



# Design and Distribution Obligations

## What do superannuation funds, platform providers and fund managers need to do?

We published our report on the implications of the new Design and Distribution Obligations (*DDO*) regime for financial product issuers and distributors, with a focus on banks and banking products, earlier this year. In this report, we focus on superannuation, managed funds and platforms (which we will generally refer to as 'wealth' products). While the same basic obligations apply to issuers and distributors of wealth products, they raise some specific issues that need to be worked through.

## What we will cover:

- **Some questions relevant to all wealth products:**
  - What is the latest on commencement of DDO and ASIC guidance?
  - Which wealth products does DDO cover?
  - What are the DDO obligations of issuers and distributors of wealth products?
  - Do investment options need their own TMD or target market?
  - Does DDO apply to closed products?
- **For managed fund products, will DDO apply to secondary sales of these products?**
- **For superannuation products:**
  - How useful is the MySuper exemption?
  - Does DDO apply to successor fund transfers of superannuation members?
  - How does DDO apply to insurance within superannuation?
  - What is the scope of the employer superannuation exemption?
- **Next steps**

## WHAT IS THE LATEST ON COMMENCEMENT OF DDO AND ASIC GUIDANCE?

To the relief of many, the original commencement date of 5 April 2021 has been pushed out. ASIC recognised that the COVID-19 interruptions would make the original start date difficult and has given the industry a six-month extension – the regime will now commence on 5 October 2021. But there is still a lot to work through between now and then, and we expect many issuers and distributors will need every bit of the additional time to comply.

ASIC issued its draft Regulatory Guide on DDO in December 2019 and the industry has been expecting a final version for some time. We understand that it will be issued in September, although ASIC had been promising further discussion with the industry about the application of DDO to superannuation and platforms. We comment on the draft Regulatory Guide in this report, and will give you an update on the content of the final Regulatory Guide when ASIC issues it.

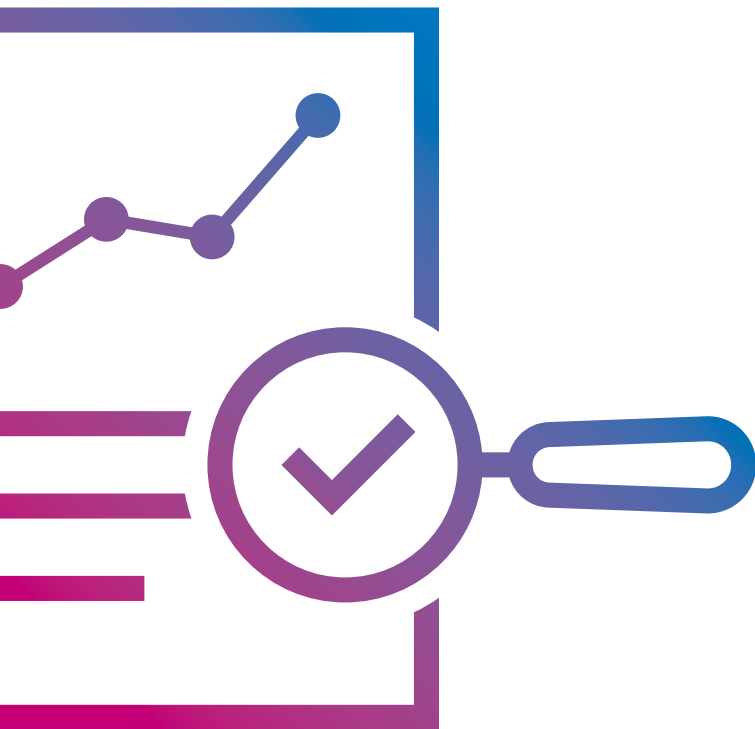
## WHICH WEALTH PRODUCTS DOES DDO COVER?

In short, the DDO regime covers wealth products that require a product disclosure statement (**PDS**), investor directed portfolio services (**IDPSs**), and certain exchange traded wealth products.

Those in the first category (requiring a PDS) include superannuation products. However, the DDO regulations specifically exclude MySuper and defined benefit interests, which means that the regime will apply only to choice and retirement income products. MySuper products have been excluded on the basis they are separately subject to product-specific rules under the Superannuation Industry (Supervision) Act 1993 (Cth) that are 'aimed at ensuring that firms provide appropriate products to consumers'. Consumer credit was supposed to be excluded from the DDO regime on a similar basis (because it is subject to the rules under the consumer credit legislation), but was slipped back in at the 11th hour. Defined benefit interests have been excluded on the basis that they are unlikely to be inappropriately distributed. They are now hardly offered at all, and when they are offered, it is generally as part of an employment package. Eligible Rollover Funds have also been excluded, but they are set to be phased out altogether, possibly as soon as 2021.

Another group of products requiring a PDS, and so covered by the DDO regime, are interests in registered managed investment schemes. This is the case regardless of whether they are interests in simple registered managed investment schemes → with a shorter PDS prepared under Schedule 10E of the Corporations Regulations, or interests in a registered managed investment scheme with a long-form PDS.

Both superannuation products and interests in managed investment schemes may be 'platforms', which the regime also covers. The term 'platform' is used generally to refer to products that offer investors access to other underlying financial products. An issuer of a platform product will typically provide the client with a PDS (or IDPS guide) for the platform, as well as a PDS for each underlying product selected by the client for which a PDS is required. This means that the platform provider will be both an issuer of the platform product (either superannuation or non-superannuation), and a distributor of the underlying products.



## WHAT ARE THE OBLIGATIONS OF ISSUERS AND DISTRIBUTORS OF WEALTH PRODUCTS?

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The obligations of issuers of wealth products are the same as for other products the DDO covers, and we have provided some detail about these in our previous [report](#). The key obligation is to make a target market determination (**TMD**) for the product. A platform provider will need to make a TMD for the platform, while issuers of the underlying financial products will be required to make a TMD for the products they issue, if they are available to retail clients.

In making the TMD, issuers need to consider the target market for the product and what distribution conditions should be imposed. In defining the target market for a wealth product, the cost, complexity and range of investment options offered through the product are all relevant considerations. Platform providers, in particular, will need to think about whether the platform should be offered directly to investors or whether the target market should be confined to clients receiving personal advice.

The TMD must be reviewed both periodically and when events or circumstances occur that suggest it is no longer appropriate. The issuer must also take reasonable steps that are reasonably likely to result in 'retail product distribution conduct' being consistent with the TMD. There are likely to be some practical difficulties for issuers in monitoring the distribution of their products. This is particularly so where the product is distributed through a platform, advisers, or a person who does not deal in financial products or provide advice about financial products but who is nevertheless brought into the regime as a 'distributor'. Issuers may have limited or no direct contact with clients, and may also have limited contact with distributors if the product is offered widely and the disclosure document is publicly available. They will need to think about whether distribution should be restricted to comply with their reasonable steps obligation and, if so, how. The issuers of underlying products offered through a platform will need to consider whether the platform is an appropriate distribution channel for their product, and whether any additional distribution conditions should be imposed on the platform issuer. The issuer must also report to ASIC significant dealings in the product that are inconsistent with the TMD.

Distributors likewise need to take reasonable steps that are reasonably likely to result in their retail product distribution conduct being consistent with the TMD. Platform issuers will need to consider the TMDs for each of the underlying products offered through their platform, and what they need to do to comply with their reasonable steps obligations. This may require them to impose restrictions on access to certain investment options within the platform. They will also need to notify issuers of significant dealings outside the target market for the underlying product, and other matters the issuer has specified in the TMD.

Issuers of both underlying products and platforms will need to consider the extent to which they need to monitor distributors of their products, and what information and reporting they need to identify whether a trigger has occurred that requires the TMD to be reviewed. The industry has raised the practical problems this will create for distributors who may need to comply with different reporting obligations in relation to the various products they distribute.

## DO INVESTMENT OPTIONS NEED THEIR OWN TMD OR TARGET MARKET?


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The DDO regime does not require a TMD to be prepared by the provider of a wealth product for each investment option or accessible investment offered within the wealth product (such as a choice superannuation product or a platform). The obligation to prepare a TMD applies at a 'product' level – ie the issuer of each product must prepare a TMD.

However, the investment options offered within a wealth product do need to be taken into account by the provider in formulating the TMD; and, in particular, in determining the target market for the product and what distribution conditions should be imposed. Defining the target market for some wealth products will not be easy. ASIC says in the draft Regulatory Guide that issuers should, in working out the target market, consider the common objectives, financial situation and needs of investors in totality, and that a broad objective on its own is unlikely to be sufficient to define the target market for a product. But many wealth products are specifically designed to meet a broad range of investor objectives. They may offer lots of investment options, so that they will appeal both to

those who are more risk averse as well as the more adventurous, and to those who are looking for capital growth as well as those looking for income (or a bit of both).

One possible approach is to define the target market broadly. But this carries risks. ASIC says in the draft Regulatory Guide that:



***an issuer would be in breach of its obligations if it defined the target market too broadly, such that the product is not likely to be consistent with the likely objectives, financial situation and needs of some consumers in that target market, even if the issuer attempted to narrow distribution to a narrower set of consumers by use of distribution controls.***

ASIC instead suggests that issuers prepare a single TMD for the product, but that it 'describes multiple target markets for each investment option or group of investment options offered as part of the product'. While this guidance is given in relation to investment options offered within superannuation products, there is no reason it should not apply to other wealth products offering multiple investment options or accessible investments. It is unclear, though, whether this is going to be workable. Some platforms offer hundreds of investment options and investments. Even if these were grouped according to common investor objectives, it will make the TMD very complex.

We also question the purpose and usefulness of a TMD for these types of products. If the product is intended to meet a broad range of investment objectives, specifying target markets for individual options seems pointless, given that an investor will have access to all options once they are invested (unless the product issuer also proposes to impose specific distribution conditions for investment options, which would add another layer of complexity). These issues have been raised with ASIC through the consultation process for the draft Regulatory Guide.

Issuers offering large numbers of investment options and platform providers will also need to consider how the addition of new investment options and accessible investments will affect the TMD. If the TMD sets out specific target markets for investment options or investments (or groups of investment options or investments), changes to the investment menu may also require changes to the TMD.

## DOES DDO APPLY TO CLOSED PRODUCTS?

A TMD will not be required for a closed wealth product if a PDS is no longer required to be prepared for the product (or, in the case of an IDPS, if a PDS would not be required in the absence of the exemption under the ASIC Class Order). This will be the case if the product is no longer being offered or issued to new investors.

However, DDO may still apply in relation to closed platforms if investors continue to be able to switch investment options. The issuer of a closed platform product may not be required to give a PDS (or IDPS guide) for the closed product itself, but they are likely to need to give investors a PDS for underlying products, which will be 'retail product distribution conduct'. This means that the issuer of the underlying product will need to have a TMD for the product, and the issuer of the closed platform product will need to continue to comply with its distributor obligations in relation to the underlying products.

There are further complications regarding legacy superannuation products. While the product may be closed to new members, it is often possible for an interest in the product to be acquired by the member's beneficiary following the member's death or as part of a family law split. Depending on the circumstances, a PDS may be required to be given in these situations, and so DDO may apply. A trustee of a closed product will need to think about whether this interest in the product may be issued in this way, and, if so, will need to take this into account in defining the target market and distribution conditions for the product. The trustee may not have much information about the new acquirers of the interests in the fund and so will need to consider how it can comply with its reasonable steps obligations in these circumstances.

# Managed funds

## WILL DDO APPLY TO SECONDARY SALES OF MANAGED FUND PRODUCTS?

In general, the sale of a wealth product on a secondary market will not trigger either issuer or distributor obligations, given that a PDS is not required for these secondary sales. There are some limited circumstances in which the regime captures a secondary sale (such as sales amounting to indirect issues, off-market sales by controllers and sales amounting to indirect off-market sales by controllers), but these will not arise in the ordinary operation of most secondary markets.

For securities listed on the ASX and other financial markets (eg interests in LICs or REITs), although the DDO regime will apply to IPOs and secondary raisings that require a regulated disclosure document, it will not apply to ordinary trading of those securities on the market once they have been quoted.

However, there is some complexity as to the treatment of quoted exchange traded products (eg ETFs) under the DDO regime. The DDO regulations specifically require a TMD to be made for exchange traded products that meet certain criteria; yet, the sale of the same products on a secondary market may not require compliance with the DDO regime. This tension, and the need for clear guidance, has been raised with ASIC through the consultation process for the draft Regulatory Guide. In addition, it is important to note that unquoted managed fund products, such as those sold through the mFund Settlement Service, do require a PDS and will be subject to the DDO regime.

# Superannuation products

## HOW USEFUL IS THE MYSUPER EXEMPTION?

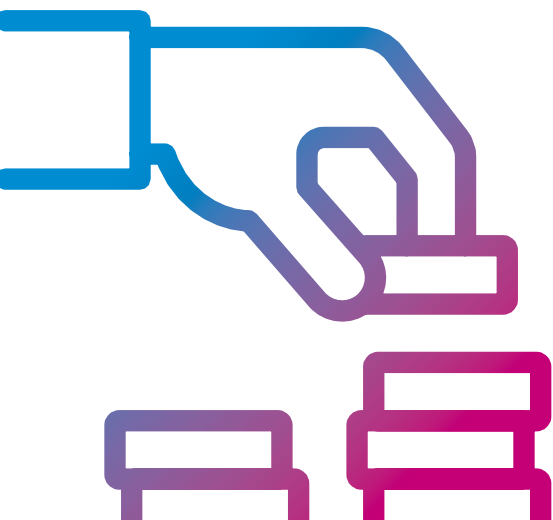
While there is a specific exemption for MySuper products, PDSs for superannuation products are rarely (if ever) confined to a MySuper product. Invariably, superannuation products offer members investment choice, and members may hold a MySuper or a choice product, or both. The class of product the member holds can also change at any time if they make an investment choice.

We therefore expect that the MySuper exemption will have limited practical application. A TMD for a choice superannuation product that includes a MySuper product and allows members investment choice will therefore have to take into account MySuper to some extent. Likewise, a distributor that is providing financial services to clients in relation to a MySuper product will need to comply with their distribution obligations in relation to the choice product if members have investment choice and are able to select other investment options within the product.

## DOES DDO APPLY TO SUCCESSOR FUND TRANSFERS OF SUPERANNUATION MEMBERS?

Both the issuer and distributor obligations are likely to be triggered by a successor fund transfer (SFT) of members from one superannuation fund to another.

A PDS will be required for the fund into which members are being transferred (the 'receiving' fund). The transfer will involve 'retail product distribution conduct' because it will involve the issue of interests in the receiving fund to the members being transferred, as well as the need to give a PDS to those members. It may also involve the giving of financial product advice to transferring members. The advice is likely to be given by the trustee of the transferring fund, and so both trustees need to consider their obligations.



The receiving trustee will need to have a TMD in place for the receiving fund before the SFT can occur, and before any general advice can be given to transferring members about the transfer. Additionally, the distributor obligations will apply in the context of an SFT, as both trustees are likely to be engaging in retail product distribution conduct in relation to the interests in the receiving fund that will be issued to transferring members.

Trustees will therefore have to be mindful of DDO in relation to any SFT, and should include in the due diligence process for any SFT an assessment of their 'reasonable steps' obligations under the DDO regime and whether the transfer would be consistent with the receiving fund's TMD.

## HOW DOES DDO APPLY TO INSURANCE WITHIN SUPERANNUATION?

Where insurance is offered to members as part of a choice superannuation product, the trustee will also need to consider this in preparing a TMD for that product. The insurance offered within a choice superannuation product forms part of the member's interest in the fund. This is also true for 'risk only' interests in a superannuation product. Insurance is issued to the trustee in both cases and is not a separate product issued to the member, and so does not require its own TMD.

However, the trustee will need to consider the features of the insurance benefits in formulating the TMD for the superannuation product. It will need to think about the likely objectives, financial situation and needs of members who will acquire the product, and whether the insurance benefits are likely to be consistent with these. If they are inconsistent, either the target market for the product or the features of the insurance benefits provided through the product may need to be adjusted.

An insurer who issues a group policy to the trustee is not required to prepare a TMD for the policy (unless the trustee is a retail client – such as the trustee of an SMSF). If the trustee is a wholesale client and no PDS is required for the policy, the trustee will not be a distributor of the underlying policy. It will just be the issuer of the superannuation product that

includes insurance benefits. But, again, it will need to take into account the features of the insurance provided under the group policy in preparing the PDS for the product, as well as in preparing the TMD for the product.

## WHAT IS THE SCOPE OF THE EMPLOYER SUPERANNUATION EXEMPTION?

Employers may engage in 'retail product distribution conduct' in relation to the superannuation arrangements for their employees. For example, they may arrange for the issue of a default superannuation product for the employee.

Employers are exempt from the distributor obligations regarding certain conduct they may need to engage in to comply with their superannuation guarantee obligations in relation to their employees. The exemption covers giving employees a PDS for the employer's default fund, paying contributions on behalf of employees into a default fund or chosen fund for the employee, and arranging for the issue to the employee of either the employer's default fund or the employee's chosen fund. The exemption does not cover advice, and employers should, in any case, be careful not to give financial product advice to employees in relation to their superannuation arrangements.



## Next steps

Issuers and distributors of wealth products are in the process of reviewing their products, and thinking about what TMDs should look like and what changes need to be made to distribution arrangements. The industry is eagerly awaiting ASIC's Regulatory Guide on DDO and, once the guidance is finalised, we will be in touch with our take on what ASIC expects.

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