance including addressing unanticipated issues.*

## Concluding remarks

We thank Treasury for the opportunity to comment on this exposure draft and hope our comments will be of some assistance. We look forward to continuing to work with Treasury on this issue. If you have any queries regarding our submission, please contact Christine Cupitt, Executive Director, Policy on [REDACTED] or [REDACTED].

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