Design and distribution obligations: Compliance with the reasonable steps obligation

Report 795 | September 2024

About this report

In 2023–24, we reviewed compliance with the reasonable steps obligation by issuers of high-risk investment products, accident and funeral insurance, and medium amount credit contracts. This report summarises our key observations on how issuers are complying with the reasonable steps obligations. We found some progress from our previous review, but also several areas for improvement.

Contents

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Executive summary

The design and distribution obligations are intended to help consumers obtain appropriate financial products by requiring issuers and distributors to have a consumer-centric approach to the design and distribution of products.

As part of the design and distribution obligations, an issuer must take reasonable steps that will, or are reasonably likely to, result in distribution being consistent with the target market determination (TMD): see s994E(1) of the *Corporations Act 2001* (Corporations Act).

An issuer must take into account all relevant factors in assessing what reasonable steps need to be taken, such as the nature and degree of harm that might result from an issue or regulated sale of the financial product: see s994E(5) of the Corporations Act. If the issuer distributes products directly to consumers, they are also subject to the reasonable steps obligation in s994E(3) of the Corporations Act.

It is critical that issuers comply with the reasonable steps obligation. To date, we have issued four interim stop orders for concerns about compliance with the obligation. We have also engaged in civil penalty proceedings. In the first court outcome related to the reasonable steps obligation, *Australian Securities and Investments Commission v Firstmac Limited* (*Firstmac*), the court found that Firstmac contravened the reasonable steps obligation for cross-selling a high-risk financial product to consumers holding a guarantee-protected term deposit. These regulatory actions play a critical role in preventing and deterring inappropriate distribution of financial products.

Note: See Media Release (24-151MR) *ASIC successful in first DDO case against Firstmac* (10 July 2024).

Our review

As outlined in the [ASIC Corporate Plan 2023–27: Focus 2023–24](), in 2023–24 we increased our surveillance focus on the 'reasonable steps' obligations. We reviewed compliance with the reasonable steps obligation by 19 issuers of high-risk investment products, accident and funeral insurance, and medium amount credit contracts. Our aim was to obtain a snapshot of how issuers are complying with the obligation across multiple industries and products.

The products in our review had a narrow target market, where more steps are required to distribute a product consistently with the TMD.

Most issuers we reviewed (18) were a distributor for their product(s). Some issuers also used third-party distributors. A variety of channels and methods were used to distribute products: see Figure 1.

Figure 1: Distribution channels and methods used by issuers we reviewed

Most issuers distributed their products via their websites.

Some issuers used call centres, particularly issuers of funeral and accident insurance.

Some issuers of accident insurance and registered schemes used financial advisers to distribute their products.

All issuers we reviewed used questionnaires or knockout questions to identify whether or not customers were reasonably likely to be in the target market.

Note: For simplicity, we use the term 'issuer' to refer to entities we reviewed, including where the entity was acting as a distributor.

What we found

Issuers have made progress

Our review followed two previous major reviews of compliance with the design and distribution obligations: Report 762 *Design and distribution obligations: Investment products* (REP 762) and Report 770 *Design and distribution obligations: Retail OTC derivatives* (REP 770).

Our review suggests that issuers have made progress since these previous reviews. All issuers had policies or procedures in place to comply with the reasonable steps obligation across the product life cycle – for example, we observed a reduction in mass marketing of high-risk products and no instances of issuers asking consumers to self-certify that they are in the target market.

But improvements are still required in several areas

Issuers still need to do more to comply with the reasonable steps obligation. For example, we observed:

- limited due diligence arrangements to assess and monitor third-party distributors' ability to distribute a product in accordance with the TMD
- some issuers of high-risk products relying on broad search terms in online marketing
- reliance on poor-quality questionnaires that did not seek to understand a consumer's attributes and had poor design features such as prompts with 'correct' responses, and
- limited monitoring of consumer outcomes to inform product governance arrangements and future distribution practices.

Our response

During our review, we issued two interim stop orders, after observing reliance on a poor-quality questionnaire by an issuer of a high-risk investment product: see Media Release (24-109MR) *ASIC issues DDO stop orders against Trademax Australia* (23 May 2024).

Notably, the other two interim stop orders we have issued for concerns about compliance with the reasonable steps obligation also related to reliance on poor-quality questionnaires: see Media Release (23-141MR) *ASIC issues first DDO stop order for failure to take reasonable steps in CFD distribution* (2 June 2023) and Media Release (24-120MR) *ASIC issues DDO stop order against Australian Unity Funds Management* (5 June 2024).

These stop orders were revoked after the entities made changes to the questionnaires and, in some cases, to other areas relating to compliance with the reasonable steps obligation. These changes addressed our concerns with the entity's compliance with the reasonable steps obligation for their specific product, considering all relevant factors.

After our review we also raised concerns with six issuers, who agreed to make changes to their policies and procedures to improve their compliance with the reasonable steps obligation: see case studies 1–3.

Observations and recommendations for issuers

We expect issuers to review the observations in this report, including some of the 'better practices' among the issuers we reviewed, and consider whether they need to amend their distribution practices for:

- the selection and supervision of distributors (see pages 5–7)
- training staff (see page 8)
- marketing and promotional materials (see pages 9–10)
- the use of questionnaires (see pages 11–14), and
- the use of information and monitoring outcomes (see pages 15–16).

More broadly, it is important that issuers consider how different distribution steps interact with each other throughout the product life cycle. For example, if an issuer chooses to rely on call centres as a distribution channel, greater emphasis on training for frontline staff is needed.

Issuers should also consider how to integrate the reasonable steps obligation into their broader governance and compliance frameworks. For example, during our review the responsible entities of six registered schemes agreed to amend their compliance plans to adequately address the design and distribution obligations.

In *Firstmac*, the court noted that an assessment of whether an entity had taken reasonable steps requires a 'holistic analysis that considers the full framework of an entity's contracts, policies and procedures' [50] and concerns whether an entity has 'put in place adequate systems, policies, practices, and procedures – including a process of oversight and supervision – to address identified or reasonably identifiable risks of retail product distribution conduct which was inconsistent with the TMD' [55].

Ensuring compliance with the design and distribution obligations is a key focus for ASIC, as shown in our work to date: see page 17. We will continue to take regulatory action where warranted and use the design and distribution obligations to improve consumer outcomes.

Key observations: Selection and supervision of distributors

Issuers should check that a distributor has the capacity to distribute a product in accordance with the TMD before selecting them.

Issuers should have adequate arrangements in place to monitor distributors. Asking a distributor to self-certify that they are complying with the design and distribution obligations is unlikely to be adequate supervision of a distributor.

Selection of distributors

Among the issuers who were using third-party distributors, most only conducted basic due diligence before selecting and appointing a distributor. For example, most issuers checked basic characteristics such as solvency, whether the distributor had an Australian financial services (AFS) licence and any misconduct by the distributor (such as checking for any banned directors).

We found there was limited consideration of the distributors' actual capacity to comply with the design and distribution obligations and distribute a product in accordance with the TMD. This may be inadequate, particularly for a product with a narrow target market. Issuers should ensure that a distributor has the capacity to distribute a product in accordance with the TMD.

Better practices for issuers to consider

Two issuers completed due diligence on a distributor's capacity to comply with the design and distribution obligations as part of their selection process.

As part of their due diligence, they:

- checked the distributor was likely to have access to consumers who are in the target market, and
- assessed whether the distributor had the resources to act as a distributor of the particular product.

Supervision of distributors

Formal arrangements with third-party distributors

The design and distribution obligations do not require formal arrangements between an issuer and a distributor: see Table 4 in Regulatory Guide 274 *Product design and distribution obligations* (RG 274). However, formal arrangements may be considered a 'reasonable step' when they are practicable and would promote distribution that is consistent with a product's TMD.

Better practices for issuers to consider

Issuers who formalised relationships with distributors were able to:

- insert clauses that required the distributor to take particular steps to ensure distribution conduct would be consistent with the TMD, and
- ensure they have the right to review and audit the distributor's compliance with the TMD, including by appointing a third-party auditor.

We observed that some issuers who were using third-party distributors did not require third parties to take the same approach to distribution as they were taking to directly distribute their products to consumers. For example, an issuer who used a filtering questionnaire did not require third-party distributors to use the issuer's filtering questionnaire. In these circumstances, the issuer should ensure the third-party distributors have alternative controls.

Supervising distribution by third parties

Some issuers indicated that, to better supervise distribution, they stopped using third-party distributors after the design and distribution obligations commenced.

Many issuers who relied on third parties for distribution simply required the distributor to self-certify that they were complying with the design and distribution obligations. This may be inadequate for the issuer's compliance with the reasonable steps obligation.

Better practices for issuers to consider

A few issuers monitored distributors by auditing and sampling distributors to ensure they were distributing products in accordance with the TMD. For example, they sent questionnaires to distributors that asked about staff training, marketing materials and the distributors' processes for reporting significant dealings.

Some issuers used monitoring questionnaires that asked distributors about their conduct on an 'issuer-wide' basis (rather than about their conduct in relation to a particular product). Issuers should carefully consider whether the responses received to such questionnaires are adequate, especially when the target market, distribution conditions and other features differ among the issuer's products.

We also observed instances where an issuer didn't contact or request more detail from third-party distributors when the distributor:

- failed to respond to a monitoring questionnaire, and
- provided generic responses to a questionnaire rather than responses specifically related to the issuer's product, and did not even include the name of the product.

Case study 1: Issuer improves supervision of third-party distributors following intervention by ASIC

An issuer of a registered scheme used a due diligence questionnaire to supervise its third-party distributors.

We identified that some responses from distributors did not clearly demonstrate that they had the capacity to distribute the scheme in line with the TMD. We also identified that the issuer was not using the questionnaire with all third-party distributors.

After we raised these concerns, the issuer informed us that they had implemented a new process that included:

- requiring all third-party distributors to complete the due diligence questionnaire
- asking how the distributor is taking reasonable steps in relation to the distribution and marketing of high-risk products
- analysing the answers it receives from distributors
- asking follow-up questions and requesting supporting material from distributors, and
- arranging a follow-up meeting with distributors if required.

Information sharing with distributors

Issuers should consider whether distributors require certain information to assist them with meeting their obligations to ensure distribution is consistent with the TMD: see Table 4 in RG 274.

Better practices for issuers to consider

- Two issuers provided an annual refresh on the design and distribution obligations to their distributors, and one issuer tested distributors on their understanding of the design and distribution obligations.
- One issuer of accident insurance conducted monthly monitoring of a random selection of calls made or received by a distributor's call centre. They also provided feedback on their observations to their distributors.

Personal advice

Where personal advice was a selected distribution method, we observed that issuers took minimal steps to check customers actually received the advice before acquiring the product.

We acknowledge that in some circumstances an issuer will be unable to review the personal advice (e.g. if there are privacy concerns). In these circumstances, an issuer could rely on certification from the adviser (e.g. certification that the client received current advice): see RG 274.207. However, we did not observe any issuers seeking such certification, although one issuer sought the adviser's contact and AFS licensee details.

Key observations: Training staff

Issuers should ensure that staff involved in the distribution of a product receive sufficient training to ensure distribution is consistent with the TMD. Staff training should go beyond general training on the design and distribution obligations, and periodic training may be required.

Training coverage and frequency

Although most issuers we reviewed conducted some form of staff training, in many instances it related to general topics, without covering the practical application of the design and distribution obligations in detail. For example, most issuers provided training on the product and its features. However, training should go further than this – it should cover the connection between features and the target market, and enable staff to apply this knowledge when engaging with consumers.

We observed that most issuers only trained staff at the point of onboarding.

Better practices for issuers to consider

Some issuers provided periodic training or refreshers on the design and distribution obligations (at least annually). Some issuers also provided updated training when changes were made to the product, TMD or a related policy.

Most issuers provided training for staff in specific roles. For example, the training delivered by one issuer to staff contained separate topics: one directed at staff involved in designing marketing and promotional material, and the other to staff involved in direct engagement with customers.

Better practices for issuers to consider

When distribution occurred primarily through a call centre, most issuers provided specific training for staff, including scripts. This helps ensure consistency in distribution practices.

Some issuers had staff perform specialised roles – for example, assessing consumer responses to questionnaires to determine whether a consumer is in the target market. In these cases, more intensive training specific to this role should be given as it requires a greater degree of judgement at a critical point in the distribution process.

The court's decision in *Firstmac* shows that a failure to provide training on the practical application of the design and distribution obligations to consumer-facing staff can significantly increase the risk of distribution to consumers outside the target market, especially if the issuer has not developed a coherent internal policy on compliance with the reasonable steps obligation [174–176]. The court observed that Firstmac's investment specialist, who spoke to prospective customers, needed to be trained or supervised and given explicit directions in relation to what was needed to ensure that the design and distribution obligations were complied with [174].

Staff incentives

Our review did not seek specific information on conflicts of interest. However, one issuer noted they had cancelled staff incentives to reduce the risk of pressure selling. In developing remuneration and incentives, issuers should consider whether incentives could lead to distribution being inconsistent with the TMD: see Table 4 of RG 274.

Key observations: Marketing and promotional materials

Marketing and promotional materials play an important role in directing distribution towards customers in the target market for the product. Issuers should ensure that their overall marketing strategy and the content and marketing channel for any marketing and promotional materials are aligned with the TMD.

Integrating marketing and promotional materials in the product life cycle

Most issuers relied on checks by compliance or legal teams before publishing marketing and promotional materials to ensure that the materials were consistent with the TMD. While this step is an important control, issuers should use procedures and checklists to guide the production of marketing and promotional materials, with an explicit consideration of the design and distribution obligations.

The court's decision in *Firstmac* also shows that entities need to consider the appropriateness of their marketing strategies and review how these strategies are being implemented by consumer-facing staff to ensure that they are complying with the reasonable steps obligation [179].

Better practices for issuers to consider

Some issuers had procedures and checklists that required:

- consideration of the TMD when preparing marketing content, including creative elements such as illustrations and photos, and when selecting the marketing channel, and
- an assessment of the target audience of the campaign to ensure it aligns with the TMD of the product and a written explanation of why the relevant marketing channels were chosen, taking into account the target audience and TMD.

One issuer maintained a register of marketing and promotional materials for the product. Issuers should maintain oversight of and periodically review their marketing and promotional materials so that any changes to the TMD can be reflected in these materials.

Online marketing

Some issuers targeted consumers who used broad search terms that would indicate the consumer's interest in the relevant product. For example, consumers who searched 'loan' would be sent advertisements for medium amount credit contracts.

It is important that issuers recognise that consumers who are interested in a product do not necessarily fall within the target market. Issuers should ensure that online marketing strategies, including the selection of keywords to direct online advertising to consumers, are aligned with the target market. They should also consider how their marketing interacts with other steps being taken to better direct a product's distribution to consumers in the target market.

Better practices for issuers to consider

One issuer of contracts for difference (CFDs) had an online marketing focus on professional networks, forums dedicated to CFD trading and experienced users. We considered this to be a better marketing practice, compared to targeting consumers who use broad search terms, in light of the nature and degree of harm that might result from CFDs being distributed otherwise than in accordance with the TMD.

Inadequate oversight of the tools used to engage with retail investors on digital platforms (including behavioural techniques, differential marketing, gamification, design elements or design features) may, among other things, indicate a failure to take reasonable steps to distribute a financial product consistent with the TMD: see Report 778 *Review of online trading providers* (REP 778).

Mass market advertising

We observed a reduction in mass marketing of high-risk investment products through, for example, advertising on public transport. However, one CFD issuer we reviewed continued to sponsor high-profile sports teams whose main supporter base would likely be outside their target market.

Mass marketing or prominent online methods, such as banner advertising, generally are inappropriate for a product with a narrow target market – see Table 6 of RG 274 – particularly if the product is a high-risk product (and depending on other steps being taken to comply with the reasonable steps obligation).

Referral programs and lead buying

Two of the issuers we reviewed offered cash or gift card incentives as part of referral programs with existing clients or with third parties. One of the issuers took the view that existing clients are likely to refer family and friends with similar objectives, financial situation and needs, making them more likely to be in the target market. Issuers cannot rely on this assumption on its own.

Both issuers took additional steps to ensure that prospective clients referred through these programs were likely to be within the target market (i.e. by applying the same application processes to both referred and unreferred clients).

Issuers should also evaluate the impact referral programs have on the likelihood of distribution being consistent with the TMD, with consideration of the risk and harm associated with the product.

Key observations: Use of questionnaires

Where a distributor decides that it is appropriate to use a questionnaire as part of complying with their reasonable steps obligation, they should ensure it is effective for the product, considering all relevant factors.

An effective questionnaire should seek to understand the consumer's attributes to reliably assess whether they are reasonably likely to be in the target market. How a consumer responds to a questionnaire will also be greatly influenced by the design of the questionnaire, and it is important that this is consistent with questionnaire design principles: see Figure 2.

Prevalence of questionnaires

All issuers (in their capacity as a distributor of the product) administered questionnaires at the point of sale. Issuers used the answers to assess whether or not the consumer was likely to be in the target market before the product was issued.

In REP 762 and REP 770, we cautioned against over-reliance on questionnaires, and emphasised the need for a broader governance and distribution framework for meeting the reasonable steps obligation. While we did not observe any entities who relied solely on questionnaires to comply with the reasonable steps obligation, we did observe a number of deficiencies in the way questionnaires are used.

Understanding consumer attributes

Our previous review found questionnaires that asked whether the consumer was in the target market or other forms of 'self-certification'. While this review did not identify any issuers who required the consumer to certify they were in the target market, we did observe elements of self-certification. For example, one CFD issuer required consumers to confirm they had enough funds to meet living expenses, despite the consumer's response indicating they were unemployed.

We also observed some issuers requiring consumers to acknowledge a pop-up risk warning when their answers to the filtering questionnaire indicated they were likely to be outside the target market. For example, one CFD issuer required consumers to confirm they understood that CFD traders need to have a high risk tolerance if the consumer's initial response indicated they wanted a safe investment. Another CFD issuer required consumers to acknowledge a 'financial risk warning' if their answer indicated their financial position was poor. This undermines the aims of the design and distribution obligations to reduce over-reliance on disclosure: see RG 274.2.

A more common practice was questionnaires that simply asked if consumers had each of the consumer attributes in the TMD. A consumer might not understand such questions and, where appropriate, the questionnaires should seek to ask about characteristics that would tend to underly these consumer attributes. Depending on the product, the questionnaire could ask about other characteristics (e.g. income, age, debts), behaviours (e.g. spending habits), loss tolerance, and use or need of funds for basic living expenses (e.g. food, rent or utilities).

In relation to the funeral and accident insurance products, we observed:

- consumers still being offered a quote where responses to a knock-out question indicated they were unlikely to be in the target market, and
- questionnaires that solely asked about insurance eligibility criteria (such as age, residency status) and failed to ask about key target market criteria that related to affordability. Issuers should consider ways to promote distribution in accordance with affordability-related criteria in TMDs. For instance, asking questions that prompt consumers to consider if they will be able to continue to afford ongoing and increasing premiums.

Questionnaire design

The deficiencies in the design of questionnaires that we observed are inconsistent with questionnaire design principles: see Figure 2.

Designing an effective questionnaire for retail consumers requires care and skill. If an issuer is relying on a questionnaire for a high-risk product, they should consider obtaining professional assistance with designing the questionnaire (in the same way that they might seek professional assistance to improve the effectiveness of their marketing).

There are a range of professionals who have specialised training and expertise in questionnaire, survey and scale design. For example, psychometric researchers, behavioural scientists, research psychologists, research economists and statisticians.

Figure 2: Examples of questionnaire design principles

Use plain language and avoid ambiguity	Avoid technical jargon and ambiguity. Keep wording specific, definitive and consistent.
Consider tone	Even small wording changes can influence responses. Avoid language that may trigger people's emotions or natural behavioural tendencies (e.g. social desirability bias, conforming with norms).
Avoid leading questions	The language, tone, response options and presentation of questions should not lead respondents toward certain answers or direct their focus in an unbalanced manner.
Avoid double-barrelled questions	Avoid asking about more than one concept in a question or as part of the response options. These make questions hard to answer and interpret.
Consider sequencing, order and flow	Questions and answers should be logical and smooth. Answers to earlier questions could influence or prime responses to later questions.
Consider visual design elements	All design features have the potential to influence consumers, either deliberately or inadvertently (e.g. images, font, text size, colours, medium, screen size). Keep these neutral.
Test	Ideally questionnaires would be professionally validated. At a *minimum* informally testing them before going live can help identify flaws (but will not guarantee the questionnaire will work as intended).
Monitor and compare data from other sources	You cannot know if a questionnaire is working as intended until it is live and can be viewed alongside other data (e.g. cancellations, complaints, consumer outcomes). This will help identify areas for improvement.

Leading and unbalanced questions

We observed issuers using leading questions or a leading set of questions that could influence and undermine the objectivity and reliability of consumer responses. For example:

- unbalanced questions, such as ‘do you have a long-term investment horizon (i.e. more than five years)’, with a ‘yes’ or ‘no’ response option. These types of questions only provide one option to consider and can be subject to acquiescence bias. Questions that are open ended or provide multiple options may help reduce this bias
- having the same response to all questions (‘yes’ or ‘no’) equates to being in the target market. It is better practice to have a mix of question wording and response options, and
- questions that indicated the answer that would result in the consumer being in the target market, either alongside the questions and responses or by describing who the product was intended for, before proceeding with the question (e.g. a prompt immediately before or after the question about investment time frame such as ‘If you have a short investment term (i.e. five years or less), you are outside the target market and will not be issued this product’).

Case study 2: Issuer removes leading questions from their questionnaire following intervention by ASIC

An issuer of a registered scheme’s questionnaire contained questions that indicated the answer that would result in the consumer being in the target market alongside the questions and responses.

After we raised our concerns, the issuer informed us that they were removing the indications of answers to the questions.

Double- or triple-barrelled questions

Some questionnaires asked about more than one concept in the same question. For example, one issuer asked consumers about multiple factors pertaining to risk tolerance and investment terms in one question.

Questions that ask about multiple concepts are confusing for consumers. The responses are also hard to interpret because it is unclear what part of the question the respondent is responding to.

Use of complex terms and follow-up contact

Some questionnaires used very complex terms that consumers are unlikely to understand. It is good practice to use plain language in questionnaires and avoid any ambiguity. Otherwise, there is a risk of consumer confusion or misinterpretation that undermines the integrity of the consumer’s answers.

Some issuers contacted consumers to explain complex questions, which resulted in the consumer changing their response so that they were in the target market. If a question has to be explained to consumers with subsequent contact, it likely indicates a problem with the design of the question (e.g. the language used or response options given).

Additionally, there is a high risk of consumers being unduly influenced or misled through the direct contact by a staff member, particularly if there are no strong controls and reviews of this contact. Issuers should explore improvements to the design of their questionnaires that avoid the need to provide additional follow-up explanations from sales staff. For example, after reviewing complaints and other information that indicated consumers were having difficulty understanding a question that referred to ‘standard risk measure’, one issuer revised their questionnaire accordingly.

Encouragement of multiple attempts and the use of lock-out periods

We observed that some issuers encouraged consumers to review their answers and submit alternative answers to 'pass' the questionnaire. This practice undermines the purpose of the questionnaire.

Better practices for issuers to consider

Some issuers used 'lock-out' periods, which placed restrictions on the number of times and the period during which a consumer could attempt a questionnaire. This is an improvement since our previous reviews, where we observed consumers being able to re-attempt questionnaires multiple times with no restrictions. One issuer used IP addresses to identify if the consumer had taken the questionnaire previously and restricted the number of attempts on that basis.

Following the end of the lock-out period, some issuers required the consumer to provide evidence or an explanation of a change in circumstances if the consumer's original response indicated that they did not have a critical attribute of those in the target market (such as an adequate income).

Case study 3: Issuer limits the number of times an applicant can attempt a questionnaire following intervention by ASIC

An issuer of a registered scheme's questionnaire had no limits on the number of times an applicant could attempt their questionnaire.

After we raised our concerns, the issuer informed us that they had introduced a limit so that an applicant could only attempt the questionnaire once within a 60-day period.

Case study 4: ASIC imposes an interim stop order due to reliance on a poor questionnaire

We made two interim stop orders against a CFD issuer due to concerns that there were failures to comply with the reasonable steps obligation, including reliance on a poor-quality questionnaire.

The questionnaire failed to adequately inquire into prospective clients' financial situation, risk tolerance, investment objectives or investment needs. These were characteristics of the class of retail clients that comprised the target market.

There were also messages prompting applicants to review their answers, allowing prospective retail clients to submit alternative responses to 'pass' the questionnaire. The issuer also permitted two failed attempts at the questionnaire and only implemented a lock-out period of 24 hours.

The stop orders were revoked after our concerns with the questionnaire, including the questions and the design of the questionnaire, were addressed.

Key observations: Use of information and monitoring outcomes

Issuers should use existing information or data about a consumer or class of consumers (where available) when taking reasonable steps to direct distribution of a product to the target market.

Monitoring outcomes and using data can help an issuer identify and pre-empt any issues with their distribution practices so that they can be addressed accordingly in future distribution conduct.

Using existing information

We did not observe many instances of issuers using existing information they held about a consumer to assess whether the consumer was likely to be in the target market for an initial acquisition or subsequent acquisition where the design and distribution obligations applied. Existing information about consumers could include:

- indicators about the likely circumstances of the consumer or class of consumers (e.g. concession card status, income, employment status)
- reasonable inferences about the likely circumstances of the consumer or class of consumers (e.g. for insurance, information inferred from the consumer's postcode)
- results derived from analyses of that data (e.g. analysis undertaken by the distributor of common characteristics of consumers who have purchased a product) – see RG 274.181, and
- web analytics (e.g. click data and website paths).

Better practices for issuers to consider

Some issuers of medium amount credit contracts used suppression lists to exclude consumers who had previously been declined for the product, or consumers with similar characteristics to those who had been declined.

Monitoring outcomes

Monitoring outcomes is essential to understanding how the product works in the hands of consumers. With this understanding, issuers can determine whether changes are needed to the existing product governance arrangements, the product itself, or the target market.

Senior management should be involved in product governance: see RG 274.55. We observed improvements in board oversight since our previous reviews (e.g. most CFD issuers had procedures to ensure compliance with their design and distribution obligations, rather than delegating the responsibility to sales staff).

Note: Senior management must also consider what other obligations may be relevant (e.g. directors' duties under the Corporations Act, accountability obligations under the *Financial Accountability Regime Act 2023*).

However, most issuers we reviewed took little to no steps to test the outcomes of the product after it was distributed.

In circumstances where subsequent acquisitions, re-issuing or renewal of a product occurred, we observed that some issuers had no process to assess whether consumers remained in the target market. Instead, we observed that some issuers merely sent existing consumers a notification if, for example, there was a new TMD, with the expectation that consumers would self-assess that they still fit the target market: see RG 274.13.

Better practices for issuers to consider

- One issuer changed its complaints reporting process to capture information about the target market, to improve analysis of complaints.
- One issuer of a registered scheme monitored funds under management and flow reporting to detect any unusual activity (e.g. material changes in client numbers, investment via particular channels, flows reported to be outside of the target market) and material deviations in the actual performance of the product against benchmarks over various horizons.
- One CFD issuer monitored the frequency, value and time period of consumer losses to determine if the data indicated the target market might not be appropriate. If the percentage of consumer loss-making accounts for a product increased by 10% year on year, this would trigger a review of the product and the TMD.
- Another CFD issuer assessed data on consumers' trading patterns. Consumers would be flagged for follow up if the consumer indicated during the onboarding process that they would only trade small amounts or would only trade lower risk products, but data indicated the consumer traded larger amounts or traded higher risk products.
- One issuer tracked the results of their questionnaire and identified that large numbers of consumers were falling outside the target market for their high-risk product. This indicated that the questionnaire was working effectively. As a result of the tracking, the issuer was considering introducing a new, lower risk product that would meet the needs of a broader target market.

While this will vary for specific products and issuers, examples of other metrics that can be used to monitor outcomes are set out in Table 1.

Table 1: Examples of metrics for monitoring outcomes

All products	Information gathered from complaints and post-sale feedback. Early cancellation rates or high switching rates may indicate that there is distribution to consumers outside the target market.
CFD products	Individual client outcomes, including whether they are consistent with data provided in the onboarding questionnaire. This may be used to determine whether the issuer should exclude the client from future issues of the product, update the target market or adjust the distribution strategies of the product.
Registered schemes	Performance of the product compared to other products of a similar nature, and volatility and realised return. This data may help issuers determine when a product is no longer suitable for certain groups of consumers.
Medium amount credit contracts	Default rates and other repayment-related information. For example, first or early repayment defaults may indicate distribution outside of the target market. If a consumer is repeatedly cycling through these contracts with the issuer and concurrently using other credit products (including short term high-cost credit), this may indicate distribution to consumers outside of the target market or poor product design.
Accident and funeral insurance products	Metrics related to claims ratios, and the number, nature and magnitude of paid, denied and withdrawn claims. This data can provide insights into the suitability of the product, not just eligibility. High rates of lapsed policies and premium defaults, particularly early in the contract, may indicate distribution outside of the target market.

Compliance with the design and distribution obligations: Our work to date

Reviews focused on the design and distribution obligations

In 2022–23, we focused on the appropriateness of TMDs. In addition to REP 762 and REP 770, we published:

- Report 754 *Target market determinations for small amount credit contracts* (REP 754)
- letters sent by ASIC to the Insurance Council of Australia, the Council of Australian Life Insurers and the Financial Services Council about ASIC's review of over 100 TMDs for general and life insurance products, and
- findings from our reviews on buy now pay later products and superannuation trustees.

Regulatory action

In 2022–23, we also used interim stop orders to quickly rectify problematic TMDs. Since the introduction of the design and distribution obligations, we have issued 88 interim stop orders.

We issued one final stop order where we found that Centrepay credit arrangements placed consumers in Coral Coast's target market at risk of financial hardship. The other stop orders we issued were revoked after our concerns were addressed or the product was withdrawn.

In addition to ASIC's success in its case against Firstmac, we have also been successful in our cases against:

- Amex: see Media Release (24-158MR) American Express ordered to pay $8 million penalty for failing to meet its design and distribution obligations (19 July 2024), and
- Bit Trade: see Media Release (24-186MR) ASIC wins case against Kraken crypto exchange operator for design and distribution failure (23 August 2024).

We have also commenced two other civil penalty proceedings for alleged breaches. See:

- Media Release (23-204MR) *ASIC sues eToro in its first design and distribution action to protect consumers from high-risk CFD products* (3 August 2023), and
- Media Release (22-359MR) *Finder Wallet sued for alleged unlicensed conduct and inadequate risk disclosure over Finder Earn product* (14 December 2022).

Figure 3: Outcomes of our work on the obligations

5 civil proceedings commenced	**88** stop orders	**7** reviews published

Looking ahead

We will continue to take regulatory action for contraventions of the design and distribution obligations where warranted, including where there is a high risk of consumer harm.

We will also continue to use the design and distribution obligations as a tool across our work to improve consumer outcomes. For example, as part of our Better Banking for Indigenous Consumers project, several banks expanded the target market of their low-fee accounts to include all customers eligible for an Australian Government concession card (not just those who hold a concession card) and amended the distribution conditions to reflect this change: see Media Release (24-153MR) *Big banks to refund millions in fees to low-income customers following ASIC report* (15 July 2024).

Appendix: The design and distribution obligations and the scope of our review

The design and distribution obligations

The design and distribution obligations require:

- issuers to prepare a TMD, comprising a target market reflecting a class of consumers whose likely objectives, financial situation and needs are met by the product
- issuers and distributors to take 'reasonable steps' that are reasonably likely to result in financial products reaching consumers in the target market defined by the issuer, and
- issuers to monitor consumer outcomes and review products to ensure that consumers are receiving products that are likely to be consistent with their likely objectives, financial situation and needs.

RG 274 explains ASIC's interpretation of the design and distribution obligations and sets out guidance on developing product governance, distribution and review arrangements to meet the obligations.

Our review

From October 2023 to August 2024, we reviewed 19 issuers to obtain a snapshot of compliance with the reasonable steps obligation across different sectors. This included:

- five issuers of medium amount credit contracts
- three issuers of funeral insurance and accident insurance
- six issuers of registered managed investment schemes, and
- five issuers of over-the-counter (OTC) derivatives, namely CFDs.

We selected issuers of products with a narrow target market (e.g. because the product was high risk).

Our review obtained information about compliance with the reasonable steps obligation, as set out in RG 274.140–RG 274.148. This included information on:

- the selection of distribution channels and methods
- marketing and promotional materials
- training, and
- supervision and monitoring of distribution.

Note: Our review did not specifically ask about conflicts of interests such as selling incentives, which is another factor that can be relevant to compliance with the reasonable steps obligation.

Key terms and related information

Key terms

AFS licence	An Australian financial services licence under s913B of the Corporations Act that authorises a person who carries on a financial services business to provide financial services **Note:** This is a definition in s9.
CFD	A contract for difference
Corporations Act	*Corporations Act 2001*, including regulations made for the purposes of that Act
Firstmac	*Australian Securities and Investments Commission v Firstmac Limited* [2024] FCA 737
OTC	Over the counter
REP 762 (for example)	An ASIC report (in this example numbered 762)
RG 274 (for example)	An ASIC regulatory guide (in this example numbered 274)
TMD	Target market determination

Related information

Headnotes

design and distribution obligations, issuers, reasonable steps obligation, target market determinations, third-party distributors, TMDs

ASIC documents

REP 754 *Target market determinations for small amount credit contracts*

REP 762 *Design and distribution obligations: Investment products*

REP 770 *Design and distribution obligations: Retail OTC derivatives*

REP 778 *Review of online trading providers*

RG 274 *Product design and distribution obligations*

Legislation

Corporations Act 2001, s994E

Financial Accountability Regime Act 2023

Revised Explanatory Memorandum to the Treasury Laws Amendment (Design and Distribution Obligations and Product Intervention Powers) Bill 2019, note 34