

11 March 2020

Mr Andrew Fawcett
Senior Executive Leader, Strategic Policy
Australian Securities and Investments Commission
120 Collins Street
MELBOURNE VIC 3000

By email: product.regulation@asic.gov.au

Dear Mr Fawcett

CONSULTATION PAPER 325: PRODUCT DESIGN AND DISTRIBUTION OBLIGATIONS

The Insurance Council of Australia (Insurance Council)¹ appreciates the opportunity to provide our comments on the ASIC consultation paper 325: Product Design and Distribution Obligations (the Consultation Paper) which sets out ASIC's proposals on the implementation of the product design and distribution obligations (PDDO) in Part 7.8A of the Corporations Act 2001 (Cth).²

We are supportive of the overall approach taken in the Consultation Paper and the accompanying draft regulatory guide, and would like to offer three key recommendations for ASIC's consideration.

Executive summary

The Insurance Council makes three key submissions.

Recommendation 1: We support ASIC's intent to adopt a flexible approach to the implementation of the PDDO especially in the initial period in relation to the treatment of personal financial advice and bundled products.

Recommendation 2: Given that the legislation requires Target Market Determinations (TMD) to address classes of customers, the draft regulatory guide should clarify that reasonable steps required under Section 994E (to ensure that distribution is consistent with TMDs) would include collection and analysis of data in relation to those classes of customers, rather than the individual purchasers of the relevant financial products.

¹ The Insurance Council of Australia is the representative body of the general insurance industry in Australia. Our members represent approximately 95 percent of total premium income written by private sector general insurers. Insurance Council members, both insurers and reinsurers, are a significant part of the financial services system. December 2019 Australian Prudential Regulation Authority statistics show that the general insurance industry generates gross written premium of \$50.2 billion per annum and has total assets of \$129.7 billion. The industry employs approximately 60,000 people and on average pays out about \$152.3 million in claims each working day.

Insurance Council members provide insurance products ranging from those usually purchased by individuals (such as home and contents insurance, travel insurance, motor vehicle insurance) to those purchased by small businesses and larger organisations (such as product and public liability insurance, professional indemnity insurance, commercial property, and directors and officers insurance).

² All subsequent legislative references are to the Corporations Act 2001 (Cth) unless expressly stated otherwise.

Recommendation 3: Consistent with the approach taken by ASIC with “negative target markets”, policy concepts imported from outside Part 7.8A such as “choice architecture” should be treated as helpful suggestions which the industry could voluntarily adopt, recognising that they are not expressly required by law.

Recommendation 1: A flexible approach to regulatory implementation

The Consultation Paper recognises that the PDDO are a new regulatory paradigm for both ASIC and the financial services industry, and that ASIC’s approach to administering the PDDO may evolve over time with the benefit of experience, and that its guidance will be updated as required.³ Similarly, for the financial services industry, ASIC recognises that the product governance framework should provide for an ongoing, iterative and responsive process, whereby issuers address problems when they arise and improve products and their distribution as needed.⁴

We welcome this approach and believe it will beneficially allow both ASIC and the industry to accumulate and share learnings over the initial period about how the PDDO can be most effectively implemented. A constructive dialogue between industry and ASIC is particularly critical given ASIC does not propose to provide formal guidance that is industry specific.

In order to facilitate ASIC’s intended approach, the Insurance Council submits that the draft regulatory guide should provide greater certainty that a more flexible approach to regulatory enforcement will be taken, especially during an initial period following the 5 April 2021 commencement date of the PDDO.

Personal financial advice

In particular, the draft regulatory guide notes Section 766B(3A) which provides that the acts of asking for information solely to determine whether a person is in a target market, and of informing the person of the result of that determination, do not of themselves constitute personal advice.⁵

As ASIC would be aware the practical challenges in applying Section 766B(3A) arises from the fact that to ensure that an individual customer is in a target market, substantial and detailed information will often be required from the customer. If it is determined that the customer is within the target market, this could in turn lead to a consideration of specific objectives, financial situation or needs.

While insurers have been developing systems and processes as part of their product governance framework to engage in customer conversations in compliance with Section 766B(3A), the Insurance Council submits that a flexible approach to its enforcement in the initial period will assist them to accumulate learnings from a first round of implementation and improve their systems accordingly (for example system changes to ensure that customer understanding is recorded).

³ Paragraph 22, Consultation Paper.

⁴ RG 000.50, Draft regulatory guide.

⁵ RG 000.176 – 179, Draft regulatory guide.

Bundled products

We also note that the draft regulatory guide states that a TMD must be made for each separate product when multiple products are “packaged” or “bundled” by an issuer. In relation to insurance, ASIC argues that Section 764A(1A) provides that single contracts of insurance which provide two or more kinds of cover are deemed to be separate products, and that Section 764(1A) and (1B) provide that contracts of insurance which provide a kind of cover in relation to two or more kinds of asset are deemed to be separate products, and accordingly, a separate TMD should be made for each product in those circumstances.⁶

We suggest that ASIC’s regulatory guidance should be clear that a more consumer-centric approach would be to provide greater scope for issuers to decide whether a single TMD or multiple TMDs would be appropriate for a package of products, having regard to which approach would result in better customer outcomes. A separate TMD for each element of a package of products could in many cases simply be confusing for the class of customer for whom it was intended (and may lead to the customer becoming more disengaged); the insurer may decide that (having regard to the class of customer and their needs as a cohort) a single TMD could be more effective in determining whether the customer is in or out of the target market for the package as an integrated whole.

A home and contents policy is a good example. Would insurers need to provide two separate TMDs – one for the home component, and another for the contents component? Would separate TMDs be required at a more granular level, such as contents with accidental damage and without accidental damage? In either scenario, multiple TMDs would need to be read in conjunction with each other in order to determine whether the customer is in the target market. We submit that the insurer in question should be able to decide whether having a single TMD or multiple TMDs would be more effective in determining whether the customer is in or out of the target market for the package as an integrated whole.

Objectives, needs and financial situation of the target market

The draft guidance does not provide an indication of ASIC’s expectations on the factors insurers should consider in determining the objectives, needs and financial situation of the target market. The industry has consistently outlined the challenges of undertaking granular assessments of objectives, needs and financial situation for broad target markets.

When implementing the obligations, key questions for insurers will arise in relation to how granular such an assessment needs to be. For example, would a high level objective to transfer risk of damage to the home building be sufficient, or would insurers need to consider objectives at a more granular level (such as transfer only particular types of risk or transfer only a certain level of risk)? Determining the financial situation of the target market is even more complex for general insurance products. Do insurers consider affordability per benefit within a policy, or all of the possible options that may be selected by a consumer?

An ongoing dialogue with ASIC, at least in the initial period following commencement of the obligations, will give industry greater confidence in its efforts to comply with the new requirements.

⁶ RG 000.103, Draft regulatory guide.

Recommendation 2: Clarifying that Target Market Determinations should be in relation to classes of customers

Part 7.8A makes it clear that where Section 994E requires reasonable steps to be taken for the distribution of financial products to be consistent with their TMDs, this would be in relation to a class of customers rather than the eventual individual purchasers of those financial products. This is given that:

- Section 994B(5)(b) clearly states that a TMD must describe a *class of retail clients* that comprises a target market for the financial product.
- The explanatory materials to the PDDO legislation also make it clear that the reference to a class of products is to *hypothetical* customers rather than individual purchasers.⁷
- It would also be *unreasonable* for a TMD to refer to individual purchasers when Section 994B(2) requires TMDs to be made before distribution.

The Insurance Council submits that the draft regulatory guide could be helpfully modified to make it clear throughout that reasonable steps to be taken for the distribution of financial products to be consistent with their TMDs are in relation to a class of customers rather than individual purchasers.

While the draft regulatory guide generally recognises that TMDs are to describe classes of customers rather than individual purchasers,⁸ we note for example that the following commentary on “*reliance on existing information about the consumer*” in Table 5 (*Factors relevant to our administration of the distributor’s reasonable steps obligation*) appears to refer to collection and analysis of data for individual purchasers rather than the “hypothetical” class of customers for which the product is suited as intended in Part 7.8A (emphasis is added):⁹

Reliance on existing information about the customer:

In some cases, the distributor *may already have information about a prospective consumer* (e.g. if they are an existing consumer in the case of a renewal) prior to distribution...

We will take into account whether the distributor has relied on the following matters appropriately:

- Broader indicators about the *likely circumstances of the consumer* or a particular grouping of consumers ...
- Information that the distributor *may already hold about the consumer*.

We suggest that such an approach is inconsistent with the requirements of Part 7.8A, and also appears to be at odds with other parts of the draft regulatory guide including Example 14 on the annual renewal of general insurance policies which consistently refer to “*consumers in*

⁷ The reference to “hypothetical” consumers comes from Paragraph 1.56, Explanatory materials, Treasury Laws Amendment (Design and Distribution Obligations and Product Intervention Powers) Bill 2018, which states that (emphasis added):

The amendments use language similar to that currently used in the Corporations Act in the context of personal advice. In particular, it must be reasonable to conclude that if the product were issued or sold it would “likely be consistent with the likely *objectives, financial situations and needs* of persons in the target market”... [emphasis added]. This reflects that the factors that are important to providing good personal advice are also important to good product design, particularly when determining the *hypothetical consumers* in a product’s target market.

⁸ RG 000.67, RG 000.73, Draft regulatory guide.

⁹ RG 000.163, Draft regulatory guide.

a particular class” rather than the individual purchasers of those policies in relation to the reasonable steps requirement under Section 994E.¹⁰

We understand from the 5 March 2020 roundtable that ASIC believes that while the TMD may refer to a hypothetical class of customers, checking for consistency of distribution against the TMD should be done using individual customer data.

Our impression is that ASIC may consider that this position is supported by Section 994B(8) which states that a TMD must be such that it would be reasonable to conclude that, if the product were to be issued or sold to a retail client in accordance with the distribution conditions, it would be likely that the retail client is in the target market, and that the product would be consistent with the likely objectives, financial situation and needs of the retail client.

We submit however that such an interpretation would be inconsistent with the clear intent of Section 994E that only reasonable steps are needed to ensure consistency with TMDs. In practical terms, it would mean that insurers could be required to collate and analyse new data in addition to what was done in preparing for the TMD *at each renewal* (which would vary from customer to customer) which we submit would go beyond reasonable steps. By comparison, we consider there is greater likelihood that collating and analysing new data at the end of the review period as specified in the TMD would constitute reasonable steps (although this would of course depend on specific circumstances).

We also note more generally that there may be, at least currently, definite limits to the amount of customer data which insurers can collate and analyse to check for consistency of distribution against the TMD. There may for example be various privacy law restrictions, as well as system changes that will be required to facilitate data flow and analysis (noting that the latter may be addressed over a period of time).

Clarifying the reasonable steps to be taken in order for the distribution of financial products to be consistent with the class of customers identified in their TMDs would, in our view, be more consistent with the position in RG 000.63, Draft regulatory guide, that TMDs are not to be a “consumer-facing disclosure document” (which we support).

If the existing references to “reliance on existing information about the customer” are to be retained, the Insurance Council requests additional examples to explain the references to “broad indicators about the likely circumstances of the consumer or a particular grouping of consumers”. Clarity is essential when such indicators may result in the exclusion of a class of customer from the target market.

Recommendation 3: Reference to policy concepts from outside Part 7.8A

The Insurance Council recognises that ASIC will look for ideas on best practice regulation from outside the relevant legislation, including from foreign jurisdictions. This will often result in helpful suggestions for the industry as it looks to continuously improve its regulatory compliance strategies. A useful example is the commentary on “negative target markets” in the draft regulatory guide:

While the law does not require the issuer to state the negative target market in the target market determination... we expect that identification of a negative target market is likely to

¹⁰ RG 000.163, Draft regulatory guide.

assist the issuer in defining the target market at a sufficiently granular level to avoid the inclusion of any groups of consumers whose likely objectives, financial situation and needs are not likely to be consistent with the financial product.¹¹

We submit that the approach taken in relation to “negative target markets” should be used for all other cases in the draft regulatory guide where ASIC is looking to introduce policy concepts from outside Part 7.8A. Given that they are not required by legislation, exogenous policy concepts should be presented as helpful suggestions which industry could voluntarily choose to adopt to help improve their regulatory compliance strategies; the industry should not be required to comply with such approaches.

A notable example in the draft regulatory guide is the “choice architecture” concept.¹² ASIC should be commended for the considerable body of work that it has developed in recent years around this concept, most notably in its recent work on improving financial services disclosure.¹³ It does not however appear to be a concept that is directly sourced from Part 7.8A or the extrinsic materials that can be used in the interpretation of Part 7.8A.¹⁴

On that basis we submit that the same approach taken in relation to “negative target markets” should be used. The “choice architecture” concept should be a helpful suggestion that the industry could voluntarily adopt, recognising that it is not expressly required by law. It should not in our view be regarded as being relevant in determining whether an issuer is complying with the reasonable steps obligation in Section 994E as stated in the draft regulatory guide.¹⁵

We also note that there are some differences in the terminology and concepts used in the draft regulatory guide which differ, in our view, from Part 7.8A. We have identified examples of this in the Attachment. While some of these examples may seem minor, any inconsistencies between the guidance and the law has the potential to cause confusion and adds complexity to legal compliance. We suggest that the draft guidance be reviewed to ensure greater consistency with the Part 7.8A requirements.

Next steps

If you have any questions or comments in relation to our submission please contact John Anning, the Insurance Council's General Manager Policy, Regulation Directorate, on Telephone: 02 9253 5121 or email: janning@insurancecouncil.com.au.

Yours sincerely



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¹¹ RG 000.90 – RG 000.92, Draft regulatory guide.

¹² RG 000.47, RG 000.117 – RG 000.121, Draft regulatory guide.

¹³ ASIC and Dutch Authority for the Financial Markets, “Disclosure: why it shouldn't be the default”, Report 632, October 2019.

¹⁴ Section 15AB, Acts Interpretation Act 1901 (Cth).

¹⁵ RG 000.47, Draft regulatory guide.

Attachment – Potential Inconsistencies between Draft Regulatory Guide and Part 7.8A

	Regulatory Guide reference	Regulatory Guide content	Difference with Part 7.8A
1.	RG 000.12	Issuers and distributors must now design and distribute products that are likely to be consistent with the likely objectives, financial situation and needs of consumers.	The law requires issuers and distributors to design and distribute products that are likely to be consistent with the likely objectives, financial situation and needs of the 'target market'.
2.	RD Table 1	A target market determination must specify what information distributor(s) must report to the issuer (and how frequently) to enable the issuer to identify whether the target market determination needs to be reviewed.	The law requires the target market to specify the 'kinds of information' distributors must report, which is broader.
3.	RG 000.48	...we expect the product governance framework to include processes and controls designed to reduce the risk of financial products being issued to consumers that are inconsistent with their objectives, financial situation and needs.	The law requires that products are designed and distributed so that they are likely to be consistent with the 'likely' objectives, financial situation and needs of the 'target market'.
4.	RG 000.54	It is also important for issuers and distributors to consider consumer vulnerabilities, and how these vulnerabilities (which can include a consumer's personal circumstances and the specific influence or impact of features in a product's choice architecture) may increase the risk that products sold to consumers do not meet their needs and lead to poor consumer outcomes.	This commentary gives the impression that a consumer's personal circumstances need to be considered, which as we understand it, is not the intent of the law. The law also requires consideration into consumers' 'likely needs' rather than 'needs'.
5.	RG 000.81	To help ensure that it complies with the design and distribution obligations, an issuer...will need to critically assess that the financial product it ultimately develops is likely to be consistent with the likely objectives, financial situation and needs of its intended target market. Questions that issuers could usefully consider as part of this process include: (a) what is the purpose of the product? Does it fulfil a well-founded need for	The draft guide introduces the concept of a 'well founded' need. Does this differ from the 'likely need' test under the law?

	Regulatory Guide reference	Regulatory Guide content	Difference with Part 7.8A
		consumers in the target market? Is it fit for purpose?	
6.	RG 000.116	As part of the distribution strategy, we also expect the issuer to select distributors whose typical consumers, and services offered, are consistent with the target market for the financial product, and consider the potential vulnerabilities of existing and prospective distribution methods.	'Distribution strategy' is a new concept not contained within the law.
7.	RG 000.139	Information from a distributor that may be necessary to enable an issuer to identify whether a target market determination should be reviewed include: <ul style="list-style-type: none"> a) Complaints data b) Consumer feedback (including on the performance of the product) c) Request for information from consumers d) Percentage of sales to consumers who are not in the target market e) Samples of recorded sales calls f) Conversion rates g) Volume of sales h) Web analytics (e.g. click data and website paths) 	The law requires issuers to identify the 'kinds of information' needed to enable the issuer to identify whether a review trigger for the TMD, or another event or circumstance that would reasonably suggest that the TMD is no longer appropriate, has occurred. In contrast, the examples in the draft guidance of the data which issuers should require in a TMD are very specific.