

SPECIAL BRIEFING

DDO learnings – one year in

Here are some 'learnings' and clarifications about ASIC's current expectations in relation to compliance with the design and distribution (DDO) requirements. Our list is not exhaustive and will be updated from time to time to reflect further guidance from ASIC and as implementation of the DDO regime evolves.



General

The standard FSC template may not be appropriate for all financial products. For bespoke products that are higher risk or have limited or no liquidity, ASIC expects effort to be made to tailor and amend the template to reflect the specific features of the fund. This has always been our approach.

ASIC considers a TMD is not intended to be a consumer facing document and under the regime issuers and distributors are obliged to distribute products properly.

Description of class of retail clients that comprises the target market

ASIC considers the target market should be defined using objective and clear parameters that address the suitability of an investment in the fund for investors in the target market by reference to the features and risks of the product. The target market must not be solely based on the broad objectives and preferences of an investor. For example, ASIC considers the following insufficient:

the investor looks to invest in commercial properties, a managed fund which is "professionally managed", a product requiring no further contributions of capital, a "pooled investment structure" facilitating investments in commercial properties, otherwise not available to investors who do not have the financial capacity to invest personally and that the investor has "access to funds designated for investment".

ASIC considers when describing classes of consumers as being 'potentially in the target market', the TMD should sufficiently identify the factors indicating product suitability for the relevant consumers who are potentially in the target market and perhaps just as importantly, those who are not. This is particularly relevant for issuers who have adopted the 'traffic light' system used in the FSC template and have identified their product 'may' be suitable by using the 'amber' traffic light.

Capital preservation. In correspondence to one client ASIC has said it generally takes 'preservation of capital' to mean that an investor looks to protect ('preserve') capital and minimise losses, as opposed to taking on further risks with the view to maximising capital gains from an investment. ASIC considers it is not reasonable to conclude that a fund which employs a significant degree of leverage, which increases the investors' chances of incurring larger losses, would be consistent with the likely objectives, financial situation, and need of a retail client with a need for the 'preservation of capital'. This is an area we suggest clients review as while a product might have a goal of preserving capital or delivering modest capital gains, if there is a real potential for investors to lose all or part of their capital, then investors seeking 'capital preservation' may not be in the target market.

Income distribution. Where investors seeking income distribution are within the target market ASIC considers any risks associated with the ability to pay distributions should be clearly articulated. Following on from this, we consider the timing of distributions should also be made clear in the TMD. For example, monthly/quarterly/at the end of a term etc.

Consumer's intended product use. Currently the FSC template used by many issuers provides for three categories:

1. Standalone (75-100 percent)
2. Core Component (25-75 percent)
3. Satellite (<25 percent).

ASIC has suggested there should be more than three categories of product use and in particular the introduction of a category for a very small allocation (e.g, up to 10%) which would be relevant for very high-risk products, products with low diversification and products with very limited liquidity.

Liquidity. ASIC has said they expect the liquidity features of the fund to be objectively clear. For products which do not offer regular liquidity (such as property funds), the target market should be

limited to investors who have no ongoing liquidity or withdrawals needs until whenever the next liquidity event is proposed, and this date or timing should be clearly specified.

Distribution conditions and restrictions

ASIC expects all products to have distribution conditions. That is, it is not satisfactory to say 'There are no distribution conditions'. This has always been our approach.

ASIC has also confirmed a distribution condition relying solely on investors to self-certify they are in the target market is inconsistent with the objectives of the DDO regime. This has always been ASIC's published view.

Review periods

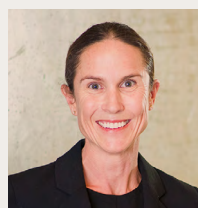
Review periods must be clear and specific. ASIC expects a minimum of an annual review of a TMD.

Reporting requirements

A TMD must include information about reporting requirements, even where the sole distributor is also the issuer of the product. That is, while there is no practical benefit, ASIC considers the TMD must still include reporting requirements for distributors even though the issuer and distributor are the same.



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