



Property funds should prepare early for ASIC's new draft product Design & Distribution Obligations

Property funds will be impacted by ASIC's recent guidance on the often contentious product Design and Distribution Obligations. A consultation paper was also released, with consultation closing 11 March 2020.

The DDO introduces higher compliance demands for retail unlisted property funds. The good news for unlisted property funds is the regime is principles-based. The bad news is the potentially costly and onerous requirements to undertake a Target Market Determination for new products.

While the 5 April 2021 start-date for the product Design and Distribution Obligations (DDO) regime seems a long way off, there are several profound changes regarding product design: the DDO is not just a compliance and legal issue, it goes to the heart of how financial products are established.

Given the long lead time on many retail property funds, managers will benefit by considering the new regime now.

The DDO will also place greater emphasis on monitoring investment products and building review triggers into internal processes, to ensure the product remains appropriate for its target market.

Key issues for property funds:

Product governance framework:

Issuers and distributors should design, document, implement, monitor, and report on a product governance framework. This refers to all arrangements in place to comply with the DDO.

Product issuers should consider the "choice architecture" at the product design stage, to ensure it is consistent with the target market – for example, considering the impact of complexity and frictions in choices, processes and information.

Fund managers/product issuers cannot take advantage of certain behavioural biases:

Managers should not take advantage of behavioural biases or other factors which prevent consumers from obtaining appropriate products. For example, ASIC says consumer interaction with information should be considered.

Target Market Determination:





Among the most contentious obligations is product issuers must make a Target Market Determination (TMD) for each product. Issuers are required to make the TMD publicly available, though ASIC does not consider the TMD a consumer-facing document.

Exactly what a TMD looks like remains to be seen, as ASIC does not give definitive guidance on the content and form of a TMD, nor give definitive guidance on how a target market should be described.

ASIC also requires product issuers to consider its “negative target market”, defining who would “not” invest in the product, which could create its own challenges.

Ongoing review of Target Market Determinations:

Product issuers are expected to continually review their TMD to ensure appropriateness for the target market.

Managers will need to establish several review triggers, which may be enacted around issues including product performance, consumer complaints, and product fees.

Fund managers must take “reasonable steps” to ensure distribution is consistent with the TMD:

The reasonable steps obligation requires a manager/product issuer to manage the risk of the product being sold to consumers who do not have a diversified portfolio.

ASIC takes a principles-based approach around what constitutes “reasonable steps”, and ASIC states issuers are “best placed” to determine these steps. Some potentially relevant factors identified by ASIC include:

- distribution conditions
- marketing and promotional materials
- selection of distributors
- issuer’s supervision and monitoring of distributors
- management of conflicts
- whether issuers have provided distributors with sufficient information to help ensure distribution is consistent with the target market determination.

ASIC must be notified about any “significant dealings” which are inconsistent with the TMD:

“Significant dealings” may include:

- The proportion of consumers outside the target market acquiring the product





- The actual or potential harm to such consumers acquiring the product
- Inconsistency between the target market and the product's distribution.

ASIC also expects to be notified about any steps taken for those affected by the dealings, and preventative steps to ensure it does not happen again.

Records must be kept for seven years:

Managers are required to keep records of TMD-based decisions for up to seven years.

Conclusion: expect significant impact on arrangements between product issuers and distributors

The new DDO will have an interesting impact on the relationship between product issuers/fund managers, and product distributors. Many believe the indirect effect on issuer/distributor arrangements will be significant.

ASIC expects fund managers to assess their distributor's capacity to comply with the TMD distribution conditions. This and the degree of an issuer's supervision and monitoring of distributors, will be relevant to whether ASIC believes an issuer has satisfied their reasonable steps obligation.

Unlisted property managers may therefore expect increased due diligence and increased involvement in their distribution network. This is also likely to increase product manufacture and distribution costs.

