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HOW ASIC'S NEW PRODUCT INTERVENTION POWER MAY BE USED IN THE FUTURE – LOOKING OVERSEAS FOR CLUES

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Introduction

ASIC's Product Intervention Power (**PIP**) regime is still a relatively new tool in their regulatory tool kit. It allows ASIC to stop, or impose conditions on, the issue and distribution of financial products. Despite recent commentary clarifying the scope of ASIC's powers, many questions remain regarding the application of the power going forward and the kinds of financial products it may be used upon.

In this briefing, we provide an overview of the Australian PIP regime, compare it to overseas regimes and list some of the products which have been banned in Australia and under comparable regimes overseas. This briefing offers an insight into the types of products that ASIC may intervene on in the next few years.

Product Intervention Power

Under the new Part 7.9A of the *Corporations Act 2001* (Cth) (the **Act**), ASIC is empowered to make product intervention orders (**PIO**) to stop, or impose conditions on, the issue and distribution of financial products, if ASIC is satisfied that a financial product (or class of products):

(a) is, or is likely to be, available for acquisition by issue, or for regulated sale, to persons as retail clients; and

(b) has resulted, or is likely to result, in significant detriment to retail clients[1].

ASIC can make PIOs in respect of an individual product or a market-wide class of products. Importantly, ASIC can exercise the PIP in relation to a product (or class of products) regardless of whether there has been a breach of the law.

The duration of a product intervention order will depend on the circumstances of each case. ASIC is empowered to make an initial order for a duration of up to 18 months.[2] This can be extended or made permanent with the approval of the Minister. Entities served with a product intervention order have a right of appeal to the Administrative Appeals Tribunal under section 1317B of the Act and section 327 of the *National Consumer Credit Protection Act 2009* (Cth) (the **NCCP**).

ASIC v. Cigno – two rounds in

Presently, ASIC has only fully applied its PIP in one instance where a PIO was issued against Cigno Pty Ltd (**Cigno**) in relation to a particular short-term lending model. The lending model operated as follows; Gold-Silver Standard Finance Pty Ltd (**GSSF**) provided credit under a short term credit facility and Cigno provided collateral services such as speeding up the loan process for a fee. As a result of this model, Cigno's fees avoid protections afforded to consumers under the NCCP and could add up to 1,000% onto the initial loan. By the PIO, ASIC sought to limit the fees GSSF and Cigno could charge a consumer to the maximum amount of credit fees and charges allowed under section 6(1) of the National Credit Code, as ASIC alleged the structure amounted to a tripartite credit contract.

Cigno challenged the PIO on the basis that the short-term lending model was not a 'financial product' for the purpose of section 1023D(1) of the Act and that the 'financial product', being the short term credit facility provided by GSSF, did not result in significant detriment to retail clients and thus ASIC's PIP was not enlivened. Cigno lost in the first instance,[3] although the decision is currently subject to appeal. The Federal Court adopted a broad interpretation of the term "resulted in significant detriment" and found that the causal requirement is satisfied if the detriment would not have occurred but for the financial product or class being made available in those circumstances.[4] Accordingly, for a financial product to "result in" detriment, indirect causation is sufficient.

[1] Corporations Act 2001 (Cth) s 1023D(1).
[2] Ibid s 1023G(2).
[3] Cigno Pty Ltd v Australian Securities and Investments Commission [2020] FCA 479 at [76].
[4] Ibid at [42].

Following this decision, on 9 July 2020, ASIC released Consultation Paper 330 outlining a further proposed PIO in relation to continuing credit contract (being credit contracts where multiple advances of credit are contemplated). Consultation Paper 330 states that:

(a) BHF Solutions Pty Ltd (**BHFS**) provides loans under a continuing credit contract to retail customers and charges a fixed fee for each advance of funds under the contract, up to a maximum of $120 in a 12-month period;

(b) an associate of BHFS, Cigno, enters into a services agreement with those retail clients, and charges fees for various services including fast-track processing and loan management. Those fees can make the original costs of the loan add up to 490% of the original lend; and

(c) neither BHFS nor Cigno hold an Australian Credit Licence due to the 'continuing credit contract' exemption pursuant to section 204 of the National Credit Code, and the continuing credit contracts referred to above do not give retail clients access to external dispute resolution schemes, have high fees payable on default and are not given in circumstances where the retail clients' capacity to repay the contract is considered.

In light of the above, ASIC is concerned that continuing credit contracts such as the above are likely to result in significant detriment due to borrowers incurring very high cost relative to the loan amount and products being issued predominantly to vulnerable clients. The consultation period ended on 6 August 2020.

ASIC's regulatory guidance

With the recent publication of ASIC's Regulatory Guide 272 – Product Intervention Power (**RG 272**), ASIC has provided additional clarification on the scope and operation of the PIP. The guide notes (non-exclusively) three classes of products that PIOs can be issued for:

- **Financial products under the Corporations Act** (including securities, interests in managed investment schemes, derivatives, insurance products, superannuation products and deposit-taking facilities);
- **Credit products under the National Credit Act** (including a credit contract, mortgage, guarantee or consumer lease); and
- **Financial products under the ASIC Act** (including some types of extended warranties, some types of short-term credit and certain buy-now-pay-later arrangements that are not covered by, or are exempt from, regulation under the Corporations Act and the National Credit Act).

International PIP regimes

Australia's PIP regime falls somewhere between the narrow standards in the US (where an actual breach of law is required) and the broad standards in the UK (where there are limited exceptions to the power)[5] and was modelled after the UK regime. Other jurisdictions such as Hong Kong have PIP regimes that are tightly regulated. RG 272 and the Cigno litigation indicate that ASIC's PIP is broad and will be used by ASIC proactively. Below, we consider what products may be targeted by ASIC in the future by considering the approach taken by regulators in comparable regimes.

In the US, a rule similar to an Australian PIO can only be issued after a breach of law has been established.[6] The scope of the Consumer Financial Protection Bureau's (**CFPB**) power to issue such rules under section 1031(b) of the *Dodd-Frank Wall Street Reform and Consumer Protection Act* is limited to credit products, deposit products and residential mortgages offered to retail customers however, the CFPB has further powers to take enforcement action. While the CFPB's rule making powers are more restricted than in other jurisdictions, the CFPB is willing to impose severe penalties on contravening entities once a breach of the law has been established.

[5] Dimity Kingsford Smith & Dr Marina Nehme, *Product Intervention Powers: a Legal, Comparative & Policy Analysis*, (Research Report, University of New South Wales, 2015) p 11.
[6] Ibid.

In the UK, the Financial Conduct Authority's (**FCA**) powers may operate to restrict the behaviour of all UK FCA-authorised firms in relation to any products or practices (including those covered by other acts and wholesale products) without the need for a breach of law. The UK model generally requires public consultation however, an exemption exists if the FCA wishes to issue a temporary product intervention (**TPI**). TPIs exist for 12 months and do not require public consultation if the FCA considers that a delay in the issue of the TPI would be prejudicial to the interests of consumers.[7] PIOs and TPIs under the UK scheme are intended to advance consumer protection, competition and market integrity.

For further detail on which financial products are captured, when the PIP is exercisable and the scope of appeal for each PIP within the US, UK, Hong Kong and Australian PIP regimes we have prepared a comparative analysis table at **Annexure A**.

Where could ASIC look next?

Set out below are products or classes of products that other jurisdictions have issued PIOs for in recent years. These products and/or classes of products may face similar scrutiny from ASIC under the Australian PIP regime:

- **Contingent Convertible Securities (CoCos):** on 1 January 2014, the UK FCA issued a PIO to restrict firms from distributing contingent convertible securities to retail investors who meet certain criteria.[8] CoCos are highly complex, hybrid capital instruments that are considered high risk as they can be written off (either partially or as a whole) or converted into equity when an issuer's capital position is negatively impacted.

- **Mini-bonds:** on 26 November 2019, the UK FCA issued a temporary product intervention order in relation to the promotion of speculative mini-bonds to retail investors.[9] Mini-bonds are essentially IOUs issued to an investor, in exchange for a fixed rate of interest over a set period of time. As these are unlisted, any return on the investors' money depends entirely on the success of the issuer's business.

- **Listed Speculative Illiquid Securities (SISs):** on 18 June 2020, the UK FCA issued a consultation paper for a product intervention on the marketing of high-risk investments including SISs. While mini-bonds were prohibited under a TPI, this intervention proposes to make permanent and expand the scope of that TPI so that it applies to any listed bonds with a speculative nature that are not regularly traded.[10] Comments on the consultation paper are due by 1 October 2020.

- **Binary options:** on 29 March 2019, the UK FCA permanently prohibited the sale, marketing and distribution of all binary options to retail consumers. Binary options or binary bets are financial products that involve an investor 'betting' on whether an event will happen or not. The payout is usually predetermined, with an investor usually losing their initial stake if their prediction is wrong or receive a fixed pay-out if they are right.[11]

- **Contracts for difference (CFDs):** on 1 August 2019, the UK FCA intervened in this market to limit the sale of CFDs and similar products with excessive risk features that result in harm to retail consumers. CFDs are contracts between two parties where the buyer will pay or receive the difference between the current value of an asset and its value at the time a contract is enforced.[12]

- **Short-term and long-term balloon-payment loans:** on 17 November 2017, the US CFPB identified that (subject to certain exemptions) it is an unfair and abusive practice, firstly, for a lender to make covered short-term or longer-term

[7] *Financial Services and Markets Act 2000* (UK) c 2, s 138L(1).
[8] Financial Conduct Authority (**FCA**), '*Restrictions on the retail distribution of regulatory capital instruments*', Policy Statement PS15/14 (June 2015).
[9] FCA '*Temporary intervention on the marketing of speculative mini-bonds to retail investors*', Temporary Product Intervention (November 2019).
[10] FCA, '*High-risk investments: Marketing speculative illiquid securities (including speculative mini-bonds) to retail investors*', Consultation Paper CP20/8 (June 2020).
[11] FCA, '*Product intervention measures for retail binary options*', Policy Statement PS 19/11 (March 2019).
[12] FCA, '*Restricting contract for difference products sold to retail clients*' Policy Statement PS 19/18 (July 2019).

balloon-payment loans, including payday and vehicle title loans, without reasonably determining that consumers have the ability to repay the loans according to their terms and, secondly, to make attempts to withdraw payment from consumers' accounts after two consecutive payment attempts have failed, unless the consumer provides a new and specific authorisation to do so.

Indeed, ASIC has sought public consultation in relation to proposed market-wide product intervention orders relating to the issue and distribution of over-the-counter binary options and CFDs to retail clients[13] and add-on financial products through caryard intermediaries.[14]

The explanatory memorandum for the PIP also states that the power could be used to target:

- excess funeral expenses insurances; and
- certain extended warranties that are functionally equivalent to add-on insurance.[15]

In addition to targeting particular financial products as set out above, the UK FCA has also used its powers to intervene and mandate communications surrounding financial products. These interventions will also be of interest to Australian product designers. Two prominent examples are set out below:

- **Insurance renewals:** from 1 April 2017, the UK FCA intervened in this market to require renewal communications from insurers to show the premium to be paid upon renewal and the last years premium and to include text encouraging consumers to check the appropriateness of their cover and to shop around;[16] and
- **Persistent debt on credit cards:** from 1 March 2018, the UK FCA intervened in this market to require firms to tailor the content of their communication to customers with persistent debt at 18, 27 and 36 months, warn customers that card suspensions may be reported to credit agencies, refer customers with persistent debt to not-for-profit debt advice agencies and provide for a 3-4 year repayment period (depending on the customer's circumstances).[17]

The future of PIP in Australia

The PIP enables ASIC to make interventions to mitigate the significant detriment that can arise when consumers are marketed and sold investment products that are inappropriate for their risk profile or when they are unable to understand and/or assess the risk they are taking.[18] Action can also be expected for add-on or collateral charges that may fall under a different regime or are not a defined product for the purposes of the power (as was the case in *Cigno*).

For this reason, it's essential to keep up to date with product intervention consultations issued by ASIC and to seek compliance advice when issuing new financial or credit products, particularly if those products have been prohibited, or heavily scrutinised, in comparable overseas PIP regimes. ASIC has shown a willingness to use the PIP; we do not see that changing in the near future.

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[13] ASIC, '*Product intervention: OTC binary options and CFDs*', Consultation Paper 322 (August 2019).
[14] ASIC, '*Product intervention: The sale of add-on financial products through caryard intermediaries*', Consultation Paper 324 (October 2019).
[15] Explanatory Memorandum to the Treasury Laws Amendment (Design and Distribution Obligations and Product Intervention Powers) Bill 2019.
[16] FCA, '*Increasing transparency and engagement at renewal in general insurance markets – feedback on CP15/41 and final rules and guidance*', Policy Statement PS16/21 (August 2016).
[17] FCA, '*Credit card market study: Persistent debt and earlier intervention – feedback to CP17/43 and final rules*', Policy Statement PS18/4 (February 2018).
[18] ASIC, '*Product intervention Power*', Regulatory Guide 272 (June 2020).

Annexure A
PIP Powers – International Comparisons

	Which financial products, structures or practices are within scope of an intervention?	Standards for Intervention	What interventions are permitted under product intervention powers?	What scope to challenge a decision is permitted?
US	Credit products, deposit products and residential mortgages. This excludes investment products.	Conduct or practices that are 'unfair, deceptive or abusive.'	Issue individual 'Cease and Desist' orders and exercise intervention through rule making if elements of 'unfair' and 'abusive' conduct are present	Right of appeal through the court system
Hong Kong	All structured products including securities, commodities, property, interest rates, futures contracts, regulated investments agreements, equity, credit notes, etc. This excludes shares or debentures of a private company incorporated in Hong Kong	The process of enforcing relevant laws and regulations generally involves two main steps: • identifying that a breach of the relevant laws or regulations has taken place, and those responsible for the breach; and • taking necessary steps to protect the public interest and, if appropriate, to punish those responsible for the breach.	Amend or revoke conditions, or impose new conditions, in respect of any authorisation and the power to withdraw authorisation	Right to review through the Securities and Futures Commission
Australia	Financial or credit products under the Corporations Act, National Credit Act and the ASIC Act. These range from securities, insurance products, credit contracts, mortgages and types of extended warranties	A product or class of products has resulted, or is likely to result, in 'significant detriment' to retail clients	Issue an individual or market-wide product intervention order	Right to complain to the Commonwealth Ombudsman or to seek other independent review of decisions through a tribunal like the Administrative Appeals Tribunal

UK	The FCA powers operate to restrict the behaviour of UK authorised firms in relation to any products or practices (including those covered by EU powers). This can include investment products, insurance products, credit / hire-purchase contracts and financial advice.	There must be a risk of consumer detriment, a threat to market integrity or ineffective competition arising from a particular product is identified. For the FCA to issue a temporary product intervention order they will consider whether prompt action is necessary in reducing consumer detriment or threats to market integrity and competition	The PIO may require certain product features to be included, excluded or changed, require amendments to promotional materials, impose restrictions on the sales or marketing of a product or ban the sales or marketing of a product in relation to all or some types of client	Right to complain to the FCA, the Financial Ombudsman Service or to seek other independent review of decisions

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