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General Editor's note

Karen Lee *LEGAL KNOW-HOW*

Welcome to 2021. As always, there are 10 issues lined up for you this year. I will draw on the expertise and experience of the Editorial Board and contributors to bring you expert analysis and opinion on changes and developments affecting the financial services industry. It always has been my goal to enable busy practitioners to stay current on matters relating to our practice area. By bringing you articles by prominent practitioners, industry leaders as well as academics, I hope you will find the newsletter a useful and valuable resource.

In this issue, I have three articles which financial services lawyers will find interesting and relevant, and here is a little teaser to get you started.

First up is an article by editorial board member **Andrea Beatty**, **Chloe Kim**, and **Shannon Hatheier** (Piper Alderman). "A reflection on the past 30 years of credit law and COVID-19" is a great piece for the first issue of the *Financial Services Newsletter* in 2021. The authors reflect on the past 30 years of credit law and the effect of COVID-19, covering the major events and milestones that have shaped the industry.

Next is an article by **Vince Battaglia**, editorial board member **Harry New** and **Nina Mao** (Hall & Wilcox), "New ASIC guidance on AFS licensing exemptions for trustees of unregistered schemes: do all unlicensed trustees now need a licence?" What is the Australian Securities and Investments Commission's (ASIC) guidance in the recently published *Information Sheet 251: AFS licensing requirement for trustees of unregistered managed investment schemes*?[1] I am sure you will find the authors' analysis and commentary insightful.

Another recently-published ASIC guidance is *Regulatory Guide 274: Product design and distribution obligations*.[2] In "It's the final countdown: ASIC releases its final DDO regulatory guide", editorial board member **Andrea Beatty**, **Chloe Kim**, and **Shannon Hatheier** (Piper Alderman) take us through the obligations of issuers and distributors, and answer the question "where from here"?

I wish you a productive and successful 2021. And happy reading!

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Karen Lee is the General Editor of the Australian Banking & Finance Law Bulletin and the Financial Services Newsletter. She also partners with LexisNexis in other capacities, including as Specialist Editor for precedents in banking and finance, mortgages and options, and as contributing author of a number of other publications, including Australian Corporation Finance Law, Halsbury's Laws of Australia and Practical Guidance General Counsel. Karen established her legal consulting practice, Legal Know-How, in 2012. She provides expert advice to firms and businesses on risk management, legal and business process improvement, legal documentation, regulatory compliance and knowledge management. Prior to this, Karen worked extensively in-house, including as Head of Legal for a leading Australasian non-bank lender, as well as in top-tier private practice, including as Counsel at Allen & Overy and Clayton Utz.

Footnotes

1. ASIC *Information Sheet 251 (INFO 251): AFS licensing requirement for trustees of unregistered managed investment schemes* (November 2020).
2. ASIC *Regulatory Guide 274: Product design and distribution obligations* (11 December 2020).

A reflection on the past 30 years of credit law and COVID-19

***Andrea Beatty**, **Chloe Kim** and **Shannon Hatheier** PIPER ALDERMAN*

As we enter into 2021, we reflect on the past 30 years of credit law and the effect of COVID-19, covering the major events and milestones that have shaped the industry.

Before the *National Credit Code* and the Uniform Consumer Credit Code (UCCC), some but not all of the states and territories had their own unique credit codes.

Credit law was very piecemeal with some states having limited credit Acts covering credit cards and personal loans up to $20,000 ($40,000 for Queensland[1]). They also had extremely technical disclosure requirements and many banks breached them and as a result suffered enormous penalties.

Mid-1990s — Code of Banking Practice

The first major change was the introduction of the Code of Banking Practice. The Code was an industry code for the banking industry which came into effect in 1993 and was published by the Australian Bankers' Association (now the Australian Banking Association). The Code introduced written terms and conditions for a wide range of financial products and introduced key consumer protections that have since been enshrined by law.

Revised in 2003, the Code was expanded to apply to all financial services provided by banks and altered the language to emphasise the "voluntary" status of the Code. Though at the banks' discretion, once the Code was adopted, members could be held liable for breaching its provisions. The Code Compliance Monitoring Committee was established in 2004 to enforce compliance and bolster the means through which to hold banks accountable for their actions. In 2019 the Code was renamed to the Banking Code of Practice, of which there are currently 23 subscribers.

Mutual Banking Code of Practice

The Customer Owned Banking Code of Practice (COBC) was published by the Customer Owned Banking Association, which was originally introduced as the Credit Union Code of Practice in 1996. COBC was originally made for credit unions and their members and similar to the Code of Banking Practice, it was voluntary for credit unions to subscribe to it.

In 2009, the Credit Union Code of Practice was rebranded as the Mutual Banking Code of Practice (MBC) to incorporate mutual building societies alongside credit unions. The MBC was rebranded once again to the COBC in 2014, extending its coverage to mutual banks. Currently, the COBC has 58 subscribers.

1996 UCCC

In 1996, legislation moved away from piecemeal state-based regulation of consumer credit and towards a unified model with the introduction of the UCCC. The states and territories agreed under the Australian Uniform Credit Laws Agreement 1993 to pass "template" legislation in Queensland. Under the Agreement, the other states and territories could either apply the Queensland UCCC as the law, or otherwise enact legislation consistent with the Queensland UCCC.

Unlike previous credit Acts, the UCCC did not have upper monetary limits and no minimum interest rate threshold defining the limits of its application. For the first time there was regulation of, amongst other things, home loans, credit cards, consumer leases and mortgages.

It was only in the early 2000s through the Australian Securities and Investments Commission Act 2001 (Cth) (ASIC Act) that ASIC became involved in regulating consumer protection for financial services. This change created consistency in ASIC's current role as the regulator of consumer credit and the provision of financial services in Australia.

The National Consumer Credit Protection Act 2009 (Cth)

Our most significant development is the national regulation of consumer credit in 2009. This commenced a confusing journey into the world of responsible lending.

In 2008, the Council of Australian Governments reached an agreement that the Commonwealth Government would take over responsibility for the regulation of consumer credit. This agreement was reflected in the National Consumer Credit Action Plan which would be implemented in two phases.

Phase 1 saw the introduction of the National Consumer Credit Protection Act 2009 (Cth) (NCCP Act) and the amendments to the Corporations Act 2001 (Cth) which enhanced consumer protection, established a single national credit licensing regime, introduced conduct standards including responsible lending, and appointed ASIC as regulator. With the ground work covered, phase 2 extended the regime to short-term small amount lending, introduced specific regulations for credit cards and tailored its application to reverse mortgages.

External dispute resolution (EDR)/internal dispute resolution (IDR)

The NCCP Act also introduced new IDR and EDR requirements. This led to the approval of two EDR schemes — the Financial Ombudsman Service (FOS) and the Credit Ombudsman Service Ltd, later the Credit and Investments Ombudsman (CIO). The difference between the two was the industries they applied to, however, the dual system was beneficial in keeping each of the schemes honest. Members were able to change their EDR schemes if their existing scheme was not ruling in a fair manner. However, this has consequently been replaced with the Australian Financial Complaints Authority (AFCA).

Australian Financial Complaints Authority — 2018

The AFCA scheme began hearing complaints on 1 November 2018, taking over FOS and CIO as the only authorised EDR scheme for credit and financial services licensees.

AFCA abides by set constitutions and rules and has an obligation to report identified systemic issues to ASIC. Australian credit licence (ACL) and Australian financial services licence (AFSL) holders as well as credit representatives are required to become members of AFCA. AFSL-authorised representatives are not required to be a member of AFCA.

Anti-money laundering/counter-terrorism financing (AML/CTF)

AML/CTF regulation was introduced in 2006 through the Anti-Money Laundering and Counter-Terrorism Financing Act 2006 (Cth) which prescribed a risk-based system. At the time, many made the mistake of interpreting "risk-based" as being measured by having regard to practical difficulties in implementing AML/CTF measures. However, while this legislation lay dormant for a while, the sleeping giant has awakened, shaking up the industry with some of the greatest corporate penalties the financial industry has seen. In 2017 gambling company Tabcorp was fined $35 million and in 2018 the Commonwealth Bank of Australia was handed a $700 million penalty. In 2020 Westpac agreed to pay a historical $1.3 billion penalty for more than 23 million breaches of AML laws.

Unfair contract terms (UCT)

The UCT regime for financial products and services was introduced into the ASIC Act in July 2010, mirroring equivalent provisions in the Australian Consumer Law. At the time, it was intended that the UCT regime would extend to insurance contracts. However, following heavy industry lobbying, this was carved out from the regime. A decade and a Royal Commission later, the UCT regime will finally be extended to insurance contracts subject to the Insurance Contracts Act 1984 (Cth) from 5 April 2021. This will be the first significant change to UCT laws from when they were extended to "small business contracts" in November 2016.

Credit reporting

Following the introduction of the *Privacy (Credit Reporting) Code 2014* on 14 March 2014 and the overhauled Pt IIIA of the Privacy Act 1988 (Cth), privacy laws shifted from a negative credit reporting to a positive credit reporting regime.

Comprehensive credit reporting (CCR) was initially intended to come into effect around the same time as responsible lending to assist credit providers with their obligations under the NCCP Act. Due to limited participation in voluntary CCR between 2014 and 2017, the government introduced legislation making implementing CCR mandatory. The introduction of CCR on 1 July 2018 meant a person's credit report will contain positive information about how they manage their credit obligations and not just the "negative" information concerning defaults or judgments.

Banking Royal Commission

Perhaps the biggest shake-up to the industry happened in December 2017, when the federal government established the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry.

Former High Court judge Kenneth Hayne was appointed Commissioner to investigate *misconduct* in the financial services industry, as opposed to *conduct*. Arguably the findings of the Royal Commission led to a skewed public perception of the banking industry.

The Commissioner submitted his interim report in September 2018 and released the final report in February 2019. In total, Commissioner Hayne made 76 recommendations as part of the final report, of which the government in its response agreed to adopt all but one.

From 1 January 2021, the Financial Sector Reform (Hayne Royal Commission Response) Bill 2020 (Cth) was implemented into legislation seeing 20 recommendations from the Royal Commission legislated. Though somewhat attributable to the delays caused by the COVID-19 crisis, the government to date has translated 39 recommendations into law.

Open banking

On 1 August 2019, the consumer data right (CDR) was introduced as a right given to consumers, firstly starting in the banking sector which will see consumers disclosing information about themselves to themselves or others they trust in standardised machine-readable form. The purpose of the CDR is to encourage competition in other relevant sectors, create opportunities for new ideas and provide for "a vibrant and creative data sector that supports better services enhanced by personalised data".[2]

Product intervention order

ASIC's powers and regulatory functions have been ever increasing, especially as a result of the Royal Commission. In April 2019, ASIC received new product intervention powers, giving it the power to intervene where a financial product has resulted, will result or is likely to result in significant consumer detriment.

Following recommendations by the Royal Commission, the regime was extended to financial products as defined under the ASIC Act, meaning that it applies also to credit products. As the definition of "credit products" under the ASIC Act includes some types of credit which are exempt under the NCCP Act, ASIC is able to regulate credit that is otherwise excluded from regulation under the NCCP Act.

ASIC has used the power twice in relation to certain short-term credit lending models and contracts for differences and has released consultation papers in relation to a further two proposed uses of the power.

Design and distribution obligations

The design and distribution obligations (DDOs) were initially set to commence on 5 April 2021. However, due to COVID-19 and the impact it has had, the DDOs were delayed and are now scheduled to commence on 5 October 2021.

DDOs oblige offerors of a financial product to determine the target market for their products and ensure that their product is not distributed in a way that is inconsistent with that target market determination. It will be an interesting adoption for product issuers who will now need to consider their target market early on at the product design stage.

Responsible lending

Responsible lending has been quite a contentious area in the credit law space recently. After some easy wins against small credit providers — *Australian Securities and Investments Commission (ASIC) v Cash Store Pty Ltd (in liq)*[3] and *Australian Securities and Investments Commission (ASIC) v Channic Pty Ltd (No 5)*[4] — ASIC took on Westpac alleging responsible lending breaches in respect of over 200,000 loans.

After an initial settlement was rejected by Federal Court judge Perram J[5] due to the fact that the version of facts agreed between ASIC and Westpac did not disclose any breaches of the NCCP Act, the case went to trial and was decided in Westpac's favour.[6] ASIC decided not to appeal the Full Federal Court decision, citing the current challenging economic circumstances.[7]

Despite this significant case, the federal government announced on 25 September 2020 that it will take steps to abolish certain responsible lending obligations for all but small amount credit contracts and consumer leases which will have heightened obligations.

The Treasurer's announcement followed an increase in conservative lending practices sparked by the scrutiny of banker conduct in the banking Royal Commission, as well as the recent Westpac responsible lending litigation. Treasurer Frydenberg commented that when responsible lending was first introduced a decade ago, it was a principles-based framework regulating the provision of consumer credit, but it had evolved into an "overly prescriptive, complex and unnecessarily onerous" regime.[8]

Instead of responsible lending obligations, authorised deposit-taking institutions (ADIs) will need to comply with the Australian Prudential Regulation Authority's (APRA) lending standards, which will be regulated by APRA rather than ASIC. Key elements of APRA's lending standards will be adapted to apply to non-ADIs, but these will be regulated by ASIC.

Rise of regulators

In the wake of the banking Royal Commission, regulatory bodies have emerged with greater enforcement capabilities and enhanced civil and criminal penalties.

ASIC

ASIC's powers as a regulator have significantly been enhanced by their revised "why not litigate?" approach and new product intervention powers. In an attempt to avoid another clash between the law and ASIC's guidance, ASIC will also be granted the ability to set enforceable guidance, as seen in the recent *Regulatory Guide 271: Internal Dispute Resolution*[9] (RG 271). RG 271 contains IDR standards and procedures that financial firms must adhere to.

AUSTRAC

The Australian Transaction Reports and Analysis Centre (AUSTRAC) has been shaping up to be one of the most powerful regulators issuing some of the biggest penalties Australia has ever seen. With the rise of blockchain and fintech and as the financial sector grows to be increasingly complex, AML/CTF is becoming more important than ever. The sizeable penalties which have reached the billions indicate the importance of implementing and maintaining an AML/CTF program.

Key cases and penalties

The rise of regulators has been reflected in the enforcement action, litigious proceedings and penalties ordered against financial firms over the last 5 years. In 2015, the Federal Court awarded record penalties which totalled $18.975 million against Cash Store Pty Ltd and loan funder Assistive Finance Australia Pty Ltd for failing to comply with consumer lending laws. At the time this was the largest civil penalty ever obtained by ASIC.

A year later, ASIC ordered payday lender Nimble Australia Pty Ltd to refund over 7000 customers more than $1.5 million after concerns that they were failing to meet their responsible lending obligations. They were also ordered to make a $50,000 contribution to Financial Counselling Australia.

During the banking Royal Commission, APRA and ASIC were scrutinised for not embracing a litigious approach to enforcing legislative requirements on financial firms. From this scrutiny the regulatory bodies have accelerated their enforcement tactics and invigorated their supervisory role.

AUSTRAC's recent civil penalty order against Westpac for $1.3 billion indicates the significant size of penalties regulatory bodies are likely to make against financial firms for breaches of legislative requirements in the future.[10]

Recently the Federal Court ordered the National Australia Bank to pay $15 million for contravening s 31 of the NCCP Act which prohibits credit licensees from doing business with unlicensed persons on terms that would involve the unlicensed person engaging in credit activities in contravention of the NCCP Act. The third-party "introducers" did not hold an ACL and were providing credit assistance in relation to National Australia Bank home loans.[11]

Predictions for the future

Now 30 years later, we continue to see significant change in the industry.

In *D H Flinders Pty Ltd v Australian Financial Complaints Authority Ltd*,[12] the Supreme Court of New South Wales found that AFCA does not have the power to hear complaints about representatives of financial firms acting wholly outside of their authority and that AFCA does not have the power to encourage potential complainants to make complaints against certain financial firms. Interestingly, following judgment in this case, ASIC released a legislative instrument[13] requiring AFCA to amend the definitions of "financial firms" and "representative" in its rules to enable AFCA to hear complaints similar to those successfully argued by D H Flinders to be outside of the rules.

Emerging neobanks will continue to disrupt traditional banking through its digital-only model. Since the introduction of the restricted ADI (RADI) path to ADI authorisation, introduced in May 2018, two banks have made the transition from RADI to full ADI status. However, neobank Xinja, after having successfully made this transition, announced on 15 December 2020 its intention to exit the Australian market and hand back its ADI.[14] Though described as a strategic commercial decision, Xinja's exit is more likely due to insufficient adoption rates and capital. Whilst the collapse of Xinja highlighted the difficulties faced by new entrants, the neobanking sector is likely to continue experiencing growth as banking increasingly transitions online.[15]

Over the coming years we are likely going to witness a significant shift in the credit law space. If Treasurer Josh Frydenberg's proposal to unwind responsible lending laws comes to fruition, there will be a significant adjustment on how ASIC and APRA regulate credit assessment practices.

Over the next 12 months we will also observe the aftermath of the loan repayment scheme and the consequences of bringing assistive payment schemes such as JobKeeper to a halt. This will likely cause financial firms to adjust their approach to hardship and the financial assistance processes offered to struggling customers.

With the implementation of RADI licensing which came into effect on 4 May 2018, it is likely we will see more start-ups and smaller businesses with limited banking experience and lower-risk banking activities enter the banking space, stimulating competition in the banking sector.

With fintech and neobanking breaking the mould of traditional brick and mortar banking, it is likely we will see a shift in payment platforms and the transformative effects technology will have in the credit space. As we look forward to seeing how technology and other factors will continue to shape consumer credit and its regulation, we hope you have enjoyed looking back on the developments in the consumer credit landscape over the last 30 years.

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Footnotes

1. Including Victoria, New South Wales, ACT and Western Australia.
2. Treasury *Consumer Data Right Overview* (2019) 1 https://treasury.gov.au/sites/default/files/2019-09/190904_cdr_booklet.pdf.
3. *Australian Securities and Investments Commission (ASIC) v Cash Store Pty Ltd (in liq)* [2014] FCA 926; BC201420558.
4. *Australian Securities and Investments Commission (ASIC) v Channic Pty Ltd (No 5)* [2017] FCA 363; BC201702505.
5. *Australian Securities and Investments Commission (ASIC) v Westpac Banking Corp (Liability Trial)* (2019) 139 ACSR 25; [2019] FCA 1244; BC201907218.
6. *Australian Securities and Investments Commission (ASIC) v Westpac Banking Corp* (2020) 380 ALR 262; 145 ACSR 382; [2020] FCAFC 111; BC202005844.
7. ASIC "ASIC will not appeal Federal Court decision on Westpac's 'responsible lending' obligations" media release 20-166MR (22 July 2020) https://asic.gov.au/about-asic/news-centre/find-a-media-release/2020-releases/20-166mr-asic-will-not-appeal-federal-court-decision-on-westpac-s-responsible-lending-obligations/.
8. J Frydenberg and M Sukkar "Simplifying access to credit for consumers and small business" joint media release (25 September 2020) https://ministers.treasury.gov.au/ministers/josh-frydenberg-2018/media-releases/simplifying-access-credit-consumers-and-small.
9. ASIC *Regulatory Guide 271: Internal Dispute Resolution* (2020) https://download.asic.gov.au/media/5720607/rg271-published-30-july-2020.pdf.
10. *Chief Executive Officer of the Australian Transaction Reports and Analysis Centre v Westpac Banking Corp* [2020] FCA 1538; BC202010338.
11. *Australian Securities and Investments Commission (ASIC) v National Australia Bank Ltd* [2020] FCA 1494; BC202010145.
12. *D H Flinders Pty Ltd v Australian Financial Complaints Authority Ltd* [2020] NSWSC 1690; BC202011698.
13. ASIC Corporations (AFCA Regulatory Requirement) Instrument 2021/0002.
14. Xinja "Xinja Bank withdraws deposit accounts and will hand back ADI licence" media release (15 December 2020) https://xinja.com.au/press/2020/media-release-xinja-bank-withdraws-deposit-accounts/.
15. Y Yeoh, IBISWorld "Neobanks: can they succeed?" media release (17 December 2020) www.ibisworld.com/industry-insider/press-releases/neobanks-can-they-succeed/.

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New ASIC guidance on AFS licensing exemptions for trustees of unregistered schemes: do all unlicensed trustees now need a licence?

***Vince Battaglia**, **Harry New** and **Nina Mao** HALL & WILCOX*

In this article, we examine a new Australian Securities and Investments Commission (ASIC) regulatory guidance relating to Australian financial services (AFS) licensing exemptions in the context of providing trustee services in connection with unregistered trusts. In particular, we consider ASIC's guidance on the limits of the authorised representative exemption and intermediary authorisation exemption as they have been used, and could be used, by unlicensed trustees of unregistered schemes. We consider that ASIC's guidance, while not wholly new in some respects, raises questions about whether ASIC expects that only persons holding an appropriate AFS licence can operate unregistered trusts.

Background

Under the AFS licensing regime in the Corporations Act 2001 (Cth), a person who carries on a financial services business in Australia must hold an AFS licence (AFSL) covering the provision of those financial services, unless they are otherwise exempt or the activity is excluded from being regarded as a financial service.[1]

Two key exemptions, which have been in the AFS licensing regime since the implementation of the financial services reform regime in 2002, are the "authorised representative" exemption in s 911A(2)(a) of the Act and the "intermediary authorisation" exemption in s 911A(2)(b) of the Act. In brief, the authorised representative exemption permits representatives of a financial services licence to provide financial services without holding an AFSL, provided they do so as a representative of a person who is either an AFS licensee with appropriate licensing authorisations or is exempt from the need to hold an AFSL. This exemption, being the first in the list of statutory exemptions under s 911A(2) of the Act, is in widespread use.

The intermediary authorisation essentially permits a person to issue, vary or dispose of a financial product without holding an AFSL, provided they do so under an arrangement with an AFS licensee under which the AFS licensee (or their authorised representative) makes offers to arrange the issue, variation or disposal of the financial product and the first person then issues, varies or disposes of the financial product in accordance with such offers.

For some time now, ASIC has taken a position that the authorised representative exemption applies only where the person providing the financial services acts *as a representative of a principal*. This position is set out in ASIC *Regulatory Guide 36 — Licensing: Financial product advice and dealing* (RG 36).[2] ASIC has taken this view despite there being no reference to "principal" in either s 911A(2)(a) of the Act or in the definition of "representative" in s 910A.

ASIC's new guidance

On 25 November 2020, ASIC published ASIC *Information Sheet 251: AFS licensing requirement for trustees of unregistered managed investment schemes* (INFO 251).[3]

In INFO 251, ASIC sets out its position on the applicability of the authorised representative exemption and the intermediary authorisation exemption to trustees of unregistered managed investment schemes.

ASIC has now drawn a line in the sand on two key points in INFO 251. First, In INFO 251, ASIC states that the test of whether a person may rely on the authorised representative exemption is whether the person is acting as a "principal" or as "a representative of a principal". ASIC considers that the action of issuing, varying or disposing of an interest in a scheme *is, by its nature, the action of a principal*. Accordingly, a trustee may not rely on the authorised representative exemption in respect of the issue, variation or disposal of interests in an unregistered scheme for which it is the trustee. This means that a trustee must hold an AFSL authorising it to provide those financial services (unless it can rely on another exemption). Significantly, INFO 251 does not address other financial services provided by a trustee of an unregistered scheme, such as dealing in assets of the scheme or holding assets of the scheme.

Second, a trustee of an unregistered scheme who relies on the intermediary authorisation exemption cannot also be an authorised representative in relation to making offers to arrange to issue, vary or dispose of a financial product under an arrangement for that unregistered scheme. According to INFO 251, a trustee who (as "product provider" under s 911A(2)(b) of the Act) relies on the intermediary authorisation exemption to issue, vary or dispose of interests in unregistered schemes may not also "make the offers" to arrange for the issue, variation, or disposal of interests in unregistered schemes. In other words, under the intermediary authorisation exemption, the trustee may not also be the authorised representative who makes the offer to arrange for the issue, variation or disposal of interests.

The second point above does not appear that controversial in our view. The position appears consistent with the plain reading of the intermediary authorisation exemption and the background set out in the Revised Explanatory Memorandum to the Financial Services Reform Bill 2001 (Cth), which refers to the offer being made by a *second person*.[4]

Do all unlicensed trustees now need a licence?

ASIC's application of its distinction between "principal" and "representative" in RG 36 to trusts raises a fundamental question about whether a trustee *always* requires an AFSL, unless it can rely on an exemption other than the authorised representative exemption to cover the financial services it provides as trustee of the trust.

If ASIC considers that a trustee is a principal in the act of issuing, varying and disposing of interests in the trust, does the trustee have a different capacity when undertaking other financial services in connection with the trust (such as acquiring and disposing of assets of the trust and holding those assets)? If the capacity is different for these other services, then what capacity is it? As ASIC has a binary schema of principal and representative, does this mean that if a trustee is not a principal then the trustee is automatically a representative? Neither INFO 251 nor RG 36 addresses these questions.

It is also interesting to reflect on ASIC's licensing authorisations. In terms of dealing services, ASIC has two relevant types, namely dealing by "issuing, applying for, acquiring, varying or disposing of a financial product" on the one hand, and dealing by "applying for, acquiring, varying or disposing of a financial product on behalf of another" on the other hand.[5] Typically, the first authorisation is granted for the issue, variation and disposal of interests in the scheme (as well as other activities where the Act regards the trustee as issuer, such as entering into derivatives), whereas the second authorisation is granted for dealing in assets in the scheme. This demarcation suggests that there are acts — namely, dealing in assets of the fund — that are done in a representative capacity by the trustee, that is to say, "on behalf of another".[6]

It is unclear how this distinction would apply to custody, however, as ASIC does not cater for two types of custodial services authorisations in its licensing regime. Further, it may be regarded as an oddity that acquiring assets of a fund requires an "apply for" authorisation where such assets are held to protect the trustee's personal exposure. For example, ASIC will grant a trustee of a property fund an "apply for" authorisation for general insurance products to authorise it taking out an insurance policy in respect of the scheme property, however, it might be argued that the trustee is securing its own risk of loss as it holds and owns the property (and the trust relationship might not even be mentioned on the legal title to the property).

ASIC's position on the non-availability of the authorised representative exemption also raises interesting questions about the application of the key terms such as "principal" and "representative". As stated above, the term "principal" is not used in s 911A(2)(a) of the Act or in the definition of "representative" in s 910A. However, it appears in s 911B(1), but it is used as a defined term to refer to a person on whose behalf another person provides a financial service. That is, it is a term used by the legislation to describe "another person", but the legislature was free to use a term other than "principal" for this purpose. There is a danger interpreting this term "principal" in the context of the law of principal and agency. There are also references in statutory terminology relating to "acting on behalf" of the licensee in relation to representatives,[7] and presumably ASIC has also adopted the term "principal" in the context of these provisions. Does ASIC intend to invoke the common law of principal and agency when it uses these terms in INFO 251 and in its interpretation of the statutory framework?

ASIC's use of the term "principal" to refer to trustees acting in their own right makes sense in the context of a trustee acting as a fiduciary, having the assets vested in the trustee, exercising the usual powers and discretions of a trustee and being liable to third parties.[8] That is, a trustee endowed with these powers and rights will be acting on its own behalf, subject to the terms of its appointment as trustee and the law of fiduciary duties. However, if ASIC's use of the term "principal" imports the law of principal and agency, in that trustees may not act as authorised representatives because by nature they cannot be agents, the rationale for this approach is not entirely clear. At general law, a trust relationship is distinct from an agency relationship, but they are not

mutually exclusive.[9] Trustees (including in a funds management context) can be directed trustees or bare trustees under which they act on the instructions of beneficiaries, and more generally trustees may act as agents of beneficiaries. In this context, the trustee could be both trustee and agent. Is not the law of trusts a better model to understand the relationship between trustee and beneficiary, rather than superimposing the laws of principal and agency on the role of a trustee? In any event, the AFS licensing regime is a creature of statute, and in our view it was not intended to import traditional common law categories unless expressly provided in or contemplated by the legislation.

The answers to these questions above will significantly impact the AFS licensing regime as it applies to trustees. If a trustee is always a principal, then it can never provide trustee services as an authorised representative. Rather it will have to find some other exemption (such as the custodial services exemptions in reg 7.1.40 of the Corporations Regulations 2001 (Cth)), however, in our experience, these exemptions are generally not sufficient to fully cover the financial services provided by trustees of a typical unregistered fund (except where the sole member of the trust is a related body corporate of the trustee, in which case the exemption in s 911A(2)(i) of the Act applies). The answers also have consequences for fund structuring, as relying on the authorised representative exemption to operate a sub-trust may not appear viable as a result of ASIC's interpretation in INFO 251, unless an alternative exemption is found.

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Footnotes

1. Corporations Act 2001 (Cth), s 911A.
2. See Australian Securities and Investments Commission (ASIC) *Regulatory Guide 36 — Licensing: Financial product advice and dealing* (2016) RG 36.90, RG 36.91–RG 36.93.
3. ASIC *Information Sheet 251: AFS licensing requirement for trustees of unregistered managed investment schemes* (25 November 2020) https://asic.gov.au/for-finance-professionals/afs-licensees/applying-for-and-managing-an-afs-licence/licensing-certain-service-providers/afs-licensing-requirement-for-trustees-of-unregistered-managed-investment-schemes/.
4. Revised Explanatory Memorandum to the Financial Services Reform Bill 2001 (Cth), para 11.6.
5. See ASIC *Regulatory Guide 2 — AFS Licensing Kit: Part 2 — Preparing your AFS licence or variation application* (2021) para 2.71.
6. Above.
7. See, for example, above n 1, s 910A, paras (a)(iv) and (b)(iii) under the definition of "representative", and s 916A.
8. See the distinction between agents and trustees in J D Heydon and M J Leeming, *Jacob's Law of Trusts in Australia,* 8th edn, LexisNexis Butterworths, 2016, paras 210 and 212.
9. *Owners — Strata Plan No 43551 v Walter Construction Group Ltd* (2004) 62 NSWLR 169; 12 BPR 22, 639; [2004] NSWCA 429; BC200408103 at [46] per Spigelman CJ. See also above.

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It's the final countdown: ASIC releases its final DDO regulatory guide

Andrea Beatty, ***Chloe Kim*** *and* ***Shannon Hatheier*** *PIPER ALDERMAN*

On 11 December 2020, the Australian Securities and Investments Commission (ASIC) released their *Regulatory Guide 274: Product design and distribution obligations*[1] (RG 274) outlining its finalised approach to the obligations which issuers and distributions of financial products must abide by from 5 October 2021. RG 274 outlines the types of financial products which design and distribution obligations (DDO) will apply to and ASIC's interpretation and administration of those obligations.

DDO require issuers and distributors to develop and maintain product governance systems for financial products to effectively ensure consumers are receiving products which are in line with their objectives, financial situations and needs. Importantly, RG 274 covers the obligations for issuers, obligations for distributors and ASIC's role in administrating DDO.

ASIC identified the requirement for issuers and distributors to implement and maintain product governance arrangements which are efficient and robust.[2] These arrangements are existent to prevent the outcomes found in the Banking Royal Commission and manage non-financial risk. DDO requires compliance at each stage of developing and distributing a financial product, being:[3]

- product design (s 994B)
- product distribution (s 994E(3)) and
- monitoring and review (s 994C)

In RG 274, ASIC also provides a comprehensive summary of the obligations for issuers and distributors.[4]

Obligations for issuers

RG 274 provides clarity on the requirement for issuers to conclude the distribution of the product would appropriately reach its target market. In accordance with such obligations, target market determinations (TMD) must identify whether a product's key attributes are consistent with the probable objectives, financial situations and needs of the defined target market. When identifying the objectives, financial situations and needs of consumers, ASIC suggested considering characteristics such as common income levels, savings levels and employment status.[5]

RG 274 also emphasised the importance of obligations for issuers including describing the target market with sufficient granularity. An issuer will be held to be in breach of its obligations if it describes the target market too broadly, making it difficult to reasonably conclude that the product satisfies the appropriateness requirements. The class of consumers comprising the target market should be defined with "objective, tangible parameters"[6] such that it is evident which consumers comprise the target market.

Obligations for distributors

Due to their direct interaction with consumers, distributors are required to collect information about the financial products they distribute and communicate that information back to the products' issuers. Information that must be provided includes complaints received regarding the product during the reporting period and any further information that the issuer has specified. In response to concerns that the latter of the two information requirements could make reporting obligations too onerous, ASIC clarified that the information to be collected must be "relevant and necessary"[7] for the purposes of assisting the issuer to identify when a TMD is no longer appropriate.

RG 274 provided further guidance on the factors that ASIC will take into account when assessing whether a distributor has taken reasonable steps to direct distribution towards the intended target market. These include the following:[8]

- compliance with distribution conditions
- distribution methods
- marketing and promotional materials
- effectiveness of product governance
- inappropriate incentives
- training
- an assessment of whether a consumer is in the target market

Where to from here?

In lieu of the new guidelines coming into effect, issuers and distributors of financial products should

make efforts to adapt their existing governance arrangements to comply with the updated requirements. In its final report, the Financial System Inquiry stated for their firms with already effective product governance arrangements, few significant changes to its operations will be required.[9]

As the impending 5 October 2021 date for the implementation of DDO steadily comes into view, issuers and distributors of financial products should be wary of the obligations they will be required to abide by and ASIC's RG 247 providing guidance and supplementing it.

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Footnotes

1. ASIC *Regulatory Guide 274: Product design and distribution obligations* (11 December 2020).
2. Above, at [RG 274.32].
3. Above n 1, at [RG 274.35].
4. Above n 1, at [RG 274.18].
5. Above n 1, at [RG 274.74].
6. Above n 1, at [RG 274.69].
7. Above n 1, at [RG 274.112].
8. See, above n 1, RG 274.173, Table 6.
9. The Treasury *Financial Systems Inquiry* Final Report (November 2014) p 194, https://treasury.gov.au/sites/default/files/2019-03/p2014-FSI-01Final-Report.pdf.

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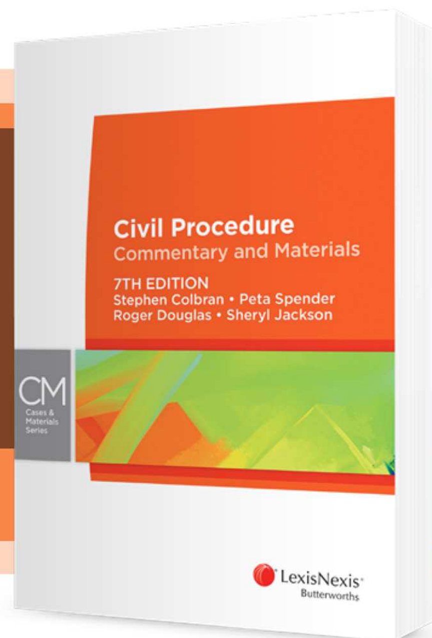

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