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ALERT

New DDOs mean more work for fund managers

ASIC has confirmed the Government's new design and distribution obligations (DDO) represent a major change in financial services regulation and require changes to the way financial service providers who issue and distribute products to retail clients do business.

ASIC's new policy in Regulatory Guide 274—*Product design and distribution obligations* (RG 274) confirms retail fund managers have a lot of work to do to ensure their systems and processes comply with the new rules on and from 5 October 2021. ASIC expects compliance from day one and has emphasised it will not take a broad 'facilitative' or no-action position on compliance after commencement.

ASIC's policy in RG 274 was developed following a lengthy consultation process with industry and other stakeholders. While it is broadly consistent with ASIC's draft policy released in December 2019, here managing partner Sean McMahon and consultant Jeunesse Meldrum set out some key points to note.

KEY POINTS

1. **Not personal advice.** ASIC has confirmed DDO is not an individualised product suitability test that requires assessment of each investor's personal circumstances at point-of-sale. Rather, DDO requires issuers and distributors to develop and maintain systems to ensure investors receive products that are likely to be consistent with their likely objectives, financial situation, and needs.
2. **Product governance arrangements.** This concept replaces the 'product governance framework' in the draft guidance. All issuers and distributors are required to implement effective product governance arrangements to ensure they comply with DDO. ASIC considers this is consistent with the general licensee obligations in the Corporations Act, which refer to the need for adequate arrangements and systems.
3. **Product design.** The new policy contains more detail about what ASIC expects from issuers, including in relation to designing new and continuing products, what 'choice architecture' means, and examples of 'vulnerabilities' to consider when taking a consumer-centric approach in product design.
4. **Target market determination (TMD).** The new policy contains more detail about how to prepare a TMD that meets the requirements of DDO. In addition to the content requirements referred to in the draft guidance, ASIC now considers a TMD must also include sufficient information to explain why the product, including its key attributes, is likely to be consistent with the likely objectives, financial situation and needs of consumers in the target market.
5. **Negative target market.** This concept is no longer referred to. However, ASIC still considers it is useful for issuers to consider the class of investors for whom the product will not be appropriate when determining the target market for the product.
3. **Standardisation.** ASIC has agreed some degree of standardisation will be useful in achieving the objectives of DDO and industry is best placed to work towards this. Examples may include a standard format TMD for certain products and

standard required information and reporting periods between distributors and issuers.

7. **Data collection required to identify and describe a target market.** ASIC has acknowledged some issuers (eg of managed funds) may have minimal direct contact with the end investors and the only information these issuers currently collect is limited to that required to satisfy limited requirements such as anti-money laundering. Nevertheless, ASIC expects this will require changes for issuers and distributors in relation to data collection to comply with DDO.
3. **Reasonable steps.** The new policy contains more detail about how ASIC expects issuers and distributors to satisfy their obligation to take reasonable steps in relation to distribution. For example, in relation to portfolio diversification, ASIC has clarified that while issuers and distributors need to manage the risk of the product being widely sold to investors who do not have a diversified portfolio, knowledge of each individual investor's financial situation is not required.
3. **Monitoring and supervising distribution.** The new policy clarifies that issuers need to consider whether the nature of their existing relationships with distributors is appropriate to enable them to meet their obligations under DDO. ASIC considers issuers may need to take steps to improve communication and over-sight of distribution, including formalising the distribution relationship.
3. **Significant dealings.** ASIC has provided additional guidance on the factors that may be relevant in determining whether a significant dealing has occurred and whether it is reportable to ASIC.

WE CAN HELP YOU

We can help you comply with DDO by 5 October 2021. We can provide practical guidance about how DDO will change the way your business operates. We can also provide you with a DDO implementation steps plan and other practical tools, including workplans, checklists and proforma documents to assist with implementation of systems, processes, procedures, and arrangements to comply with DDO.

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