



12 November 2021

Mr Stephen Alcorn
Australian Securities and Investments Commission
Level 5, 100 Market Street
NSW 2000

By Email

Dear Mr Alcorn

Re: ASIC Product Design and Distribution Obligations

Thank you for the opportunity to provide input into the Government's program for further refinement of the Product Design and Distribution Obligation (PDDO) arrangements.

We note that many elements we have raised previously have either been fully addressed or are actively being addressed. Our focus for this letter is on elements related to equity research.

We offer the below case studies for consideration of elements that might warrant legislative reform.

Given that "Retail Product Distribution Conduct" captures "general advice", there is a risk that if a listed company undertakes a regulated offer (e.g. issuance of a hybrid instrument to retail investors), any research that is written on that product (even by a research provider not participating in the selling syndicate) could be subject to the regime, which may require the sell-side research provider to adhere to the relevant target market determination (TMD). The risk that the research product may be captured increases in circumstances where the sell-side analyst changes their recommendation from "sell" or "hold" to "buy" or increases their price target as a consequence of the offering.

We do not think this is an intended outcome of the regime:

1. The consequence of this outcome is that the TMD prepared by an issuer may influence the individuals to which sell-side research is prepared. This gives them greater control than would otherwise be the case over research content and distribution that is intended to be objective and independent. Such an outcome would be inconsistent with ASIC guidance e.g. RG 264.
2. It would require sell-side research providers to selectively distribute research to clients. This could be problematic from an administration perspective, in that research distribution lists are not set up to provide for the selective disclosure of research. It may also create concerns regarding selective disclosure.

3. It limits access to a product (independent research) that is intended to educate investors about a particular company or stock and is not part of the marketing effort.

4. There is no principled basis why sell-side research should be regulated by the DDO regime in this way i.e. it does not accord with the policy underpinnings of DDO.

Given the significant penalties for failing to comply with DDO, there is a strong industry imperative in this matter being clarified.

We note also our previous comments on the concerns members have in relation to the application of the regime to equity research:

Independent Equity Research potentially caught under distribution definition

Independent research reports issued by research houses in relation to listed securities is general advice as defined in the Corporations Act. Under the DDO obligations the provision of general advice is retail product distribution conduct and therefore the issuer of the research covering an in scope financial product must comply with the DDO obligations. This includes complying with the TMD, or making a determination that it is not reasonable to comply with the TMD, and logging and reporting that the issuer has not received any complaints in respect of the financial product the subject of the research.

We believe that DDO obligations applying to independent research coverage of, for example, infrastructure funds, listed property trusts and the likely impact this will have on retail access to independent equity research is an unintended consequence of the definition of retail product distribution conduct. We also note that while it may be open to the issuer of independent research to determine that it is not appropriate to comply with a TMD, other DDO obligations including the obligation to report that there have been no complaints will still apply.

Examining this in more detail, the reason there is a risk that independent equity research, which generally involves the provision of ratings and price targets on listed securities traded in the secondary market, could be considered general advice and could be in scope for PDDO if:

- (i) it was provided in relation to an in-scope PDDO product. For example:
 - all financial products offered by infrastructure funds, listed property trusts, LICs, Exchange Traded Funds (without relief); or
 - additional financial products offered by listed companies such as preference shares, company issued options, company issued warrants, convertible notes/bonds, hybrids, etc. (non-ordinary share instruments)
- (ii) issued while an offer for new securities under a PDS or prospectus was open, it could constitute “retail distribution conduct”.

The following are some examples where there is uncertainty around the application of PDDO to this type of research:

ETFs

ETF offers are generally always open, and hence at all times the provision of the research to retail clients about these entities could be subject to the relevant TMD and PDDO obligations. We note there are a wide range of ETFs covering many different sectors and instruments in many combinations. We understand some reliefs have been granted.

Property Trusts

Consider the application to a property trust for which at the time of publication there are no open offers of new units. This research could be viewed and accessed by any retail client without needing to check if there was a TMD or taking any steps to ensure it is distributed in line with a TMD.

However, if later the trust announces a capital raising and offers new units under a PDS, then it might be the case that any general advice available at that time would need to follow the TMD. As a result, the announcement by the trust of a capital raising requiring a PDS may have implications for the way the research houses can distribute their research in real time, and may have implications for research that might be available on websites etc.

AFMA is considering the question of whether under the regime equity research could be written to establish an overall enterprise value and per share recommendation on a listed entity and still be considered general advice, rather than expressing a view on all of that entity's issued financial instruments.

A related question is whether equity research can be limited to a specific security issued by that company? If the answer to this question hinges on the specific commentary in the report this may be operationally complex to assess and track.

Convertible notes and hybrids

A variant of the above is to consider research on a bank covering a wide variety of issues including balance sheet, earnings forecasts and funding requirements. At the time the research was published the bank only had ordinary shares on issue hence the research would be out of scope for PDDO as it could only relate to ordinary shares. However, if the company announces a convertible note or hybrid issue (that involves a retail offer document), is there any situation where the earlier research could also be considered as general advice that covered the convertible notes or hybrid, notwithstanding that the equity research does not explicitly provide a recommendation or price target on anything other than on an ordinary share? After all, it is not the specific recommendation on ordinary shares that makes it general advice. It is the nature, content and commentary on the entire entity that could be considered as the substance of the general advice.

Attached options

Similarly, a mining company could offer new ordinary shares and free attaching options under a prospectus offer. The option issue might be considered an offer of an in-scope product and as a

result any general advice in relation to the options (i.e. research will be in-scope). Alternatively, it might be considered that a research paper that only comments on the company's prospects and provides a recommendation only in relation to the ordinary shares is not general advice of relevance to a prospective option investor.

Many of the concerns touched on here arise because the concept of general advice is broad and does not require much specificity. As a result, the question of whether certain conduct is in or out of scope might not be easy to determine.

The complexity associated with the research one day not being regulated by PDDO and then potentially regulated the next day presents significant administrative and operational challenges.

If a safe harbour isn't introduced this may limit the distribution of Research to retail clients that may not be in their best interest.

Conclusion

Thank you for considering our comments. We would be pleased to provide further detail as your refinement program proceeds.

Yours sincerely

A handwritten signature in black ink that reads "Damian Jeffree". The signature is written in a cursive, slightly slanted style.

Damian Jeffree

Senior Director of Policy