



ASIC

Australian Securities & Investments Commission

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Mr Gary Banks
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By email: consumer@pc.gov.au

Dear Gary

Productivity Commission Review of Australia's Consumer Policy Framework

ASIC welcomes the opportunity to contribute to the Productivity Commission's Inquiry into Australia's Consumer Policy Framework.

ASIC's mandate under the ASIC Act requires it to promote the informed and confident participation of investors and consumers in the financial system. It also requires ASIC – among other things – to contribute to the efficiency and development of the economy, commercial certainty, and reduced business costs. This requires ASIC continually to balance potentially competing interests, and to aim for the right mix of protection functions and business and economic facilitation functions.

At the highest level of public policy, ASIC does not see the elements of this mandate as in fundamental conflict. An efficient and well performing industry sector will be attractive to consumers by maximising their opportunities to meet their needs. It will compete on both price and quality to attract consumer demand. And it will provide an environment in which consumers have ready access to the information they need to make decisions to meet their needs and preferences.

Accompanying this letter is a detailed submission setting out ASIC's responses to the issues and questions raised in the Issues Paper. The submission sets out:

- a. a brief descriptions of ASIC's role as a consumer protection regulator and how ASIC performs the role;

- b. high level views on the broad issues the Issues paper raises;
- c. more detailed information about and comment on developments and issues ASIC has encountered in carrying out its consumer protection role under the Corporations Act and related legislation, and in administering the consumer protection provisions of the Australia Securities and Investments Commission Act.

The information provided in ASIC's submission draws on its now considerable experience as an industry-specific consumer regulator in the financial services sector. It is now a decade since the Wallis Committee produced the Final Report of the Financial System Inquiry. Since the legislative program giving effect to the recommendations made by the Wallis Committee, ASIC has been responsible for regulation of the financial services sector, including for administering consumer protection laws relating to that sector.

The following broad comments about developments in the financial services sector and implications of those developments for consumers and for consumer protection regulation frame some of the comments made in the detailed submission.

Developments in the financial services sector

In the decade since the Wallis Committee reported, there have been major changes in the institutional framework for financial services regulation at the Commonwealth level. At the same time, the financial services sector has grown significantly. In particular, new financial products and services have continued to proliferate, and the level of direct and indirect consumer participation in the market for financial products and services has continued to grow.

These developments should in ASIC's view be taken into account in any assessment of the overall framework for consumer protection, to identify areas where:

- where the significance of gaps and potential inefficiencies has changed since the current arrangements were put in place and therefore
- the existing framework may need to be changed or strengthened.

Implications for consumer protection and its regulation

The Wallis Committee report identified two areas that should be subject to further review: the effectiveness of the then new arrangements for the regulation of consumer credit; and the regulation of real estate agents providing financial advice.

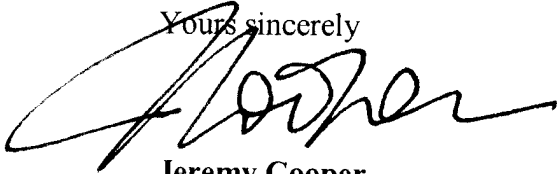
ASIC's financial services consumer protection experience highlights that consumers' credit experiences contribute significantly to their view of, and confidence in, the financial services sector as a whole. This suggests the need to see credit within the broader framework of financial services regulation, rather than as something apart from it.

Property and property-related investment plays an important and growing role for consumers. Arguably, the Wallis committee focus on investment advice provided by

real estate agents is now too narrow. This is because of significant developments in services now made available to consumers contemplating property-related investment decisions. A striking example is the growth of the mortgage broking industry. These developments suggest the need to reassess in a broader framework the application of the principle that economically equivalent activities should be subject to equivalent regulation.

ASIC's looks forward to continuing to assist the Commission with its inquiry.

Yours sincerely

A handwritten signature in black ink, appearing to read 'Jeremy Cooper', written in a cursive style.

Jeremy Cooper
DEPUTY CHAIRMAN

Attch.



ASIC

Australian Securities & Investments Commission

Productivity Commission

**Review of Australia's
consumer policy
framework**

**Submission by the Australian
Securities and Investments
Commission**

August 2007

Preface

The Australian Securities and Investments Commission (ASIC) welcomes the opportunity to provide this submission to the inquiry into Australia's consumer policy framework announced by the Treasurer on 11 December 2006.

As the Productivity Commission is aware, the Parliamentary Secretary to the Treasurer initiated a review of corporate and financial services regulation in April 2006. That review has led to a number of proposed changes to Chapter 7 of the *Corporations Act 2001* (Corporations Act). On 26 March 2007 the Parliamentary Secretary to the Treasurer released draft regulations implementing a number of these proposals for public comment. A package of legislation comprising the Corporations Legislation Amendment (Simpler Regulatory System) Act 2007, and supporting legislation, the Corporations (Fees) Amendment Act 2007 and the Corporations (Review Fees) Amendment Act 2007 were enacted on 28 June 2007.

ASIC's submission assumes that this inquiry will not include a detailed examination of the operation of Chapter 7 of the Corporations Act, in light of the work being undertaken by the Corporate and Financial Services Regulation Review.

This submission includes:

- a short summary of ASIC's consumer protection role with respect to financial services; and
- our responses to questions in the issues paper released in January 2007.

In Section 3 of the submission, we also respond to the Productivity Commission's invitation to focus in some detail on the industry-specific regulatory framework for credit.

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Background

ASIC's consumer protection role

ASIC administers various pieces of legislation, regulations, instruments and codes that impose consumer protection requirements on the financial services industry.

One of the key pieces of consumer protection regulation that we administer and enforce is the *Australian Securities and Investments Commission Act 2001* (Cth) (ASIC Act). This contains provisions modelled on the consumer protection and unconscionable conduct provisions in the *Trade Practices Act 1974* (Cth) (TPA).¹ These provisions apply to the provision of financial products and services, including credit facilities and services relating to credit.²

The Corporations Act also contains a prohibition on misleading or deceptive conduct in relation to financial products and services regulated under the Corporations Act.³ Unlike the ASIC Act, this does not cover credit.⁴

Under the Corporations Act we also administer licensing, disclosure and quality of advice requirements that apply to many financial products and services including securities, managed investments, superannuation, insurance products, bank accounts and financial advice.

Providers of financial services must generally hold an Australian financial services (AFS) licence or be a representative of an AFS licence holder, and comply with the conditions of the licence. One important condition is that licensees must be a member of an ASIC-approved external dispute resolution scheme. Financial advisers must also meet disclosure requirements and have a reasonable basis for certain advice. There are also product disclosure requirements aimed at retail investors (ie consumers).

However, these Corporations Act requirements do not apply to credit products or services (such as advice relating to credit products).

¹ Part 2 Division 2.

² See the definition of financial product in s12BAA and Australian Securities and Investments Commission Regulations 2001 (Cth) reg 2B.

³ Part 7.10 Division 2.

⁴ See the definition of financial product in Part 7.1 Division 3 Subdivision B.

What we do

ASIC performs a wide range of consumer protection functions.

Compliance monitoring

We monitor how financial services providers comply with the consumer protection laws we administer. This includes ongoing monitoring and targeted surveillance campaigns. For example, in 2006 we released the report of our shadow shopping survey that monitored compliance standards of superannuation advice, *Shadow-shopping survey on superannuation advice*.

Enforcement activity

Where we find serious breaches of the law, we take civil, administrative or criminal action. For example, in July 2006 ASIC obtained an enforceable undertaking requiring AMP Financial Planning Pty Limited to modify key aspects of how it provides financial advice to its clients as well as provide redress to consumers.⁵ This action followed extensive surveillance. We found that on many occasions:

- Financial planners did not have a reasonable basis for advice.
- Planners failed to properly disclose the cost of recommended products and significant consequences of switching products.
- AMP Financial Planning did not have adequate arrangements in place to manage conflicts of interest.

Industry codes

We work with industry to develop and update codes of conduct that provide important consumer protections. For example, we are currently reviewing the Electronic Funds Transfer Code of Conduct (EFT Code), a voluntary industry code of practice that sets out the liability allocation rules for all disputed electronic banking transactions, including over the internet. In January 2007, we released a consultation paper inviting submissions to this review.

⁵ ASIC Media Release 06-251 *ASIC accepts a legally enforceable undertaking from AMP Financial Planning* (July 2006).

Consumer-oriented research

We examine issues affecting consumers. For example, in 2005 we released a detailed report on the market for equity release products in Australia and the risks associated with these products.⁶ The report included a snapshot of the types of equity release products available and commentary on the risks associated with these products. This work led to significant improvements to the products to deal with these risks, such as the inclusion of a 'no negative equity' guarantee in most reverse equity products available in Australia. We are currently working on research examining the impact on consumers of refinancing arrangements, including loss of existing equity and transaction costs. We expect to release a report on this research mid-year. Appendix A is a more detailed list of current and completed consumer research.

Educational work

We conduct a wide range of consumer educational work, including giving warnings about recent financial scams. For example, in 2005–2006 we issued 27 consumer alerts and warnings. We also publish information about financial products and risks. This includes interactive tools, such as budget calculators and calculators that enable consumers to compare financial products. For example, we have web-based calculators on superannuation, risk and return, reverse mortgages, compound interest and retirement income stream products.

We use a range of mechanisms to deliver our consumer education material, including: FIDO, our dedicated consumer website; FIDO News, a free e-newsletter; publications; attendance at public functions; PR techniques; and a telephone hotline.

Consumer liaison

We liaise formally and informally with stakeholders who represent consumers' interests. For example, ASIC's Consumer Advisory Panel, consisting of representatives of consumer associations and an independent chair, advises us on consumer protection issues, particularly those impacting upon vulnerable consumers, and gives feedback on ASIC policies, education and research projects. In addition, we meet quarterly with consumer caseworkers from around the country to exchange information on emerging and ongoing issues in financial services.

⁶ ASIC, *Equity release products* (November 2005).

Dispute resolution schemes

Financial services providers regulated under the Corporations Act must generally be a member of an independent external dispute resolution scheme approved by ASIC. Once a scheme is formally approved, we continue to oversee it, maintaining ongoing contact with each scheme, approving changes to scheme rules and contributing to independent reviews. We also receive and respond to consumer and industry complaints about the schemes and their views and concerns about external dispute resolution generally.

Public registers

We maintain a number of public registers, including registers of AFS licence holders, authorised representatives of AFS licence holders, prospectuses and product disclosure statements (PDSs) lodged with ASIC, people banned from holding an AFS licence or being a representative, enforceable undertakings, company names, unlicensed overseas callers, registered managed investment schemes and illegal investments. Consumers can search these registers on our FIDO website.

Unclaimed money register

We maintain registers of unclaimed bank accounts, life insurance and shares. Consumers can search these registers on our FIDO website⁷ or by requesting a search.

More information about ASIC

For information about our general approach to regulation, see the booklet *ASIC: a guide to how we work*, which accompanies this submission.

⁷ www.fido.gov.au

Section 1: Rationale for consumer policy

1.1 The issues paper identifies three potential rationales for consumer protection regulation:

- the need for an efficient demand-side
- behavioural economics arguments and
- the need to protect disadvantaged and vulnerable consumers.

ASIC agrees with these rationales.

1.2 In our view, the need to prevent abusive market practices (which can affect all segments of the market, not just vulnerable consumers) is also an important rationale for consumer protection regulation.

Question 1(a)

What are the key rationales for government intervention to empower and protect consumers?

ASIC response

Demand-side efficiency

1.3 The issues paper recognises the importance of an efficient demand-side in achieving efficient markets. Where consumers and sellers have the same information about a product or service, consumers can, in theory at least, properly judge their characteristics and quality. In this situation, competition and market forces lead to market efficiency. The impact of bounded consumer rationality on demand-side efficiency is discussed at paragraphs 1.35-1.42 below.

1.4 The issues paper notes that information gaps between consumers and sellers is one factor that prevents consumers from properly judging products and services.

1.5 It is widely accepted that information asymmetry can be a feature of financial services markets. The Wallis Report described information asymmetry in financial services in the following terms: "For many financial products, consumers lack (and cannot efficiently obtain) the knowledge, experience or judgment required to make informed decisions. This is known as information asymmetry – a situation where further disclosure, no matter how high quality or comprehensive, cannot overcome market failure."⁸ In our experience, consumers and financial services providers do not have the same information practically available to them, at least in a form which it is possible to use to make ready comparisons. One reason for this is the variety and complexity of financial products and services. For example, a consumer looking for a managed investment fund has a choice of literally thousands of funds. While the consumer might be able to access information about all the choices, it is almost impossible for the consumer to be able to condense that information into a form that enables a reasonable comparison of the products available.

1.6 Another reason for the information gap is that a consumer cannot determine the quality of financial products and services by inspecting them pre-purchase—the characteristics, quality and performance of these products and services do not become apparent until a long time after purchase. For example, a consumer who chooses a superannuation fund can only determine its quality by experience, usually over many years.

1.7 The issues paper notes that market mechanisms may address information gaps. These include commercial incentives for sellers of frequently purchased goods, action by a small number of well-informed consumers, advice from intermediaries and common law actions.

1.8 However, there are a number of reasons why market mechanisms do not adequately address information gaps in financial services. First, consumers do not generally make frequent repeat purchases, that is, financial services are not generally experiential goods. Secondly, consumers cannot normally determine the quality of products and services until they have experienced their performance for some time. Thirdly, if there is a problem with the product, common law action is nearly always not a cost-effective remedy.

1.9 Investment products are unusual compared to other goods and services in that they have a risk–return balance. Unlike other goods and services, they cannot be designed or declared to be 'safe'. Many consumers mistakenly expect that, like other goods, investment products would not be permitted to be on the market if they were unsafe.

⁸ Financial System Inquiry, *Final Report* (1997) at 191.

1.10 Many consumers make decisions to buy financial products as part of a broader purchase. For example, consumers frequently take out personal loans to buy cars, holidays or other goods, and take out home loans to buy real estate. In these situations, consumers frequently focus on purchasing the car or the house rather than the associated finance and insurance. Separately, for many consumers, their first experience with buying a financial service or product will be with a bank or other large financial institution which is prudentially regulated. This can naturally lead consumers into a false sense of security about the creditworthiness of providers of investment products when they come to buy those products from non-prudentially regulated suppliers.

1.11 Financial products consist of intangible contractual promises. For at least some consumers, financial products are viewed as privileges or obligations, rather than consumer goods.

1.12 As a result, there are a number of regulatory mechanisms in place to provide additional protections for consumers. For example, consumers can access advisers and brokers to assist with buying investment and insurance products. ASIC recognises the importance of good quality financial advice in overcoming information gaps. However, financial advice only assists to address the information gaps between consumers and providers of financial services if the advice is appropriate and reflects the consumer's personal circumstances, objectives and needs.

1.13 Under Chapter 7 of the Corporations Act, financial advisers are required to have a reasonable basis for their advice.⁹ ASIC is responsible for administering and enforcing this obligation. ASIC also administers a licensing regime for financial advisers under Chapter 7 of the Corporations Act, which includes requirements for advisers to have adequate educational qualifications and experience in order to perform their role effectively.

1.14 Our research indicates that the quality of financial advice does not always meet the standards required by the Act. For example, ASIC's 2006 *Shadow-shopping survey on superannuation advice* found that 16% of advice we reviewed clearly did not meet this requirement and a further 3% of advice probably did not meet it.

1.15 These compliance findings reflect a number of underlying issues. Although Chapter 7 of the Corporations Act imposes mandatory training requirements for financial advisers, the level of expertise of some financial advisers continues to be of concern.

⁹ Corporations Act s 945A.

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1.16 Another issue is the impact of commissions paid by product issuers to financial advisers on the appropriateness of advice. Our shadow shopping survey found that inappropriate advice was far more likely to occur where the adviser was paid a commission.

1.17 ASIC's view is that regulation, such as the current requirement for advisers to have a reasonable basis for their advice and the licensing regime for advisers, is justified in order to improve demand-side efficiency because information gaps between consumers and financial services providers cannot be overcome by market mechanisms alone. Apart from setting the standard which the vast majority of participants meet, it also provides the regulator a capacity to take action against those who fail to meet the standard.

1.18 In the financial services sector, a number of other important regulatory measures specifically address information gaps, including:

- bans on misleading or deceptive and unconscionable conduct—these prohibit misleading advertising about financial products and services
- disclosure requirements, for example product disclosure and disclosure about advice and remuneration under the Corporations Act and the disclosure requirements for credit regulated under the Uniform Consumer Credit Code (UCCC)—these prescribe the information providers must give consumers
- cooling-off periods, for example the cooling-off period for investment products under Chapter 7 of the Corporations Act¹⁰—these give consumers more time to consider information
- restrictions on offering financial products in the course of, or because of, unsolicited meetings or telephone calls—this ban, which is directed at pressure selling practices such as door-to-door sales, also gives consumers more time to consider information.¹¹

1.19 However, ASIC's experience is that regulatory measures that address information gaps do not always assist disadvantaged consumers in segmented markets. This group of consumers often has little or no choice between alternative products. For example, consumers who get credit from payday lenders are often unable to access less expensive mainstream credit products.

¹⁰ Corporations Act s 1019B.

¹¹ Corporations Act s 736 (securities), s 992AA (managed investments) and s 992A (other financial products).

1.20 On the other hand, our experience is that some consumers who would be widely regarded as relatively sophisticated and well-informed can and do fall for scams. For example, research by ASIC into cold calling scams found that the consumer population targeted in these types of scams was quite diverse and included consumers with relatively high educational levels, income and investment experience.¹² Regulation cannot aim to prevent scams of this nature, but there is a need to better educate investors to identify the risks involved in investment decisions.

1.21 Another limitation of regulation that focuses on redressing information gaps is that it does not address the lack of competition in some markets. For example, a consumer choosing between credit card products with similar, very one-sided standard terms and conditions is not protected by being well informed about the nature of the competing products on offer.

1.22 Lastly, while disclosure requirements that address information asymmetry are an essential part of any financial services consumer protection regime, it must always be remembered that too much information, or poorly communicated information, can leave consumers in exactly the same position as an absence of information.

1.23 So, while ASIC recognises the importance of addressing information gaps, our view is that this is only one aspect of the rationale for consumer protection regulation in financial services. Although the field of behavioural economics is still developing, we consider that the bounded rationality of consumers, as evidenced by the theoretical and empirical studies undertaken by behavioural economists, provides another important justification for consumer protection regulation. Even leaving aside considerations of behavioural economics, because of the intangible nature of financial products and their range and complexity, it is unlikely that regulation based only on providing information will have the effect of producing the efficient demand-side necessary to encourage a competitive and efficient market.

Protection of disadvantaged and vulnerable consumers

1.24 The issues paper notes the widely held view that consumer protection regulation is justified to protect disadvantaged and vulnerable consumers from scams and inappropriate trading practices, and to assist their effective participation in markets.

1.25 ASIC agrees with this view. We think promoting consumer wellbeing and fair treatment is an important end in itself and a significant rationale for consumer protection regulation in financial services. It also promotes consumer confidence and participation in financial services, to the benefit of industry and consumers alike.

¹² ASIC, *Hook, line and sinker: Who takes the bait in cold calling scams?* (2002).

1.26 In our experience, some consumers with low levels of financial literacy are significantly disadvantaged in financial services markets. ANZ's 2005 survey of adult financial literacy in Australia identified a number of categories of consumers with especially low levels of financial literacy, including:

- consumers with an education level of Year 10 or less
- unemployed consumers and people working in unskilled and casual jobs
- consumers with low levels of savings
- young consumers aged 18–24
- older consumers aged 70 years or more.¹³

1.27 Indigenous consumers and consumers from non-English speaking backgrounds can also be very vulnerable to unscrupulous financial services operators who target them with illegal and inappropriate products and selling practices.

1.28 We have taken legal action to prevent financial services providers from marketing and selling inappropriate financial products to Indigenous communities on a number of occasions. In 2000, we investigated Combined Insurance Company of America, a financial services provider promoting and selling inappropriate accident and health insurance policies to disadvantaged Indigenous communities participating in the Community Development Employment Project, a Federal Government scheme for Indigenous communities where participants performed work for unemployment benefits. We obtained an undertaking from Combined Insurance that it would not market, promote or sell insurance policies to people in these communities.¹⁴

1.29 In 2006, ASIC and the South Australian Office of Consumer and Business Affairs investigated personal loans arranged for borrowers in Far North Queensland, South Australia and the Northern Territory. Many of the borrowers were indigenous consumers dependent on Centrelink payments for their incomes and most of the loans were to fund the purchase of second-hand motor vehicles. The loans, with the Commonwealth Bank, were arranged through a number of brokers. In response to our concerns about the loan eligibility criteria and discrepancies in some of the loan applications, the Commonwealth Bank reviewed 400 loans, implemented new lending procedures and assessment criteria and funded a dedicated financial counsellor for remote communities for three years.¹⁵

¹³ ANZ, Survey of Adult Financial Literacy in Australia (November 2005) at para 1.3.2.

¹⁴ ASIC Media Release MR 00/357 *ASIC takes action against Combined Insurance Company of America* (August 2000).

¹⁵ ASIC Media Release MR 06-010 *CBA agrees to change lending practices in remote Indigenous communities* (January 2006).

1.30 We are currently investigating similar activity by another large financial institution in regional and remote areas. We are also planning to meet with the banks to discuss their risk management and lending practices when dealing with consumers in these areas.

1.31 We regularly see unscrupulous operators exploit the vulnerability of consumers from non-English speaking communities. For example, this has occurred in the superannuation context where unlicensed financial advisers who have affinity relationships with particular communities falsely represent to members of their community that it is possible to obtain access to money held in APRA-regulated superannuation funds by switching the funds into self-managed superannuation funds. We are currently investigating a number of these illegal early release schemes in several south-west Pacific communities in New South Wales.

1.32 Lastly, economically disadvantaged consumers often buy more expensive, unsuitable products because they have fewer options than other consumers. For example, consumers with very low incomes often experience difficulties obtaining credit through mainstream credit providers and have no option but to deal with fringe credit providers such as payday lenders.

Preventing abusive market practices

1.33 Our experience is that unfair conditions and sharp practices are a considerable problem amongst marginal players in financial services and they also occur from time to time even among mainstream participants. For example, in 2006 ASIC investigated a large financial services provider which promoted a credit card on the basis that customers could transfer balances from other credit cards at a low interest rate for the life of the balance and that no or minimal fees would be incurred.¹⁶

1.34 Many customers used the card effectively by transferring balances from other cards and not using the card for purchases. This enabled these consumers to access an interest rate that was significantly below market rates. The provider subsequently introduced a \$160 charge to customers who failed to use the card to make purchases. ASIC took the view that this conduct was misleading or took action to obtain redress for the affected consumers and to enforce what we believe the general industry would regard as an appropriate standard. In our view, the need to address abusive market practices that impact on all consumers, so as to maintain consumer confidence in an appropriate standard of conduct, is another important rationale for consumer protection regulation.

¹⁶ ASIC Media Release MR 06-132 *Citibank responds to concerns about ReadyCredit card* (May 2006).

Questions 1(b) and 1(c)

What should be the balance between seeking to ensure that consumers' decisions properly reflect their preferences (empowerment) and proscribing particular outcomes (protection)?

What are the implications of developments in theory (e.g. behavioural economics) for consumer policy? Do they render some traditional views of the role for government in this area less relevant, or do they simply require more sophistication in the analytical framework and policy toolkit?

ASIC response

1.35 The issues paper notes that research using behavioural economics shows that consumers who have access to adequate information do not always make rational purchasing choices. The issues paper also states that more evidence is needed before behavioural economics can provide a more widespread policy approach.

1.36 The ACCC submission to this Inquiry includes a useful explanation of the various behavioural biases identified by behavioural economics research.¹⁷ A number of behavioural economics research studies focus on the impact of behavioural biases on consumers in financial services. These include studies that examine consumer behaviour in real settings as well as laboratory studies.

1.37 For example, in 2005 researchers from Yale University completed a large field-based study of responses to consumer credit offers made to South African consumers. The study found that psychological features of the offer documents significantly affected take-up. For example, when the offer document sent to a man included a photograph of a woman, the take-up rate increased to the equivalent of dropping the interest rate 4.5%.¹⁸

1.38 A 2003 study by researchers at the University of Pennsylvania confirmed that financial services consumers presented with numerous, complex investment choices are likely to exhibit 'default bias'—that is, in response to information overload, consumers will simply select the default option rather than analyse large amounts of complex information about numerous options. This research also found that consumers tend to be adverse to saving today, but are more willing to save if the amount saved is deducted directly from their salary and more likely to increase savings if the increases coincide with pay rises.¹⁹

¹⁷ ACCC, *Submission to the Productivity Commission inquiry into Australia's Consumer Protection Framework* (June 2007), Appendix A.

¹⁸ Bertrand, M et al, *What's Psychology Worth? A Field Experiment in the Consumer Credit Market* Economic Growth Center, Yale University, July 2005.

¹⁹ O Mitchell and S Utkus, *Lessons from Behavioural Finance for Retirement Plan Design*, Pension Research Council, Philadelphia (2003).

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1.39 2005 research by researchers at the University of Queensland found that even with heavily prescribed consumer-centric disclosure under the Uniform Consumer Credit Code, consumers find it difficult to understand and interpret point of sale disclosure for financial products. The research suggested that for consumer credit products, there was very little improvement in consumer understanding under mandated disclosure compared to consumers relying simply on the credit contract.²⁰

1.40 While the field of behavioural economics is still developing, we consider that the findings of this research in financial services to date provide an important rationale for consumer protection regulation in financial services.

1.41 Accepting the validity of the findings of behavioural economics research, the regulatory challenge is to find ways to reflect the findings of behavioural economics in policy design. One possible response to evidence of default bias, that would be worth examining, could be to regulate the default options offered by financial services providers to ensure that they are appropriate for the majority of consumers or the majority at particular ages etc. This could include mandating or prohibiting particular features of default options.

1.42 Responses to the evidence that consumers are disinclined to save could include educational work around the merit of arranging to automatic salary deductions for savings. Another response would be to use opt-out savings models. For example, from July 2007, New Zealand will introduce an opt-out, voluntary, work-based retirement savings initiative called Kiwisaver. This approach takes into account that people will generally take a default option where it is offered, suggesting that default options should be set depending on what is reasonably believed to be in the best interests of the majority being given the choice.

²⁰ P O'Shea and C Finn, 'Consumer Credit Code disclosure: does it work?' (2005) 16 *Journal of Banking and Finance Law and Practice* 5.

Section 2: Market trends and developments

2.1 A number of market developments have occurred in financial services in recent years. These include the increased role of debt in consumers' lives, important developments in the Federal Government's retirement incomes policy, increased competition, the growth of e-commerce and the emergence of equity release products and ancillary services to financial products. There has also been a trend towards consumption of overseas financial products. The ASX 2006 Share Ownership Study showed that of retail investors who own a direct share portfolio, 19% of them held a share listed on an overseas stock exchange in that portfolio.²¹

2.2 Increasing product complexity, particularly in relation to credit products, has also impacted on the ability of consumers to participate effectively in financial services markets. The growth of the financial advice industry is another market development related to increasing product complexity.

Question 2(a)

How have recent market trends changed the requirements for Australia's consumer policy framework? For example, has the growth in e-commerce made it more difficult to enforce regulation, thereby reducing its effectiveness? Or has the internet empowered a greater proportion of consumers?

ASIC response

2.3 A number of market developments have changed the requirements for consumer policy regulation. These include:

- increasing levels of debt
- the Federal Government's retirement incomes policy
- increased competition
- developments in e-commerce
- finance broking and
- the emergence of new products and services.

²¹ http://www.asx.com.au/about/pdf/shareownership_study_2006.pdf

Indebtedness

2.4 One important market development is the increasing role of debt in the lives of consumers and the increasing level of indebtedness of Australian households. Household mortgage repayments increased by 47 per cent in the five years to 2003-2004.²² Australian households now owe \$160 for every \$100 of disposable income and are spending a record 12 per cent of disposable income paying interest on debt.²³ There is evidence that a growing number of Australian households are falling behind in mortgage repayments. A report by the ACT Consumer Law Centre on house repossessions in the ACT Supreme Court indicated that the total number of Supreme Court actions for house repossessions increased substantially in 2005.²⁴

Borrowing to buy shares

According to the latest RBA data²⁵, there were 170,000 investors owing \$30.3 billion²⁶ in share margin loans at March 2007, a 41% increase year-on-year. The current average size of a margin loan is therefore around \$178,000, but this is somewhat skewed by high net worth investors who might have loans of \$10 million or more.

The average level of gearing of the average investor's portfolio rose slightly from 39% to 41% in the same period. The average frequency of margin calls in the March 2007 quarter (0.35 calls per day per 1,000 clients – ie 60 a day on current loan numbers) was slightly higher (up from 0.28 a year earlier), but still far lower than the most recent peak of 6.01 per 1,000 in the March 2003 quarter.

While the gearing levels and the proportion of debt to the overall value of retail participation in the sharemarket is still relatively conservative, it is interesting to note that the S&P/ASX 200 grew by around 23% in the year to March 2007, a bit less than half the rate of increase in margin lending over the same period.

Retirement incomes policy

2.5 There have been a number of significant developments in the Federal Government's retirement incomes policy. The first was the introduction of compulsory superannuation in 1992. The introduction of the superannuation guarantee has made participation in financial services markets mandatory for Australian employees for the last 16 years.

²² Australian Bureau of Statistics, 6530 – *Household expenditure survey, Australian Summary of Results 2003-2004* (August 2005).

²³ J Gordon and M Moncrief, 'The home front' *The Age*, Saturday 2 June 2007.

²⁴ Consumer Law Centre, ACT, *'They want to take our house' An investigation into house repossessions in the ACT Supreme Court* (2006).

²⁵ RBA Statistics Bulletin 31 March 2007

²⁶ These figures include protected loans, but do not include the exposure of retail investors to the leverage inherent in products such as CFDs, warrants and the like.

2.6 Second, the introduction of choice of superannuation fund in 2005 has given many workers the ability to choose which superannuation fund they belong to. This development has significantly increased competition for market share between superannuation funds. The Federal Government has also introduced a number of taxation and other incentives to encourage people to make voluntary contributions to their superannuation savings.

2.7 From a consumer perspective, this policy has resulted in a burgeoning number of people retiring or approaching retirement who are in an unfamiliar position in investing large amounts of superannuation. These people might be termed 'the consumer investor', as they have not and do not necessarily identify themselves as people with skills in investing. Research recently completed for ASIC into consumer attitudes towards investment found that most consumers who invest see themselves as saving towards retirement, and do not view themselves as investors. Many people approaching retirement are also chasing higher investment returns as their minds turn to the amount of money they need for a comfortable retirement.

Competition

2.8 In some areas of financial services, competition has become intense and mainstream players are now competing with new and fringe players. In some cases, traditional sources of profit have been undermined by price competition, such as interest rates on home loans. We have seen evidence that the market response to this includes the imposition of new or higher charges in areas that do not appear to attract as much competition (e.g. default fees).

E-commerce

2.9 In September 2006, there were 5.83 million household subscribers to the internet in Australia.²⁷ Growth in the use of internet banking has been particularly notable. According to the *ANZ Adult financial literacy survey 2005*, internet banking use rose from 28% in 2002 to 40% in 2005 and use of BPAY increased from 50% to 60% in the same period.²⁸

2.10 The rise of e-commerce has significantly reduced the barriers to entry as a financial services provider. There are many more entities offering financial products and services, including far more fringe players. This development has had a positive impact on competition. However, our experience is that a number of fringe players do not have concerns about establishing or maintaining a market reputation or meeting base levels of fair practice.

²⁷ Australian Bureau of Statistics, *Internet Activity, Australia, Sep 2006* (8153.0).

²⁸ ANZ Survey of Adult Financial Literacy in Australia (November 2005) .

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2.11 It is generally accepted that the level of internet banking fraud in Australia has increased over recent years, although it remains relatively contained compared to other forms of fraud. Industry estimates net losses in the vicinity of \$25 million per year, although it is acknowledged that this is only a round figure and the total costs (including costs associated with investigating fraud claims) may be higher.²⁹

2.12 As part of our review of the EFT Code, we are currently examining whether the growth in online banking and online fraud requires changes to the consumer policy framework for banking services. The EFT Code imposes the main burden of liability for losses occasioned from use of EFT technology on banking providers, unless fraud or specific types of carelessness by consumers is established.³⁰ The main policy rationale for this approach is based on economic efficiency considerations.

2.13 Both consumers and banks can take action to reduce losses—consumers can reasonably safeguard their card and PIN, and banks can maintain and improve the reliability and security of their systems. An economically efficient loss allocation rule assigns liability to consumers when they fail to reasonably safeguard their card and PIN, and to banks in other cases, to encourage them to improve the security of their systems. This is known as the ‘least cost avoider’ principle.

2.14 Another policy rationale for the liability provisions in the EFT Code is simplicity—that liability allocation rules should be simple, clear and decisive to minimise costs of administering them.

2.15 Some stakeholders have argued that the EFT Code should be modified to make customers liable for losses resulting from online fraud in certain circumstances.³¹ Other stakeholders however are firmly of the view that it is unreasonable to impose any additional liability onto consumers when all of the pricing mechanisms in recent years have driven them to using electronic banking and there is more that institutions could do to prevent fraud.³²

2.16 Internet banking allows consumers to make payments from their accounts to others. To do this, the customer must enter the intended recipient’s account number. Sometimes people enter the wrong number by mistake. The EFT Code does not currently allocate liability for losses in this situation. The consultation paper we have released as part of our review of the EFT Code identifies a number of possible policy responses to mistaken payments.³³

²⁹ ASIC, *Reviewing the EFT Code* (Consultation Paper) January 2007 at para 3.11.

³⁰ EFT Code clause 5.

³¹ For example, losses resulting from malicious software attacks on the customer's computer unless they meet minimum security requirements; losses resulting from acting with extreme carelessness in response to 'phishing' attacks.

³² ASIC, *Reviewing the EFT Code*, *ASIC Consultation Paper* (January 2007), Section 7.

³³ ASIC, *Reviewing the EFT Code*, *ASIC Consultation Paper* (January 2007), Section 7.

2.17 The EFT Code has been in existence since the mid-1980s. It came into existence against a background of financial institutions needing to encourage consumer confidence in using electronic banking, and the potential that regulation might be developed to allocate liability. Traditionally, all approved deposit-taking institutions (ADIs) that offered retail electronic banking services have been a party to it and the EFT Code has operated well and enjoyed industry, government and consumer support.

2.18 As more and more non-ADI players enter the electronic payments area, however, it can no longer be said that everyone the EFT Code potentially applies to is a member. The Code's coverage, and therefore its effectiveness, will be considered as part of this review.

Finance brokers³⁴

2.19 Another market development is the expansion of the finance broking industry. This is now one of the fastest growing sectors in the finance industry.³⁵ As the sector has grown, remuneration arrangements, especially commissions, have become increasingly complex.³⁶

2.20 There are a number of serious problems in this sector. In 2003, ASIC released a report on the mortgage broking industry prepared by the Consumer Credit Legal Centre NSW which found that consumers who use mortgage brokers can face a range of problems including poor advice, increased costs from being recommended to enter inappropriate loans, inadequate disclosure of fees and commissions by some brokers, inconsistent documentation, uncertainty about the nature and price of services and, in a small number of cases, fraudulent activity including manipulating loan applications.³⁷

2.21 More recently, Consumer Affairs Victoria has examined the mortgage broking industry. Their work also found significant problems, including lack of training requirements for brokers and absence of disclosure about the nature of the service provided leading to confusion about whether the broker is providing information, arranging finance or giving advice. Lack of remuneration disclosure and inappropriate product recommendations are also continuing problems especially in relation to selling debt consolidation packages.³⁸

2.22 ASIC's own research into refinancing advice by brokers reinforces these findings. Our research has found cases where brokers advised borrowers to refinance into a loan that had less favourable terms than their existing loans, and borrowers who acted on refinancing advice incurring high transaction costs and significant loss of equity in their homes.

³⁴ Synonymous with 'mortgage brokers'.

³⁵ Consumer Affairs Victoria, *Report of the Consumer Credit Review* (2006), Section 8.

³⁶ Consumer Affairs Victoria, *Report of the Consumer Credit Review* (2006), Section 8.

³⁷ ASIC MR 03-102, *ASIC releases report into mortgage brokers* (March 2003).

³⁸ Consumer Affairs Victoria, *Report of the Consumer Credit Review* (2006) Section 8.

2.23 Finance brokers are subject to our jurisdiction over unconscionable and misleading or deceptive conduct under the ASIC Act. For example, we recently obtained court orders against a major finance broker in relation to misleading or deceptive conduct. The broker cold-called potential clients and arranged to visit them, usually at their home. The broker made recommendations to its clients about refinancing their home loan. A number of clients were referred to a lender associated with the broker and made numerous misleading representations about the benefits of its recommendations.³⁹ However, we believe these problems require a stronger regulatory response. In particular, there is no consistent national regulatory framework for the finance broking industry. Finance broking is not regulated as a financial service under Chapter 7 of the Corporations Act or as a credit facility under the Uniform Consumer Credit Code (UCCC). Existing State-based requirements are inconsistent and inadequate.⁴⁰

2.24 In 2004, a Ministerial Council of Consumer Affairs working party released a discussion paper on national finance broking regulation. The discussion paper proposes a uniform regulatory regime for finance brokers including licensing, minimum competence requirements and written broker agreements, including full disclosure of fees and commissions. Recommendations by brokers would be required to meet quality standards and brokers would be required to give reasons for their recommendations, as well as to belong to an external dispute resolution scheme approved by ASIC.⁴¹ ASIC endorses these proposals.

2.25 In 2006, Consumer Affairs Victoria proposed that brokers should also be required to tell consumers what type of service they provide: transaction only broking, information or advice.⁴² ASIC also supports this proposal.

Equity release products

2.26 A third market development in financial services is the growth in equity release products. ASIC's report *Equity release products* (2005) describes a number of equity release products on the Australian market or in development, including reverse mortgages, home reversion schemes and shared appreciation mortgages. This sector is expanding rapidly.⁴³ An industry report estimates that the potential market for these products could reach \$15 billion by 2010.⁴⁴

³⁹ ASIC MR 07-144, *Court finds major mortgage broker's conduct misleading or deceptive* (May 2007).

⁴⁰ For a summary of the deficiencies of Victoria's regulatory regime, see Consumer Affairs Victoria, *Report of the Consumer Credit Review* (2006) Section 8.

⁴¹ Ministerial Council of Consumer Affairs, *National Finance Broking Regulation RIS Discussion Paper* (2004).

⁴² Consumer Affairs Victoria, *Report of the Consumer Credit Review* (2006) Option 8.2.

⁴³ For a summary of the growth in equity release products see ASIC, *Equity Release Products* (November 2005) at 4 – 5.

⁴⁴ Trowbridge Deloitte, *The Equity Release Opportunity for Financial Planners* (July 2005).

2.27 Equity release products can be a useful way for consumers to access the equity in their homes. However, they are complex products in which the ownership and management of the property is shared between the provider and the consumer over an extended period of time. If used inappropriately or as a result of poor advice, they involve significant risks.

2.28 One risk arises from the impact of movements in interest rates and property prices and the terms and conditions for some products—for example, consumers may be left with negative equity in their homes if the debt incurred exceeds the value of their property. Market movements may trigger immediate repayment of the loan and, depending on product terms and conditions, loss of key rights.

2.29 Used at the end of consumers' working lives, these products have significant implications for consumers' overall financial positions because consumers must manage their existing equity and income to fund their housing and aged-care needs and the desire to leave an inheritance. Consumers who do not manage their existing equity adequately end up relying on social security entitlements to fund their retirement.

2.30 In the United Kingdom, which has a more mature market for equity release products, research shows that advice on equity release products is frequently inadequate, not taking into account either client information needed to determine whether the products are appropriate and not including advice about the risks of the products.⁴⁵

Question 2(b)

Has greater product complexity made it more difficult for consumers to participate effectively in markets? What are the impacts of the greater use of product bundling and standard-form contracts?

ASIC response

2.31 The development of equity release products is one example of the ever-increasing expansion of the range of investment products being offered to the retail market. Other examples of complex products include mezzanine finance, hedge funds and most recently, contracts for difference.

⁴⁵ In 2005 the Financial Services Authority of the United Kingdom released the results of research showing that:

- 70% of advisers do not gather enough relevant information about consumers to assess whether equity release products are suitable for them; and
- 60% of advisers do not advise consumers about the risks of equity release products.

See FSA/PN/054/2005 *FSA work discovers consumers are not being properly advised on equity release (May 2005)*.

2.32 The range and complexity of products in the consumer credit market has also expanded considerably since the mid-1990s. For instance, home loan borrowers today generally have to assess the relative merits of loan and banking packages, part fixed/part variable loans, mortgage offset accounts, interest only loans, redraw facilities and the many other options now on the market. In the case of credit cards, the range of products has also increased, and bundling with other products such as reward schemes and travel insurance have also been introduced.

2.33 Higher risk facilities such as interest-only loans and margin loans have also emerged and are becoming more widely available to retail borrowers.

Use of intermediaries in response to product complexity

2.34 The issues paper states that the use of intermediaries has been increasing in response to greater product complexity, especially for financial products. This development is market-driven in response to demands for more convenience and more choice in credit products, especially home loans.

2.35 As noted in Chapter 1, financial advisers who do give personal advice must ensure that advice is appropriate based on the client's personal circumstances, objectives, financial situation and needs. They are required to be licensed and meet certain training and experience qualifications. ASIC values the role of good quality financial advice in assisting consumers to make decisions about complex financial products.

2.36 This regulation has led to significant improvements in the overall quality of advice being offered, as advisers have become better trained and more professional. However, much of our compliance work has found that financial advisers do not always meet the obligation to give appropriate advice. As stated at paragraph 1.14, in our shadow shopping project, ASIC's found that 16% of advice we reviewed clearly did not meet this requirement and a further 3% of advice probably did not meet it.

2.37 Credit intermediaries are not regulated under Chapter 7 of the Corporations Act. As described at paragraphs 2.19-2.25, there are significant problems with the quality of advice given by finance brokers. ASIC's 2006 investigation of loans to Indigenous borrowers in remote regions, discussed at paragraph 1.29, is a telling example of inappropriate lending practices by brokers. Such examples emphasise the need for consumer protection regulation to be backed by adequate capacity to take enforcement action to get compensation for consumers and enforce appropriate standards of conduct, both at State and federal level.

Other ancillary services

2.38 In addition to the increasing role of intermediaries, there has been a significant rise in the provision of ancillary services for complex financial products such as debt mediation and debt agreement services, money management services, fee-based financial counsellors and comparison services such as Cannex. ASIC is particularly interested in seeing how we can leverage the work of ratings agencies to help consumers make better decisions across a range of financial products and services.

Section 3: How well is the current framework and suite of measures performing?

Question 3(a)

Is the current consumer framework fundamentally sound? Does it simply require finetuning or are more comprehensive changes required? What measures could be used to assess whether it is delivering for consumers?

ASIC response

3.1 Our view is that Australia's consumer protection framework is fundamentally sound. However, we think that the framework would benefit from some finetuning. ASIC is currently undertaking a number of projects to improve disclosure to consumers about financial products and to improve the quality of financial advice. We also think that the regulatory framework for credit products and advice about credit requires changes. These issues are discussed at paragraphs 3.25-3.82 below.

3.2 This section of the issues paper asks for information on outcomes-based performance measures for consumer protection regulators. ASIC produces a number of outcomes-based measures, including statistics on complaints and legal proceedings and the results of surveillance and monitoring activity.

Enforcement and complaints statistics

3.3 In 2005–2006, ASIC assessed 12,075 complaints about misconduct.⁴⁶ Our target is to finalise 70% of complaints in 28 days; in 2005–2006 we exceeded this target, meeting 81% of complaints in this timeframe.⁴⁷ We also provide information about the number of complaints heard by the seven ASIC-approved external disputes resolution schemes at paragraph 4.24 below.

3.4 To protect consumers against mis-selling of financial products and services, we also take criminal, civil and banning action against businesses and individuals. In 2005–2006 we:

- were successful in 72% of the criminal litigation and 98% of the civil litigation we initiated

⁴⁶ ASIC, *Annual Report 2005-2006* at 13.

⁴⁷ ASIC, *Annual Report 2005-2006* at 17.

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- completed 102 civil proceedings, obtained civil orders against 230 people and companies and recovered \$144 million with more than \$71 million assets frozen
- shut down 102 illegal managed investment schemes, involving 5000 investors and \$788 million
- had 44 people removed from directing companies and 27 people banned from financial services
- in collaboration with Directors of Public Prosecutions, obtained 27 criminal convictions, including 17 prison sentences.⁴⁸

Appendix B is a detailed breakdown of ASIC's consumer protection enforcement activity for the last three years, including criminal, civil and administrative actions.

3.5 In 2005–2006, ASIC also achieved additional disclosure for investors in 125 cases in fundraisings valued at \$10 billion.⁴⁹

Monitoring compliance

3.6 ASIC proactively monitors the marketplace using a risk-based methodology to select our targets. In 2005–2006 we:

- conducted 837 on-site compliance reviews of AFS licence holders
- visited 536 financially troubled companies
- obtained 32 additional disclosures to the market
- achieved corrective disclosure in 92 prospectuses and PDSs.⁵⁰

3.7 In response to the introduction of Super Choice, we also undertook a number of specific superannuation surveillance projects in addition to the shadow shopping exercise. These included:

- extensive surveillance of AMP Financial Planning Pty Limited, culminating in the legally binding commitment from this licensee to modify key aspects of how it advises its customers discussed above (see page 7)
- reviewing 100 PDSs and securing numerous improvements to the quality of disclosure
- stopping a number of misleading advertisements about superannuation funds.

⁴⁸ ASIC, *Annual Report 2005-2006* at 13 and 18.

⁴⁹ ASIC *Annual Report 2005–2006* at page 13.

⁵⁰ ASIC, *Annual Report 2005-2006* at 26.

3.8 More recently we have seen the collapse of some unlisted and unrated debenture schemes, such as Fincorp. As well as any enforcement activity that may follow from those collapses, ASIC has established a team with both internal and externally sourced expertise and experience to analyse and report on the underlying business models of debenture issuers in this sector, consider what additional protection can be added on the way the business models work, assess the prospects for rating these products, assess what specific warnings might be included in retail advertisements, and develop a series of investor education programs aimed at the retail sector on diversifying risk and risk/reward premiums.⁵¹

Customer satisfaction research

3.9 The issues paper notes that performance indicators require careful interpretation. Our own research suggests that measures of customer satisfaction, while useful in assessing the customer's experience and likelihood to repeat a transaction, are not necessarily a good indicator of the quality or benefit of the product or service in the financial advice field. Our 2006 report *Shadow Shopping Survey on Superannuation Advice* asked consumers if they were satisfied with the superannuation advice they received. The results were similar to other industry-based surveys of customer satisfaction with their financial adviser. Levels of customer satisfaction are high and rising, suggesting that the customer experience is generally a good one.

3.10 However, in ASIC's survey 85% of consumers who received advice that lacked a reasonable basis reported that they were satisfied with the advice. This indicates that most consumers are not able to assess the quality of financial advice. This suggests that customer satisfaction research about financial services, if it is intended to indicate the quality or benefit of the service obtained in terms of the monetary benefit that a consumer derives from following the advice, needs to be viewed with caution.

Other measures

3.11 The first national survey of financial literacy levels in Australia was conducted in 2002. The follow up survey, published in November 2005, identified improvements in some aspects of literacy, however, real improvements are likely to take generations and even the marginal improvements listed in paragraph 3.12 will need to be tested against the results for the next survey.

3.12 For example, in 2005:

- 84% of consumers felt 'well informed' when making financial decisions, up from 80% in 2002

⁵¹ See Statement on Fincorp by Mr Tony D'Aloisio, Chairman, Australian Securities and Investments Commission, to the Senate Standing Committee on Economics, Wednesday 30 May 2007, available on www.asic.gov.au.

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- substantially more people were familiar with and used newer payment methods including internet banking (up from 28% to 40%), BPAY (up from 36% to 46%) and direct debit (from 50% to 60%)
- 94% of consumers understood the importance of full disclosure of their needs and circumstances to advisers and product issuers (up from 91%).
- 49% of consumers reported that they would not invest in investments advertised as having a return well above market rates and no risk (up from 46%).⁵²

3.13 A less quantitative story, but one that demonstrates regulatory action achieving real change for consumers, involves our work on underinsurance. ASIC undertook a project to examine home insurance following the Canberra bushfires in January 2003 that destroyed 488 homes. We found significant levels of underinsurance by homeowners, especially against the cost of rebuilding.

3.14 Evidence showed that while some consumers choose to underinsure, many homeowners relied heavily on their insurer to either set, or assist them in setting, the amount insured, and the amounts were frequently too low. Other major causes of underinsurance included consumers' lack of access to reliable tools for estimating rebuilding costs, along with the absence of policies in the marketplace that guaranteed covering the total cost of rebuilding, even if there had been a widespread disaster that led to an increase in building costs.

3.15 Following the publication of the report we worked with industry to address these issues and in 2006 did a follow-up survey of industry to see what changes had occurred. We found that insurers across Australia were providing consumers with better access to information about the costs of rebuilding through improved calculators and that consumers now had access to several new types of policies including 'total replacement' policies and 'extended replacement policies' which paid up to 30% above the sum insured where there had been a widespread disaster that led to an increase in building costs. As one major insurer rolled all of their existing customers over to their new total replacement policy we can be confident that our work in this area has reduced the incidence of underinsurance in Australia.

Question 3(b)

Does the current framework focus on the right issues and areas? Are there significant gaps or imbalances in coverage, or particular objectives that are not well catered for? Is there any significant duplication of policy effort?

⁵² ANZ, *Survey of Adult Financial Literacy in Australia* (November 2005) at 8.

ASIC response

3.16 We believe there are a number of gaps in consumer protection in financial services. These include:

- lack of regulation of finance brokers (see paragraphs 2.19-2.25)
- more generally, inadequate regulation of credit-related advice (see paragraphs 3.24-3.82)
- inadequate disclosure of costs and risks associated with equity release products (see paragraphs 2.26-2.30 above)
- inadequate regulation of property investment advice (see paragraphs 3.17-3.18 below)
- evasion of the UCCC by use of the conclusive presumption that credit supported by a business purpose declaration is not covered by the UCCC⁵³
- evasion of the UCCC using promissory notes and other bill facilities⁵⁴
- potential gaps in the definition of 'financial product' under Chapter 7.⁵⁵

3.17 Generally, advice about direct investment in real estate is regulated under the generic consumer protection laws administered by the ACCC and State and Territory legislation concerning real estate agents and the sale of land. The more comprehensive regulatory regime under Chapter 7 of the Corporations Act that applies to advice about financial products purchased for an investment purpose does not cover property investment advice. Given the prevalence of real property in Australians' investment portfolios (and that credit is normally involved), and particularly its importance to many Australians' retirement incomes, there is a case for that form of investment being regulated in a similar way to other forms of financial investment,.

⁵³ This is discussed in detail in the 2006 *Report of the Consumer Credit Review* prepared by Consumer Affairs Victoria. Consumer Affairs Victoria recommends that the conclusive presumption should not be available. The Victorian Government has endorsed this recommendation.

⁵⁴ The 2006 *Report of the Consumer Credit Review* also discusses this problem and recommends that consumer credit resulting from the use of bill facilities, including promissory notes, should be regulated under the UCCC. The Victorian Government has endorsed this recommendation.

⁵⁵ It is not clear whether the financial product promoted by the advisers involved in the failed Westpoint group of companies was regulated under Chapter 7. The most recent judicial consideration of this point was in *Financial Industry Complaints Service Ltd v Deakin Financial Services Pty Ltd* [2006] FCA 1805 (21 December 2006) at paragraphs 46-47 per Finkelstein J.

3.18 In 2004, a working party of the Ministerial Council on Consumer Affairs published a discussion paper on this issue.⁵⁶ In 2005, the Parliamentary Joint Committee on Corporations and Financial Services published a report on property investment advice that recommended making this industry subject to Chapter 7 of the Corporations Act.⁵⁷

Question 3(c)

Has the inclusion of new objectives, such as strengthening the position of small businesses in their dealings with larger enterprises, impacted on the effectiveness of the framework? Should consumer policy be further extended to cover small businesses as consumers?

ASIC response

3.19 The application of consumer protections to small businesses in financial services is inconsistent. The consumer protections under Chapter 7 of the Corporations Act and the ASIC Act apply to small businesses as consumers of financial products and advice. 'Small business' is defined to mean a business that employs less than 20 people, or for businesses that include manufacturing, less than 100 people.⁵⁸

3.20 The UCCC does not cover credit provided for business purposes. We submit at paragraphs 3.32-3.33 that consideration should be given to extending the coverage of the UCCC to cover credit purchased by small businesses.

3.21 We are also canvassing whether the EFT code should be expanded to cover small business transactions as part of the current review of that code.

Questions 3(d) and 3(e)

Is the balance of responsibility between governments, business and consumers broadly appropriate? Does the framework pay sufficient regard to the costs of intervention for consumers and businesses? Does it promote certainty and clarity for consumers and businesses and is it sufficiently evidence-based? How well has it coped with the changing circumstances identified earlier?

What broad changes to the framework could be made to deliver greater benefits or more cost-effective outcomes for the community? In this regard, what can Australia learn from the experience of other countries?

⁵⁶ Ministerial Council on Consumer Affairs, *Property Investment Advice Discussion Paper* (2004).

⁵⁷ Parliament of Australia, Parliamentary Joint Committee on Corporations and Financial Services, *Property Investment Advice – Safe as Houses?* (June 2005).

⁵⁸ Corporations Act s 761G and ASIC Act s 12BC.

ASIC response

3.22 ASIC believes that the balance of responsibility between governments, business and consumers in the financial services industry is broadly appropriate. ASIC strives to consider the costs of intervention for consumers and businesses in developing its regulatory policies. One of the key components of our Better Regulation initiatives has been to focus on better understanding the impact of our regulation on the people and entities we regulate, and using more reliable and relevant information in making decisions. We already comply with the Government's requirements by preparing regulatory impact statements that meet the standards set by the Office of Regulation Review. We have announced that we will work with industry to develop effective measures of business costs incurred in complying with the laws we administer and the policies and guidance we issue.⁵⁹

3.23 The terms of reference for this review specifically direct the Productivity Commission to take into account recent activity in the Australian and New Zealand competition and consumer protection regime. There are numerous ways of seeking to protect consumers that go beyond the information remedies that our present system is so heavily reliant upon. We think that approaches in other jurisdictions may offer opportunities to enhance the consumer protection framework for financial services in Australia.⁶⁰

3.24 Listed below are some of the alternative approaches that ASIC is aware of. At this point of time we do not seek to comment on the desirability or otherwise of their adoption.

- The United Kingdom introduced unfair contracts legislation in 1994 in response to a European Union directive.⁶¹ The Law Commission and Scottish Law Commission recently completed a review of this legislation.⁶² The United States also has a legislative prohibition on unfairness.⁶³

⁵⁹ Australian Securities and Investments Commission, *Better Regulation – ASIC Initiatives* (April 2006), available at www.asic.gov.au.

⁶⁰ We note that there are some consumer protection initiatives and remedies in Australia and New Zealand which go beyond the provision information. For example, in 2006 the New Zealand Ministry for Economic Development published a paper emphasising the important role of behavioural analysis, including behavioural economics, in policy design. See New Zealand, Ministry for Economic Development *Behavioural analysis for policy* (2006).

We also note the existence of unfair contracts legislation in several jurisdictions. Victorian unfair contracts legislation covers consumer contracts, which is defined as contracts to supply goods or services ordinarily acquired for personal, domestic or household consumption. Contracts regulated under the UCCC are expressly excluded from the ambit of this legislation. See *Fair Trading Act 1999* (Vic) s 32U.

⁶¹ *Unfair Terms in Consumer Contracts Regulations 1994* (UK); *Unfair Contract Terms Act 1977* (UK).

⁶² Law Commission and Scottish Law Commission, *Unfair Terms in Contracts* (February 2005).

⁶³ Federal Trade Commission Act (US) s 5.

- The United Kingdom has a government-funded consumer advocacy body, the National Consumer Council, with a wide jurisdiction that includes financial services.
- The United Kingdom has a single ombudsman which deals with all complaints against financial services providers which are still trading. While membership of an external dispute resolution service is compulsory for financial services providers in Australia other than credit providers, there are a number of different schemes. This raises a number of issues which are described at paragraphs 4.28-4.31. The United Kingdom regulator also publishes simple explanations about a wide range of financial products including credit cards, mortgages, investment and retirement products as well as comparative product tables to assist consumer decision making on its consumer website [moneymadeclear](http://moneymadeclear.fsa.gov.uk).⁶⁴

The regulatory framework for credit

ASIC's role

3.25 Since 2001, ASIC has had general consumer protection responsibility for credit at the Commonwealth level under Part 2 Division 2 of the ASIC Act. In this role, ASIC undertakes a range of compliance, consumer education and research activities and approves and monitors financial services external dispute resolution that cover credit issuers and intermediaries. Industry-specific consumer protection legislation in the credit area, principally the UCCC, is a states and territories' responsibility. Credit facilities broadly defined are excluded from the Corporations Act financial services regime.⁶⁵

3.26 ASIC has Memorandums of Understanding with all the state and territory agencies responsible for consumer credit and there is considerable liaison between ASIC officers and our state and territory colleagues on credit issues at a range of levels. This applies in relation to both operational issues and policy development/law reform work. For example, ASIC is a member of:

- the Ministerial Council on Consumer Affairs Working Party developing a national scheme of regulation for finance brokers
- the Standing Committee of Officials of Consumer Affairs on whose agenda credit issues figure prominently
- the Fair Trading Operations Advisory Committee, which also considers credit-related matters as part of its agenda.

3.27 ASIC has also participated in a range of review and consultation processes initiated by the state and territory fair trading agencies.

⁶⁴ www.moneymadeclear.fsa.gov.uk.

⁶⁵ Corporations Act s 765A(1)(h)(i) and Corporations Regulations reg 7.1.06.

3.28 The UCCC commenced operation in all states and territories (except Tasmania) in 1996, after a long consultation process and considerable stakeholder debate. Compared both with previous credit legislation and contemporary overseas regimes, the UCCC was seen as representing a major advance in terms of national uniformity, broad product coverage, design and pricing flexibility, and in other ways. Our understanding is that, despite some initial concerns, the regime has achieved a high level of industry acceptance and compliance among mainstream credit providers. For consumers it has delivered better regulation of contract terms and disclosure obligations, and it has been a factor in facilitating the much greater range of products and services now available on the credit market.

3.29 Notwithstanding these successes, it is arguable that the policy and regulatory framework for credit has not performed as well as it could have in a range of areas, and it may be that a further review of that framework is now needed. Some of what we see as the key issues from ASIC's perspective are set out in the following sections.

3.30 We have approached the credit regulatory framework very much from the perspective of the regulatory framework for financial services in the Corporations Act. In our view, comparison of the two regimes provides some useful insights and possible directions for credit regulation reform going forward.

3.31 The comments that follow assume the continuing industry-specific regulation of credit by the states and territories within a uniform or consistent national scheme.

Extending the scope of credit regulation

3.32 The UCCC is limited to consumer credit, defined in part as credit provided or intended to be provided wholly or predominantly for personal, domestic or household purposes.⁶⁶ Borrowing by small business is excluded, as is borrowing for investment purposes. There are various other exclusions as well.⁶⁷ Some of these exclusions have been exploited by those seeking to avoid regulation. Anecdotal evidence suggests that many consumer transactions are inappropriately characterised as business ones in order for the credit provider to be excused from compliance with the UCCC.

3.33 Arguably, industry-specific legislation covering credit should extend to small business consumers. Minimally, like other borrowers, small business borrowers should have access to good disclosure and dispute resolution in relation to credit, as they do in relation to financial products regulated under the financial services laws. There has been very little investigation, as far as we are aware, of regulatory issues in the small business finance market—this is an area deserving further consideration.

⁶⁶ UCCC s 6(1)(b).

⁶⁷ UCCC s 7.

3.34 Credit facilities as such are not regulated under the Corporations Act regime. The financial services laws do not cover situations involving the direct purchase of real estate as an investment and related financing arrangements.

Broadening the focus of credit regulation

3.35 The UCCC is primarily focused on the credit contract and related disclosure requirements. There are also disclosure requirements covering entry into (and extension of) mortgages and guarantees, and the contents of statements of account. The UCCC also includes some additional substantive and procedural control measures (these are further discussed at paragraphs 3.64-3.65).

3.36 Important issues such as the appropriateness of advice and recommendations, the management of conflicts of interest and disclosure of remuneration, and training and competence are not covered by the UCCC and existing finance broker legislation (as they would be under the Corporations Act if credit were a financial product).

3.37 Arguably, the lack of attention to these areas reflects the different marketplace for consumer credit at the time the UCCC was under development (the first half of the 1990s). Paragraphs 2.32-2.33 of this submission describe changes in the credit market since then.

3.38 When the UCCC was developed, there was less perceived, and perhaps actual, need to focus on advice about credit; how products are presented and promoted; and, generally, the conduct, competence and professionalism of advisers. In these areas, the current credit regulatory framework has probably been overtaken by market developments.

3.39 As mentioned at paragraph 2.24, in the case of finance and mortgage brokers, a national scheme of regulation is currently being developed by a Ministerial Council of Consumer Affairs Working Group that should address many of the issues under consideration. The development of this scheme was prompted in part by a report commissioned by ASIC, and ASIC welcomes the initiative to introduce a comprehensive national scheme of regulation of the finance broking industry.

3.40 The proposed regime will be limited in scope to finance brokers, and as such will not encompass the credit issuer–customer relationship (e.g. the situation where staff of a lender are involved in recommending a reverse equity product to the lender’s customers). There might also be potential for some third party intermediaries to structure their operations to avoid being caught by the finance broker definition under the proposed scheme.

3.41 Arguably, further consideration needs to be given to how all participants in the credit marketplace are regulated. This includes whether the current approach—heavily focused on the credit contract and related product disclosure—needs to be extended to cover the interaction of provider/intermediary and customer in a more comprehensive way, possibly within a single regulatory framework. Chapter 7 of the Corporations Act may be seen as a potential model in this respect.

A more flexible approach to disclosure and other areas of regulation

3.42 The contract and disclosure regime of the UCCC is centrally focused on the provision of information to the consumer about interest rates (including how they are calculated) and credit fees and charges. The credit provider's name, the amount of credit, repayment requirements, any mortgage or guarantee, commissions paid by or to the credit provider, and specified information about any associated insurance must also be included in the contract and disclosure documents. Arguably, the regime (including associated regulations) is, on the one hand, reasonably prescriptive and, on the other, rather narrow in scope.

3.43 Whether a one-size-fits-all approach to disclosure for regulated credit remains optimal requires further consideration, particularly given the increasing diversity and complexity of credit arrangements noted at paragraphs 2.32-2.33.

3.44 For example, the current UCCC regime does not mandate disclosure of the general risks associated with products such as interest-only and reverse equity loans. In the case of reverse equity products, too, the progressive cost of the facility in terms of equity foregone does not currently have to be disclosed. To take another example, state and territory governments are currently seeking to address the issue of regulatory avoidance by some fringe lenders targeting generally low income groups, who structure what is in substance a loan as a bill facility in order to bring the arrangement within one of the current exemptions under the UCCC. Assuming this exemption is ultimately removed, difficulties may well arise when applying the existing disclosure regime to bill facility products.

3.45 While many of these issues may be able to be addressed on an ad hoc basis by introducing into the legislation additional or alternative disclosure requirements applying to particular products, this may not be the best approach longer term given, among other considerations, the difficulties associated with amending a multi-jurisdictional legislative scheme, the resulting additional complexity, and the relative inflexibility of legislative solutions.

3.46 An alternative approach might be to move away from the current detailed but limited provisions to a broader, more principles-based disclosure regime, with more of the detail (where deemed necessary) being elaborated via regulations and/or administrative instruments such as policy statements and guidance notes. This approach has the potential to deliver much timelier responses to marketplace issues than one requiring legislative amendment.

3.47 Such an approach might also be applied to other areas, for example in respect of exemptions and modifications for particular products or classes of product; or, conversely, to allow particular products to be declared to be covered by the legislation. In relation to the latter, this approach may be a more efficient way of dealing with avoidance strategies, a considerable issue under the existing credit laws. As safeguards, ex ante review mechanisms would need to be applied and administrative law rights of action could be given.

3.48 Arguably, greater use of administrative mechanisms would assist in making the credit regime more flexible and responsive in a rapidly changing market. Before this could happen, however, there may need to be significant modifications to the broader regulatory architecture for credit—a theme further canvassed at paragraphs 3.77-3.82.

Harnessing industry to the regulatory task

3.49 The importance of non-state agents (including industry participants and consumer representatives) in the regulatory process is increasingly recognised in both the theoretical literature and regulatory practice. Accompanying this has been a greater focus in recent years on co-regulation, in some cases better described as regulated self-regulation.

3.50 Under the regulated self-regulation approach, the law typically establishes a broad framework of compulsion. For example, an industry may be required to meet adequate training and competency standards, or to have adequate compliance systems or complaints handling processes in place, or to address certain consumer issues in a code of practice, or to establish and resource an external dispute resolution scheme etc. Within this framework, however, the industry has considerable discretion and control in developing the standards and processes to be put in place, albeit in consultation with other stakeholders (including the regulator). Generally, there are also requirements that these arrangements should be reviewed periodically.

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3.51 The idea is to harness the expertise and resources of industry, including industry's understanding of what is commercially viable and likely to enhance market dynamism. In addition, it is hoped that substantial ownership of the process by industry will mean there is a positive attitude to compliance with the resulting regime or mechanism. At the same time, problems associated with pure self-regulation are avoided—including the tendency for fringe operators and less reputable businesses to typically refuse to participate in voluntary arrangements and, in so doing, to possibly introduce 'level playing field' issues for their more reputable competitors, as well as risks to consumers.

3.52 This kind of co-opting of industry to the work of regulation is a feature of the financial services regime under the Corporations Act. For instance, the general obligations imposed on financial services licensees under the Act include *positive* obligations to manage conflicts of interest adequately, to ensure that representatives comply with the law, to ensure that representatives are adequately trained and competent, to have adequate risk management systems etc.⁶⁸ In addition, licensees that provide services to retail clients must have internal dispute resolution procedures that meet ASIC requirements,⁶⁹ and must also belong to one or more ASIC-approved external dispute resolution schemes covering the retail services they offer.⁷⁰ ASIC provides detailed guidance on interpreting these requirements through its policy statements and guidelines.⁷¹

3.53 By contrast with the situation under the financial services laws, the use of regulation to harness industry to the regulatory task has not played a major role in the credit laws to date, no doubt partly reflecting the relative age of the two regimes. This approach deserves consideration, in our view, as part of any more general review of credit regulation.

3.54 Inevitably, any such review would also need to include consideration of the related question of licensing/registration of credit providers. Currently, each jurisdiction administering the UCCC has its own separate licensing arrangements under its own administration legislation, and these arrangements vary considerably. Thus, only WA has a positive licensing regime; Victoria and the ACT have a registration system; and NSW, Qld and SA have negative licensing regimes.

⁶⁸ Corporations Act s 912A(1).

⁶⁹ Corporations Act s 912A(2)(a).

⁷⁰ Corporations Act s 912A(2)(b).

⁷¹ ASIC Policy Statement 139: *Approval of external complaints resolution schemes*, ASIC Policy Statement 146 *Licensing: Training of financial product advisers*, ASIC Policy Statement 165: *Licensing: Internal and external dispute resolution* and ASIC Policy Statement 181 *Licensing: Managing conflicts of interest*.

3.55 From a cost to industry perspective, a single, harmonised regime would clearly be preferable. On the basis of our experience, a positive licensing regime is probably to be preferred in terms of regulatory effectiveness. Our experience with managed investments is that the positive licensing requirement for responsible entities provides some assurance in terms of financial capacity and experience and qualifications to conduct that business (admittedly a business that has stewardship over someone else's assets, unlike many credit providers), as well as a ready capacity for ASIC to stop schemes which are unviable or, worse, scams, because the promoter is unlikely to have complied with the licensing regime. This provides a capacity for much earlier intervention than, for example, having to wait to see if the product/scheme is unviable or to establish that the advice is poor (ie after consumers have suffered loss). However, we acknowledge the additional costs to industry and government involved in such an approach, as well as the stated reluctance of some State and Territory governments to adopt positive licensing regimes as a regulatory tool.

Comprehensive external dispute resolution scheme coverage

3.56 External dispute resolution scheme membership is one area where enhanced industry participation in regulation could be implemented without requiring a major overhaul of the existing architecture as a whole. ASIC supports the role of external dispute resolution schemes in financial services. In our experience, they are valuable both as a redress mechanism for individual consumers and as a mechanism for driving improved industry standards more generally.

3.57 In the consumer credit field, the largest external dispute resolution scheme is the Banking and Financial Services Ombudsman. It resolves disputes between its members (banks and their affiliates, and other bodies in the financial services industry which are granted membership) and individuals or small businesses concerning financial services, up to a limit of \$280,000.

3.58 We draw particular attention to the case studies, bulletins and other guidance published by the Banking and Financial Services Ombudsman. These constitute a significant body of quasi-jurisprudence in the banking and credit areas, and we believe they are closely considered by the industry as a whole. In our view, the activities of the Banking and Financial Services Ombudsman and other dispute resolution schemes have done much to articulate issues and raise standards in the credit marketplace.

3.59 It is anomalous that credit providers and intermediaries that are not members of the BFSO—among whom the most egregious practices often occur—are generally not required by law to belong to an approved external dispute resolution scheme. While we welcome proposals to make scheme participation mandatory for finance brokers under the proposed national scheme for brokers, we believe that a similar requirement ought to apply to all participants in the credit market providing services to retail clients.

3.60 We note in this context that the regulatory infrastructure is already in place for mandatory participation in external dispute resolution across the credit industry. In particular, there are four ASIC-approved schemes covering credit and all these schemes are open to a wide range of participants in the finance and credit industry. We believe there is no need for new schemes to be developed; indeed, we consider that any further duplication in this area would be inefficient and regressive. This is especially so at a time when considerable efforts are being made to achieve consolidation and greater harmonisation within the external dispute resolution sector.

3.61 It also makes sense, we submit, that approval and monitoring of schemes in financial services should continue to be undertaken by a single regulatory agency (ASIC).

A continuing commitment to substantive and procedural controls where appropriate

3.62 We have highlighted ways in which the Corporations Act financial services regime may provide insights and suggest possible future directions for credit regulation in Australia. It needs to be acknowledged, however, that credit products and services pose some unique challenges, and that the financial services regime should not necessarily be seen as a model (or possible framework) for addressing all the issues that arise in relation to credit.

3.63 The UCCC does not rely exclusively on disclosure as a regulatory tool, in contrast to product regulation under the financial services laws which is very largely disclosure-based.

3.64 Thus, in addition to setting out an extensive disclosure regime, the UCCC also includes a significant number of other substantive and procedural controls. For instance:

- Regulated contracts cannot prohibit borrowers and loan guarantors from withdrawing from an agreement prior to credit being obtained/used.⁷²
- How interest is to be calculated is prescribed.⁷³
- Regulated contracts cannot forbid early repayment of the whole amount (although it can impose an early termination fee⁷⁴).

⁷² UCCC s 19 and s 53.

⁷³ UCCC s 26-28.

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- There is considerable substantive control of mortgages⁷⁵ and guarantees.⁷⁶
- While a credit provider is permitted to require a debtor to take out insurance to protect its security, the credit contract can only finance up to one year's mortgage insurance premiums at a time.⁷⁷ In addition, the credit provider cannot require the debtor to take out consumer credit insurance; and 20% of the premium is the maximum commission permitted on consumer credit insurance applying to regulated credit.
- In some jurisdictions, maximum interest rate caps are imposed under credit administration legislation.

3.65 Other measures also employed as part of the UCCC regime include:

- Hardship variation provisions addressing the situation where, because of a change of circumstances, a debtor can no longer reasonably discharge their obligations unless a change in the repayment arrangements is agreed to.⁷⁸
- Provisions designed to mitigate the potential harshness of strict enforcement of contract where default occurs.⁷⁹
- Procedural provisions relating to both the process of taking possession of mortgaged goods, and the processes following possession.

⁷⁴ UCCC s 75. However, any early termination fee can be reduced or annulled if it is unconscionable: s72.

⁷⁵ Thus: Mortgages over all assets and property are void: s40. Third party mortgages where the mortgagor does not guarantee the debt are prohibited: s44. All money mortgages are unenforceable unless certain requirements are met: s43. Liability under a mortgage may not exceed the amount of the debtor's liabilities under the credit contract and reasonable expenses of enforcing the mortgage: s45. A credit provider's ability to take mortgages of future property is restricted: s41.

⁷⁶ Liability under a guarantee must not exceed amount of debtor's liabilities under the credit contract, plus reasonable expenses of enforcing guarantee: s 55. A guarantee is void to the extent it limits the guarantor's right of indemnity against debtor: s55. A guarantee cannot be extended to cover any additional borrower liability unless the guarantor is given written notice of variation and agrees in writing: s56.

⁷⁷ UCCC s 134.

⁷⁸ Under the *Change on grounds of hardship* provisions, a debtor may apply to the credit provider for a change in repayment arrangements if they are unable, reasonably, to meet their obligations and reasonably expect to be able to do so if the change is agreed to. If this request is refused, the debtor may apply to a relevant court or tribunal to make the change (s.66 – 68).

⁷⁹ These include: a 30-day notice requirement and opportunity to rectify the default, before enforcement of a contract or mortgage can occur (s.80 – s.81, UCCC); a requirement that a guarantee can generally only be enforced against the guarantor after judgment has been obtained against the debtor and that judgment remains unsatisfied for 30 days (s.82, UCCC); subject to certain exceptions, a requirement prohibiting possession of mortgaged goods (unless a court order is obtained) where the amount owing is less than 25% of the amount of credit provided under the contract, or \$10,000, whichever is lesser (s.83, UCCC); and provisions regulating acceleration clauses (s.84 – s.85, UCCC). There are also provisions allowing a debtor, mortgagor or guarantor to seek postponement of enforcement proceedings from the credit provider and, if this cannot be negotiated, from a court (s.86 – 89, UCCC).

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- Related sale contracts provisions under which a credit provider linked to a supplier of goods or services may be liable for the supplier's misrepresentations, breach of contract, and/or failure of consideration.

3.66 The UCCC also includes provisions relating to unjust transactions⁸⁰ and unconscionable interest and other charges.⁸¹ While these are generally comparable with the unconscionable conduct provisions of the general consumer laws, they are more specifically tailored to the credit context. In addition, they also encourage a greater focus than the general unconscionability regimes on assessment of capacity to repay at the time credit is extended, and price comparability, as relevant factors in determining unjustness or unconscionability.

3.67 In summary, the UCCC utilises additional, and in some respects more interventionist regulatory tools to those provided within the Corporations Act financial services framework, which as noted is heavily reliant on disclosure. Like other aspects of the credit framework, these additional measures would appropriately be reviewed as part of a more general review of credit regulation. ASIC does not consider that all the mechanisms under discussion should necessarily be retained in their current form as part of a reconceived regime; or, if retained, that additional, higher-level protections should necessarily be available to all borrowers (e.g. measures that may be appropriate in the context of fringe lending to vulnerable groups may not be appropriate in the small business finance context).

3.68 Apart from the general limitations of disclosure canvassed earlier in this submission, there are in our view, as already indicated, specific aspects of the credit market and products that may justify additional or alternative measures, measures that may not necessarily be appropriate or relevant in the context of other financial products and services.

3.69 We note that unlike most other financial products credit products create indebtedness. There may well be good policy reasons for seeking to impose, with a broad framework of product diversity and consumer choice, some regulatory constraints on how, and on what terms, debtors become indebted as well as on how contractual obligations are enforced. Note also that many of the specific requirements of the UCCC (and preceding credit and money-lending legislation) were developed in response to specific market practices seen as overreaching and exploitative. In our view, this legacy of actual experience should not be lightly dismissed simply on the basis of abstract conceptions of consumer choice and autonomy.

⁸⁰ UCCC s 70 and s 71.

⁸¹ UCCC s 72.

Resources for the administration of credit regulation by state and territory agencies

3.70 ASIC has concerns about the level of resources available to state and territory agencies to undertake the range of tasks associated with administration of the industry-specific regulation of credit. While significant resources do appear to have been committed to educational initiatives by most agencies (including as part of innovative broader projects targeting particular demographic groups), the resources available for both policy development/law reform and compliance and enforcement activities appear unevenly spread and inadequate.

3.71 In the policy development/law reform context, policy responses on such issues as the development of a more effective disclosure regime, removal of various exemptions from the law, and addressing legislation-avoidance schemes/strategies in the fringe market have been in development for long periods of time. This is despite the fact that there appears to have been relatively little disagreement among agencies about the need to respond to these issues and, in most cases, the relatively confined nature of the issues that need to be addressed.

3.72 In this context, for example, significant recommendations of the Post Implementation Review of the UCCC (the final Report of which was released by the Ministerial Council on Consumer Affairs in December 1999) remain to be implemented, notwithstanding Ministerial Council on Consumer Affairs endorsement.

3.73 Another example is the abuse of the business purposes declaration under the UCCC, an issue we commented on in detail in our submission to the recent Consumer Credit Review undertaken by Consumer Affairs Victoria. In our experience, this misuse, which remains to be addressed, has been a significant problem in the fringe credit market for at least five years now.

3.74 Each of the issues alluded to has its own complex history and specific associated problems. In addition, the need to consult stakeholders and satisfy other ex ante review requirements inevitably makes even modest law reform undertakings time-consuming and resource-intensive. We also acknowledge that there has been an increase in the level of engagement with UCCC policy issues in the last couple of years, following the appointment of a dedicated National Project Officer by state and territory agencies.

3.75 We note that Consumer Affairs Victoria has committed to increasing its compliance and enforcement activity in relation to credit, and that this has been backed up by action on a number of matters in the recent past. More generally, however, a quick survey of reports over the last five years indicates that there have been no more than a handful of reported decisions in matters initiated by state and territory agencies, including just one or two licensing matters. In some smaller jurisdictions there would appear to be virtually no resources available for compliance and enforcement activity.

3.76 No doubt reported decisions do not tell the full story, and we understand that the Productivity Commission is seeking further information from agencies about their activities.

Regulatory responsibility for credit and reviewing the administrative architecture

3.77 The issues paper asks whether there are areas of regulatory responsibility that could readily be consolidated within one level of government. This is an issue which is raised from time to time in relation to credit.

3.78 While the *Final report of the Financial System Inquiry* (Report) recommended that the states and territories should retain responsibility for the UCCC, the Report also recommended that the UCCC should be subject to a comprehensive and independent review after two years of operation to consider what improvements are necessary and whether a transfer to the Commonwealth would be appropriate. The members of the Financial System Inquiry (FSI) were conscious that the UCCC regime had only recently come into force and were reluctant to propose a further review until there had been some experience of the operation of the new regime.

3.79 To date, the FSI recommendation of a further review after two years has not been taken up, and we are not aware of any current proposals to initiate such a review. As we have indicated, however, we consider that the time for a review of the whole credit policy framework may now have arrived. Moreover, it would be appropriate (if not inevitable) for such a review to consider the question of jurisdictional responsibility for credit, among other issues.

3.80 ASIC does not seek to express a view on whether responsibilities for credit should be transferred to the Commonwealth—the issue is one of high level policy for the central agencies of government and, ultimately, the Parliaments of the Commonwealth and states and territories.

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3.81 However, as we have sought to establish in this submission, the current regime, while delivering some significant benefits, has arguably not performed as well as it could have. In particular, there are unresolved issues going to the scope and flexibility of the framework, including its applicability/adaptability to changing market circumstances and products. The regime also largely fails to engage industry as a partner in the task of driving improved standards and practices.

3.82 Lastly, it should be noted here that ASIC is already extremely active in the credit area as a result of our responsibilities under the ASIC Act. Our recent work in the area has included:

- research, education and enforcement activity in relation to equity release products
- research, education and enforcement activity in relation to the activities of finance and mortgage brokers
- compliance and enforcement activity around the promotion of credit cards followed by related educational activity.⁸²

⁸² For example, in August 2006 Aussie Credit Cards agreed to suspend the introduction of a higher interest rate for cash advances following concerns raised by ASIC that it may have engaged in bait advertising. See ASIC Media Release MR 06-276 *Aussie responds to ASIC's concerns over bait advertising* (August 2006). In October 2005, ASIC accepted an enforceable undertaking from Coles Myer Limited to resolve concerns about misleading advertising of a Coles Myer credit card. See ASIC Media Release MR 05-305 *Coles Myer undertakes to fix problems with fuel discount advertising campaign* (October 2005). We provide a credit card calculator on our FIDO website as well as tips on using credit cards for consumers. See <http://www.fido.gov.au/fido/fido.nsf/byheadline/Credit+cards?openDocument>.

Section 4: Policy tools

4.1 ASIC has a range of tools to advance its consumer protection objectives. While we believe that the existing suite of tools is important, we also support the introduction of additional tools in certain circumstances.

Question 4(a)

Are the right tools being used to meet the objectives of consumer policy? Is the current range of tools sufficiently diverse?

ASIC response

Existing tools

4.2 For financial products and advice regulated under Chapter 7 of the Corporations Act, our existing policy tools include:

- positive licensing (the AFS licence issued by ASIC)
- minimum competence requirements for providers
- a standard for quality of personal financial advice (advice must be appropriate)
- cooling-off periods (these apply for investment and superannuation products)
- disclosure requirements for services, products and advice
- mandatory membership of an ASIC-approved external dispute resolution scheme
- bans on some selling practices (e.g. hawking financial products door to door)
- prohibitions on misleading or deceptive conduct and unconscionable conduct modelled on the consumer protection provisions in the TPA
- power to approve industry codes of practice, and ability to encourage industry to develop their own codes of practice (e.g. the Code of Banking Practice)
- consumer education and information.

4.3 While these tools are generally effective some problems still exist.

Regulation of financial advice

4.4 Australia's retirement incomes policy includes compulsory superannuation, superannuation choice and various incentives for superannuation savings generally. This means the Australian community depends on good quality financial advice, and that the need for good quality advice will continue to grow.

4.5 The regulatory requirements for financial advice under Chapter 7 of the Corporations Act were designed to move the financial advice industry from a 'sales culture' to a culture of professionalism. While the current policy setting has produced some improvements in the quality of financial advice, our surveillance and compliance work, including our *Shadow shopping survey on superannuation advice* and the enforceable undertaking entered into by AMP Financial Planning Pty Ltd referred to at page 7 indicates that there are still significant problems with the quality of financial advice and that there is less likely to be a reasonable basis for advice where conflicts of interest exist.

4.6 As discussed at paragraph 1.14, our shadow shopping report found that 16% of advice clearly did not have a reasonable basis and that a further 3% probably did not have a reasonable basis. We found that advice that did not have a reasonable basis was six times more common where the adviser had a conflict of interest over remuneration and was three times more likely where the adviser recommended an associated product. We do not believe this standard is adequate.

4.7 We will continue to work co-operatively with financial advisers and where necessary, to take directive action to require advisers to modify the way they formulate and give advice. We will also continue to monitor the quality of advice through further surveillance activity. If further improvements are not apparent, it may become necessary to consider the need for further regulatory measures, possibly going beyond disclosure, to deal with the impact of conflicts of interest on the quality of financial advice.

Disclosure

4.8 Disclosure obligations are a fundamental aspect of the regulatory regime for financial services under the Corporations Act. Financial providers are required to give retail clients disclosure about services, products, advice, performance of investments and material changes to products, for example fee increases.

4.9 Disclosure of fees, commissions and returns in all of these documents is heavily prescribed. For investment products, this information must generally be presented in dollar amounts.

4.10 ASIC has published a wide range of policy statements and guidance for financial services providers on compliance with these obligations, including:

- Policy Statement 168 *Disclosure: products disclosure statements (and other disclosure obligations)*

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- Policy Statement 175 *Licensing: Financial product advisers—conduct and disclosure*
- Policy Statement 182 *Dollar disclosure*
- *Enhanced fee disclosure regulations: Questions and answers—An ASIC guide* (July 2006)
- *A model for fee disclosure in product disclosure statements for investment products* (August 2003, revised June 2004)
- ASIC's guide to good transaction fee disclosure for bank, building society and credit union products (June 2002)
- *Example Statement of Advice* (August 2005).

4.11 We support the value of disclosure as a fundamental plank of consumer protection in financial services. Some, active consumers do want to consult disclosed information, and should have it available to them at the level of detail they want. These consumers can have a salutary impact on the market more generally in some circumstances. Full information should also be available to advisers. Disclosure requirements, especially if in plain English, can also have a useful secondary function helping parties to resolve disputes if they subsequently arise.

4.12 We also note the importance of consumer protection agencies educating consumers about the importance of using disclosure information in their decision-making. This education needs to focus on what the important things are to look for and why they are important. This is something ASIC seeks to do in relation to financial services disclosure. The media and product comparison services also play a useful role in using information about individual products to produce comparative material about groups of products. This activity depends on the existence of disclosure about individual products. That said, it has to be recognised that these activities do not currently reach as many consumers as we would like, especially at the point of making a financial decision when they would most benefit. The media and product comparison services also play a useful role in using information about individual products to produce comparative material about groups of products. This activity depends on the existence of disclosure about individual products.

4.13 Disclosure alone, even accompanied by good consumer education, cannot always deliver adequate consumer protection. Disclosure of itself may not adequately protect vulnerable and disadvantaged consumers faced with limited choices. For example, the development of a payday lending market in Australia reflects the fact that some vulnerable consumers may not have access to mainstream credit. Compliance with the disclosure obligations under the UCCC may not adequately protect these consumers.

4.14 Consumer research undertaken by the Financial Services Authority in the United Kingdom also suggests that many consumers do not read disclosure documents and when they do their understanding of products is not improved.⁸³ The evidence from behavioural economics also suggests that even when consumers have complete information, they do not necessarily make choices in their best interests.

4.15 Another limitation of the role of disclosure in financial services is the limited financial literacy of some Australian consumers. The findings of the ANZ financial literacy surveys discussed at paragraph 1.26 support the view that some Australians have low levels of financial literacy and some products and service are less understood by a broad cross-section of the community than others.

4.16 Our research into financial advice about superannuation found that the vast majority of consumers could not assess the quality of advice they received. Similarly, following the collapse of the Westpoint group of companies in 2005, it became clear that many Westpoint investors did not understand what they had invested in.

4.17 Lastly, the time constraints that increasingly busy consumers operate within mean that consumers do not always read information before making purchasing decisions.

4.18 The online environment may provide an opportunity to explore different approaches to disclosure. One interesting feature of the online environment is that it has evolved effective mechanisms for capturing and sharing customer ratings of products and services. There is precedent for this in financial services. For example PayPal is an online payments transfer service associated with eBay which publishes user ratings.

4.19 In the United Kingdom the Financial Services Authority provides league tables on financial products and the private sector provides similar services there. Information about how other consumers rate a product or service or about how one product compares with another on predefined objective features is useful to consumers and consideration should be given to finding ways to stimulate further developments of this kind and/or increasing the extent to which these information sources are accessed by consumers.

4.20 The other tools currently in use, including cooling off periods for investment products, the hawking ban and prohibitions on misleading or deceptive and unconscionable conduct, are important in this context. There may well be a need for more conduct and product design-related regulation in the future.

⁸³ The most recent published research by the Financial Services Authority is *Investment Disclosure Research* (2006).

Dispute resolution

4.21 Financial services providers must have an adequate internal dispute resolution scheme that complies with standards and requirements imposed by ASIC under Policy Statement 165, *Licensing: Internal and External Dispute Resolution*. Policy Statement 165 provides that a provider's internal dispute resolution procedures must comply with the Essential Elements of the Australian Standard on Complaints Handling, AS 4269-1995.⁸⁴ Australian Standard 4269-1995 has now been superseded by the new Australian Standard AS ISO 10 002 *Customer satisfaction – Guidelines for complaints handling in organisations*. The new Standard contains a broader definition of complaint that includes any expression of dissatisfaction made to an organisation related to its products where a response or resolution is explicitly or implicitly expected. ASIC is currently reviewing Policy Statement 165 in light of the release of the new Australian Standard on complaints handling.

4.22 The requirement that all licensees that deal with retail clients must be a member of an ASIC-approved external dispute resolution scheme is an important consumer policy tool in financial services.⁸⁵ We have approved seven external dispute resolution schemes under our approval power. We are required to take a number of principles into account when considering whether to approve a scheme, including accessibility, independence, fairness, accountability, efficiency and effectiveness.⁸⁶

4.23 ASIC Policy Statement 139 *Approval of external complaints resolution schemes* and Section B of ASIC Policy Statement 165 *Licensing: Internal and external dispute resolution* set out our approach to approving schemes. For example, we require that:

- schemes are free to consumers
- providers notify consumers about the opportunity for external dispute resolution when rejecting complaints
- providers are bound by scheme procedures and decisions
- schemes reach final decisions and can make financial awards
- both providers and consumers are afforded procedural fairness
- consumers who do not accept scheme decisions can initiate legal proceedings
- schemes give written reasons for their decisions.

⁸⁴ Policy Statement 165.14.

⁸⁵ Corporations Act 2001 s 912A(1)(g) and (2).

⁸⁶ Corporations Act 2001 s 912A(1)(g) and (2).

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4.24 The seven schemes deal with approximately 125,000 consumer enquiries and 7000–8000 formal complaints per year. The three biggest schemes deal with 90% of enquiries and complaints. Schemes are required to determine complaints based on what is fair and reasonable in all the circumstances. The existence of the schemes also encourages providers to enhance their internal dispute resolution procedures. This has meant that we are seeing more complaints resolved at the institutional level, saving time and money.

4.25 We also have an ongoing role to monitor approved schemes for ongoing compliance with our policy requirements. This includes receiving complaints about the schemes, receiving regular statistical and systemic incidents reports, chairing quarterly roundtable meetings and participating in regular independent reviews of the schemes.

4.26 In the absence of the schemes, consumers would either need to complain to ASIC or initiate legal proceedings. ASIC is not empowered to perform a dispute resolution function, in that we cannot make determinations nor order market participants to provide redress to consumers. Even if we were empowered to perform this function, ASIC does not have the capacity to deal with thousands of additional complaints every year. Resourcing this capacity would be extremely costly for government. Instituting legal proceedings would not be a practical option for consumers in the vast majority of cases.

4.27 In our experience administering external dispute resolution schemes for financial services, we have learned a number of useful lessons, which may have application to other markets. First, it is extremely important that the coverage of the schemes is adequate to deal with the majority of complaints. For example, the Financial Industry Complaints Service (FICS) has jurisdiction over complaints relating to advice to invest in the Westpoint group of companies. This scheme has a monetary limit of \$100,000 for complaints about advice. This monetary limit would not be adequate to compensate many consumers for the full amount of money they lost as a result of their investment in Westpoint in cases where advisers have breached their duties in advising on Westpoint products. FICS is currently reviewing this monetary limit.⁸⁷

⁸⁷ See Financial Industry Complaints Service Limited, *Review of the FICS Monetary Limits*, Consultation Paper (May 2007).

4.28 While providers see the ability to choose between different schemes and the competition this generates as positive, feedback from consumer advocates suggests that the existence of multiple, overlapping schemes causes confusion for consumers in some cases. However, it should be acknowledged that the schemes have made considerable advancement in minimising that confusion. For example, all schemes can now be accessed by a common phone number and costs are reduced by many of them sharing back-office processes. In an address to the Investment and Financial Services Association conference on 2 August 2007, the Parliamentary Secretary to the Treasurer, Chris Pearce announced that a report recommending that FICS, the Banking and Financial Services Ombudsman and the Insurance Ombudsman Service merge into a single scheme. He reported that the Boards of these schemes will be considering this recommendation shortly.

4.29 The seven schemes have different coverage and procedures and it is difficult for ASIC to mandate common coverage and procedures. The Parliamentary Secretary to the Treasurer has recently suggested that the schemes look at merging into one.⁸⁸

4.30 ASIC's ability to address under-performance is also limited. While we are able to revoke the approval of a scheme, this would be a significant step with serious implications for both the providers who are members of the scheme and consumers. We have not felt the need to do this yet, although we did refuse to approve one scheme from the outset. We do impose conditions when approving schemes but they tend to relate to set up issues, for example the establishment of audit and reporting obligations.

4.31 Despite these issues, we have found the external dispute resolution schemes to provide an extremely useful service in resolving disputes between consumers and financial services providers.

Consumer education and information

4.32 Consumer education is an important and useful tool to meet the objectives of consumer policy. ASIC conducts a wide range of consumer educational work, including issuing consumer alerts and warnings, publishing information about financial products and risks and interactive web-based calculators. ASIC's Guide *Helping consumers and investors* summarises our education and information work. A copy of this Guide accompanies this submission. Other federal and state agencies also do a considerable amount of valuable consumer education work.

⁸⁸ Speaking at the Investment and Financial Services Association Annual Conference *Breakthrough 2007* in Brisbane on 2 August 2007.

4.33 Recent high profile investment failures, such as Westpoint, Fincorp and Australian Capital Reserve have illustrated the importance of educating retail investors about portfolio diversification, and the relationship between risk and return. One of ASIC's identified priorities over the next 12 months and beyond will be consumer education around these fundamental investment concepts. One issue we will be particularly focussing on is the best way to educate consumers about risk ratings and how to use them. While consumer education is an essential component of the regulatory toolkit, it is important to recognise that it cannot, on its own, deliver adequate consumer protection. For example, we note that the states have relied very heavily on consumer education and information as a tool for regulating credit. However, education has proven to be an inadequate substitute for a focus on compliance in regulating the fringe credit market. Similarly, if investor education initiatives do not adequately address the issues relating to investment in unlisted, unregulated, heavily promoted high yield investments, it may be necessary to examine the need for additional regulatory intervention in relation to these products.

Other potential tools

4.35 Research into behavioural economics, our experience of the limited financial literacy of some consumers and the limits of disclosure suggests to us that there may be a case for banning the sale of some very complex products to retail clients. There is a precedent for this in financial services in the prohibition on hawking (door-to-door sales) of financial products and as mentioned at paragraph 4.21, the prohibition on marketing certain high-risk, complex products directly to consumers in the United Kingdom.

4.36 The United Kingdom regulator is also currently focusing on ensuring that product manufacturers consider how best to factor in the obligation to treat customers fairly as part of the product development process. The Financial Services Authority has indicated that it expects firms to develop products that are appropriate for specific target markets based on the needs and financial capability of these markets, and assess the risks that a product may pose to consumers in different situations.⁸⁹

4.37 As discussed above, over the next 12 months and beyond, ASIC will focus on educating investors about fundamental investment concepts including risk and return and portfolio diversification. However, if these initiatives do not adequately address this issue, it may be necessary to examine the need for additional regulatory intervention in relation to unlisted, unregulated, heavily promoted products, for example the introduction of compulsory warnings about particular types of products in advertisements.

⁸⁹ United Kingdom, Financial Services Authority, *Product Design – Considerations for Treating Customers Fairly*.

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4.38 Paragraphs 2.26-2.30 describe a number of regulatory gaps in relation to equity release products. We note that Consumer Affairs Victoria has called for a prohibition on negative equity in equity release products and a requirement that consumers should get comprehensive disclosure of the distinctive risks associated with them as well as an analysis of the need for additional consumer protection in relation to these products.⁹⁰ The Victorian Government supports this proposal⁹¹ and ASIC also endorses this.

4.39 A Trowbridge Deloitte study on behalf of the Senior Australian Equity Release Association of Lenders (SEQUAL) showed that the average age of reverse mortgagors was 74.⁹² This age profile places great pressure on the consumer protection regime to deliver the appropriate outcomes.

⁹⁰ Consumer Affairs Victoria, *The Report of the Consumer Credit Review* (2006) option 7.4.

⁹¹ Consumer Affairs Victoria, *Government Response to the Report of the Consumer Credit Review* (2006) at 12.

⁹² SEQUAL/Trowbridge Deloitte Reverse Mortgage Study (Dec 06) released in March 2007-
http://www.sequal.com.au/images/stories/sequal_deloitte_research_report_april_2007.pdf

Section 5: Vulnerable and disadvantaged consumers

Question 5(a)

What interpretation of the terms vulnerable and disadvantaged should be applied for the purposes of consumer policy? Are the needs of vulnerable and disadvantaged consumers best met through generic approaches that provide scope for discretion in application, or through more targeted mechanisms?

ASIC response

5.1 ASIC's experience is that in financial services, consumer vulnerability and disadvantage result from the interaction of the market, the characteristics of specific transactions and the capacities and circumstances of consumers.

5.2 Consumer Affairs Victoria has adopted the following definitions of vulnerability and disadvantage:

- vulnerability is the risk of exposure to detriment
- disadvantage is persisting susceptibility to detriment.⁹³

5.3 ASIC's experience is that consumer detriment arising from both vulnerability and disadvantage is a significant risk in the financial services context. Disadvantage arises from limits on a consumer's capacity when participating in the financial services market. For example, the use of promissory notes and other bill facilities to evade the UCCC is widespread in Western Australia where credit providers target indigenous consumers with low levels of financial literacy who do not have access to mainstream credit because of their disadvantaged economic situation. Consumers from different cultural backgrounds and those from non-English speaking backgrounds are also often disadvantaged.

⁹³ Consumer Affairs Victoria, *What do we mean by 'vulnerable' and 'disadvantaged' consumers?* (2004).

5.4 The issues paper notes that consumer vulnerability depends on circumstances and that even well-informed consumers are likely to be vulnerable in some situations. We agree with this observation. Consumer vulnerability arising from personal circumstances is a common issue in financial services. For example, shared appreciation and equity release products target aspiring first homeowners and under-funded older people. These groups include many who are vulnerable to making poor financial decisions as a result of financial inexperience, emotional attachment to the idea of owning their own home or financial constraints.

5.5 Consumers can also become vulnerable at particular points during their lives as a result of changes in their personal circumstances such as relationship breakdown and unemployment. In the financial services context, vulnerability can result in consumers losing significant amounts of money, in many cases their life savings or retirement savings.

5.6 Our experience is that a large proportion of the population are vulnerable in the sense that they find it difficult to understand complex products. The findings of behavioural economics support this observation. As we have observed at paragraph 1.20, in ASIC's experience, victims of overreaching investment schemes and scams often include successful business and professional people.

Section 6: Generic versus industry specific regulation

6.1 In financial services, consumer protection consists of generic and industry-specific elements. The prohibitions on misleading or deceptive and unconscionable conduct in the ASIC Act and the Corporations Act mirror the generic provisions in the TPA. These operate in conjunction with the specific obligations on financial services providers under the Corporations Act. We support the inclusion of industry-specific consumer protection regulation for financial services as part of the overall consumer policy framework.

Question 6(a)

How effective are the generic provisions in the TPA and Fair Trading Acts in meeting their intended objectives? What, if any, changes are required to deliver better outcomes?

ASIC response

6.2 Our view is that overall the generic prohibition on misleading or deceptive conduct under the TPA is an example of highly effective generic regulation. The prohibition sets broad standards for behaviour that are adaptable to changing circumstances and has raised standards over time. The general law has evolved over time a very nuanced regime providing a high level of consumer protection.

6.3 An important component of the success of the generic prohibition on misleading or deceptive conduct is the ability of traders to commence proceedings against each other for conduct in breach of the prohibition. Indeed, the majority of proceedings for misleading or deceptive conduct have been between private parties.

6.4 However, we think it is important to acknowledge that the effectiveness of the generic prohibition on unconscionable conduct has been limited. A series of court decisions have defined some significant restrictions on the scope of the prohibition, in particular confining it to the particular facts and circumstances of individuals involved. For example, until recently the prohibition was limited by case law to the unconscionable exploitation of a consumer with a disability known to the provider. It did not provide a general remedy against a business practice or model that was broadly unfair.

6.5 By contrast, in 2005 the Full Federal Court found that National Exchange Pty Limited, a company owned and operated by Mr David Tweed, was guilty of unconscionable conduct in relation to an unsolicited off-market offer to buy shares in Aevum Limited.⁹⁴ The Court found that Aevum shareholders as a group were vulnerable targets and ripe for exploitation. It is not yet clear whether this decision represents a potential expansion of the scope of the definition of unconscionable conduct.

6.6 However, the existence of industry specific consumer protection regulation in addition to generic regulation is also justified in the financial services sector for a number of reasons discussed in the next section.

Question 6(b)

What principles should guide the choice between generic and industry-specific regulation? How well does current mix of regulation accord with these principles?

ASIC response

6.7 In practice, consumers are compelled to buy certain financial products and have little choice but to buy others. The consequences of poor consumer choice can be extremely severe. Poor consumer choice could also undermine the Federal Government's retirement savings policy.

6.8 Australian employers are required to pay 9% of their employees' income to a superannuation fund because of the compulsory superannuation guarantee. In reality, these financial products are essential services. The fact that consumers have no choice but to participate in the markets for these products is one reason for industry-specific consumer protection measures. Similarly, it is not possible for the majority of Australians to be paid a wage or receive social security unless they have a bank account.

6.9 The issues paper notes that industry-specific legislation is necessary where the consequences of consumers making the wrong choices may be severe. This is a significant factor in financial services. Reasons why consumers may make poor choices include:

- Consumers generally have low financial literacy.
- Financial products are technically complex and evaluating them requires considerable expertise and time – both things many consumers are short on.

⁹⁴ *ASIC v National Exchange Pty Limited* [2005] FCAFC 226 (25 November 2005).

- Some financial products, especially superannuation and some mortgages, involve very long term obligations and judgments, and it is very difficult to predict the future, especially the further into the future one is asked to make judgments about.
- It is difficult for consumers of financial products to determine their quality by inspecting them pre-purchase.
- As they aren't experiential goods, consumers don't quickly build up a body of personal experience to draw upon when making their decisions.
- There is often a long time between purchase of financial products and their performance (or lack thereof) becoming apparent. This makes some degree of uncertainty about performance unavoidable and any purchasing decision therefore involves making assessments about probability of performance and market factors.
- Fee structures and other bells and whistles make comparing products difficult even with regulatory intervention to assist and almost impossible in many areas without this assistance.

6.10 These factors mean that consumers are heavily dependent on financial advice, yet our research indicates that consumers are also not capable of assessing the quality of advice before they act on it (after all, they are not experts and have little against which to judge the advice). In this situation, industry specific regulation is necessary to establish minimum standards in the advice industry.

6.11 For these reasons, there is a clear need in financial services for positive standards and obligations and to have them actively monitored. It would be impossible to achieve adequate disclosure or management of conflicts of interest without industry specific regulation.

6.12 The generic provisions do not prevent misconduct. It is important that consumer protection regulation in financial services include mechanisms to prevent problems before they happen as well as providing an efficient mechanism for resolving disputes that arise. ASIC's experience is that increasingly the community is demanding speedier responses to emerging problems, to identify potential areas of misconduct and take action to prevent it occurring or at least to act on it quickly once identified to mitigate potential losses. Industry-specific regulation imposing barriers to entry, service delivery standards and mechanisms for resolving disputes helps to address this.

6.13 An industry-specific regime that includes positive licensing, conduct and disclosure obligations enables ASIC to effectively monitor the financial services industry. For example, ASIC's 2006 *Shadow shopping survey on superannuation advice* was conducted by reviewing statements of advice prepared by financial advisers in accordance with their obligations under Chapter 7 of the Corporations Act. If this disclosure obligation did not exist, it would be extremely difficult for ASIC to conduct audit and surveillance work on participants in the financial services industry.

6.14 The existence of a positive industry-specific licensing regime also provides another useful and timely remedy in terms of our ability to impose license conditions.

Questions 6(c), 6(d) and 6(e)

Is industry-specific regulation particularly well suited to some areas? Are there examples where specific regulation has been helpful in putting a particular sector on notice? To what extent has the growth in specific regulation reflected inadequacies in generic regulation or its enforcement?

Are there significant areas of industry-specific regulation that do not provide a net benefit to the community? To what extent does this reflect the pursuit of redundant objectives or objectives that could be adequately addressed using the available generic regulatory instruments? Are there any substantial inconsistencies between industry-specific regulation and the generic regime and, if so, with what consequences?

Are there ways that the costs of industry-specific regulation could be reduced without reducing its effectiveness? For example, would more emphasis on principles-based regulation be helpful?

ASIC response

6.15 Chapter 7 of the Corporations Act is a principles-based regime. Under this regime there has been a move away from reliance on detailed, prescriptive rules in favour of reliance on high level, broadly stated principles to set the requirements for financial services providers. For example, disclosure documents are required to be clear, concise and effective. While ASIC is supportive of principle-based regulation, we note that it is not without its problems.

6.16 Proponents of principles-based regulation argue that it is cost effective compared with industry-specific regulation. However, the standard criticism of principles-based regulation is lack of certainty about how to comply with principles-based requirements and lack of predictability about regulatory response.⁹⁵ Our experience in administering Chapter 7 of the Corporations Act is that there is a risk that in practice, this regulatory approach may sometimes lead to increased uncertainty and unpredictability, with consequent costs.

6.17 Often in practice, the principal means by which certainty can be delivered is by the provision of formal and informal guidance by the regulator administering the principles-based regime. The need to elaborate principles-based requirements with extensive guidance involves significant additional costs. An example of this in financial services is the requirement that financial services licensees must have adequate arrangements for the management of conflicts of interest.⁹⁶ Industry requested guidance on this obligation which led to ASIC publishing Policy Statement 181, *Licensing: Managing conflicts of interest* in 2004. Following the release of this policy statement, licensees requested further guidance and as a result, ASIC released a discussion paper in April 2006 containing a series of case studies that were examples of the types of conflicts of interest that might arise in financial services and practical solutions to manage them.⁹⁷ The proliferation of guidance also has other potential impacts including increasing prescription, complexity and inaccessibility.⁹⁸

6.18 That said, there are also a number of additional benefits to principles-based regulation, including the fact that it can better deal with emergence of new products and services and is more responsive to changing market conditions.

⁹⁵ J Black, "Principles Based Regulation: Risks, Challenges and Opportunities" Banco Court, Sydney, 27 March 2007 at 14.

⁹⁶ Corporations Act s 912A(1)(aa).

⁹⁷ ASIC, *Managing conflicts of interest in the financial services industry: An ASIC Discussion Paper* (April 2006).

⁹⁸ J Black, "Principles Based Regulation: Risks, Challenges and Opportunities" Banco Court, Sydney, 27 March 2007 at 15-20.

Section 7: Enforcement and redress issues

7.1 We think the existing consumer protection enforcement framework for financial services is working relatively well. However, we believe there are some specific gaps, including factors that limit ASIC's ability to commence representative actions on behalf of groups of consumers and the absence of specific statutory disgorgement remedies.

7.2 We have discussed the effectiveness of the enforcement framework for credit at paragraphs 3.70-3.76 of this submission.

Questions 7(a) and 7(b)

Are there significant enforcement gaps in the current framework? If so, do they mainly reflect the level of resourcing for those entities responsible for enforcement or are there other factors at work? To what extent has more regulation been substituted for better or more timely enforcement?

Are current redress and penalty provisions appropriate and effective? Would changes to these provisions in the TPA, Fair Trading Acts and other generic regulation reduce the incentive to employ specific regulation?

ASIC response

Representative actions

7.3 Following the decision of the Full Federal Court in *Cassidy v Medibank Private Ltd*, the ACCC is constrained in its ability to seek redress under the ASIC Act for large numbers of consumers because of the need to locate and name all consumers in an action.⁹⁹ This case was initiated by the ACCC under a delegation of powers by ASIC to the ACCC. The constraints under the ASIC Act identified by the Full Federal Court apply equally to ASIC. The ACCC's submission to this Inquiry argues that the ACCC should be empowered to obtain compensation for parties that are not named in proceedings.¹⁰⁰

7.4 Like the ACCC, ASIC is empowered to institute representative proceedings on behalf of plaintiffs who have opted in in advance.¹⁰¹ However,

⁹⁹ *Cassidy v Medibank Private Ltd* [2002] FCA 315.

¹⁰⁰ ACCC, *Submission to the Productivity Commission inquiry into Australia's consumer protection framework* (June 2006) at 101.

¹⁰¹ Corporations Act s 1325(3); ASIC Act s 12GM.

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ASIC also has powers to institute representative actions that differ somewhat from the powers of the ACCC.

7.5 Where a court has a power under the Corporations Act to grant an injunction, the court may order that a person pay damages to compensate another person affected by the misconduct, even if they are not a party to the application.¹⁰² ASIC is also empowered to commence civil proceedings in the name of another person where this appears to be in the public interest¹⁰³ Again, these are proceedings on behalf of persons who have opted in.

7.6 ASIC has commenced proceedings under these powers in a limited number of cases. Representative proceedings can sometimes be complex and difficult to run. As they are statute based, uncertainty about jurisdiction and procedure can arise. In some circumstances, these cases may give rise to interlocutory challenges and procedural issues.

7.7 One procedural difficulty relates to representative proceedings that require ASIC to obtain written consent from claimants. In cases where thousands of consumers have suffered a loss, this may impose an administrative burden.

7.8 ASIC can also institute representative proceedings relating to breaches of the consumer protection provisions in the ASIC Act in the Federal Court of Australia. Federal Court representative proceedings are available where at least seven persons have claims against the same defendant that are all in respect of or arise out of the same, similar or related circumstances and the claims give rise to a substantial common issue of law or fact. It is not necessary to get the written consent of claimants, but potential claimants can opt out of group proceedings.¹⁰⁴

7.9 Representative proceedings are also available to consumer protection regulators in other jurisdictions. For example, in the United States the Federal Trade Commission has this power.¹⁰⁵ The New Zealand Commerce Commission is also empowered to seek restitution orders in favour of non-parties.¹⁰⁶

¹⁰² Corporations Act s 1324(10).

¹⁰³ Corporations Act s 50.

¹⁰⁴ *Federal Court of Australia Act 1976* (Cth) Part IVA.

¹⁰⁵ Case law interpreting s 13(b) of the Federal Trade Commission Act (US) has accepted the Federal Trade Commission is able to obtain orders imposing monetary equitable relief without the need to obtain the consent of affected consumers.

¹⁰⁶ *Fair Trading Act 1986* (NZ) s 43(1).

Disgorgement remedies

7.10 Our view is that, in principle, when used in the right circumstances, disgorgement is an appropriate and useful remedy. It can act as a powerful deterrent against undesirable conduct by stripping away the profits that would otherwise be earned by an offender, in excess of any compensation payable to affected consumers. We would welcome the inclusion of a disgorgement remedy in the remedies available to ASIC under the ASIC Act and Corporations Act.

7.11 Disgorgement is also available to regulators in other jurisdictions. For example, in the United Kingdom the Director of Fair Trading may increase the fine payable by wrongdoers to include gains made in the course of misconduct.¹⁰⁷ The United States Federal Trade Commission has sought disgorgement successfully for contraventions of competition law and has released a policy statement setting out the circumstances in which it will seek disgorgement remedies.¹⁰⁸

7.12 There are, however, a number of legal and policy considerations in developing disgorgement as an effective remedy. These include:

- addressing the circumstances in which disgorgement should be available, e.g. whether it could be used for inadvertent or 'borderline' breaches;
- ensuring that there is no danger that an order for disgorgement could adversely impact on subsequent claims by consumers for compensatory damages;
- considering how the level of profit to be disgorged should be assessed; and
- to the extent that disgorgement acts as a punitive remedy, whether different standards should apply in relation to burdens of proof and standards of evidence.

Civil pecuniary penalties

7.13 The ACCC submission to this Review argues that the ability to seek civil pecuniary penalties for fair trading and consumer protection matters would significantly enhance the ability of the ACCC to obtain effective outcomes and provide a higher degree of deterrence.¹⁰⁹

¹⁰⁷ *Napp Pharmaceutical Holdings Limited and Subsidiaries v Director General of Fair Trading* (15 January 2002).

¹⁰⁸ Federal Trade Commission, *Policy Statement on Monetary Equitable Remedies in Competition Cases* (31 July 2001).

¹⁰⁹ ACCC, *Submission to the Productivity Commission inquiry into Australia's consumer policy framework* (June 2006) at 92.

7.14 In September 2005 a working party of the Standing Committee of Officials of Consumer Affairs issued a discussion paper, which raised the possibility that the ACCC be empowered to seek civil penalties for prohibitions that attract criminal penalties. The working party is currently preparing its final report.

7.15 We think the ability to seek civil penalties in appropriate cases could enable ASIC to deliver improved outcomes for consumers. However, this will only occur in cases where the award of a civil penalty will not result in insufficient funds being available to compensate consumers.

7.16 In our view it is unlikely that civil penalties will be appropriate in cases where there is sufficient evidence to support a criminal prosecution. Nor are civil proceedings likely to solve all the problems faced by consumer protection regulators in running criminal proceedings.

7.17 ASIC has extensive experience administering civil penalty provisions in other contexts under the Corporations Act. These cases are significant pieces of litigation which are costly and time consuming. Where ASIC is seeking a civil penalty or a disqualification order, individual defendants can claim privilege against self-incrimination. This significantly increases the time and resources necessary to prepare and present ASIC's case. These difficulties cannot be underestimated.

7.18 Other limitations of civil penalties are discussed in the draft final report of the working party of the Standing Committee of Officials of Consumer Affairs and by the Australian Law Reform Commission in its 2002 Report *Principled Regulation: Federal Civil and Administrative Penalties in Australia (2002)*.

7.19 Lastly, it is important to emphasise that we do not consider that changing the redress and penalty provisions in the generic consumer protection provisions in the ASIC Act and the Corporations Act in the ways outlined in this section would reduce the need for specific consumer protection regulation in financial services.

Question 7(c)

Are the current dispute resolution mechanisms and arbitration processes, including consumer tribunals, readily accessible and effective?

ASIC response

7.20 We consider that the external dispute resolution framework for financial services includes provides a useful service. Paragraphs 4.28-4.33 discuss some of the issues we have encountered with external dispute resolution schemes.

Section 8: Self and non-regulatory approaches

8.1 ASIC has extensive experience approving and overseeing industry codes and our experience is that self-regulation can be effective when the circumstances are right. We also believe non-regulatory responses, such as the establishment of a consumer advocacy body, could play a significant role in Australia's consumer protection framework.

Question 8(a)

What principles and considerations should guide the use of self-regulatory, co-regulatory and non-regulatory options in the consumer policy framework? What are the best examples of effective self-regulation, co-regulation and non-regulatory approaches and why have they worked well in these cases? Is enough use currently made of such measures? If not, where are the main opportunities for further uptake?

ASIC response

8.2 In ASIC's experience, self-regulatory approaches are effective where they have real and widespread industry support. Industry is most likely to support self-regulation if either or both of the following circumstances exist:

- there is a need for the industry to build consumer trust and confidence in it, and/or
- there is a real threat that regulation will be introduced if the self-regulatory measures are not effective.

8.3 While ASIC does not have the power to make codes of practice mandatory, we do have the power to approve industry codes. We have issued a policy statement on what we will want to see before a code is approved.¹¹⁰ The requirements we have imposed are based upon our experience of what distinguishes a good code that delivers real consumer benefits from poorer codes that are mere window dressing.

8.4 When considering whether to approve a code, the key requirements we consider include that:

- the code is freestanding and written in plain language
- it is a comprehensive body of rules not just a single rule

¹¹⁰ ASIC Policy Statement 183, *Approval of Financial Services Codes*.

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- it is enforceable against subscribers, and is monitored and enforced in practice
- it meets statutory criteria
- that it was developed via a consultative process that sought input from industry, consumers and the regulator
- there is effective and independent code administration
- there are appropriate sanctions and remedies for breaches
- the code content addresses stakeholder issues
- there is adequately promotion of the code, and
- it is reviewed regularly.¹¹¹

8.5 There are a number of existing codes that do work effectively, including the EFT Code of Conduct and the Code of Banking Practice.

8.6 The EFT Code has been successfully used to assist with the resolution of disputes about unauthorised electronic banking transactions for over 20 years. It was developed against a background of the need to build consumer trust and confidence in electronic banking and concern about the real possibility of government-imposed consumer protection regulation.

8.7 The Code of Banking Practice was developed against a similar background of industry seeking to address lack of confidence and trust in banks and threat of regulation. Interestingly, at its most recent review the Banking Code was significantly improved even though there was no meaningful threat of additional regulation. However, reputational issues remain important for the banking industry.

8.8 As well as effective industry codes of practice such as the EFT Code and the Code of Banking Practice, many industry bodies have other standards, rules and codes of ethics. In our experience, these rules and standards often do not meet the criteria in Policy Statement 183 *Approval of financial services sector codes of conduct* and are less effective. In particular, where there is no active monitoring of compliance with a standard or rule, no provision for resolving disputes, no remedies for consumers who suffer loss as a result of a breach, and no scope to discipline an industry member for a breach of a rule, these instruments are unlikely to deliver uniformly improved levels of consumer protection.

¹¹¹ In Policy Statement 183 we require that a code must be reviewed every 3 years. We are currently considering whether that is too often for well established codes and whether we should change this requirement to something like there must be a review after the first 3 years of operation and thereafter every 5 or 6 years.

8.9 As noted, financial services providers regulated under Chapter 7 are required to belong to an external dispute resolution scheme that is approved by ASIC.¹¹² The external dispute resolution schemes that we have approved are another example of effective self-regulation. These have been discussed at paragraphs 4.22-4.33. As noted there, we see these schemes as delivering significant benefits to consumers of financial services.

8.10 Lastly, there are many partnerships between industry, the consumer sector and/or government that deliver real consumer benefit although they do not involve a formal self-regulatory approach. For example:

- Indigenous Enterprise Partnerships involving Westpac and indigenous communities in Cape York. The aim of these partnerships is to develop the financial independence of the local indigenous communities by developing income management skills within families and providing training and support for indigenous entrepreneurs.¹¹³
- National Australia Bank's No Interest Loan Scheme and Step-Up, the low-interest loan program the bank delivers in partnership with Good Shepherd Youth and Family Services.¹¹⁴
- Saver Plus, a financial literacy and matched savings program for low-income customers of the ANZ Bank, delivered in partnership with the Brotherhood of St Laurence, Berry Street Victoria, the Smith Family, the Benevolent Society and the Victorian Government.¹¹⁵
- The ANZ Bank's suite of adult financial education programs, MoneyMinded. ANZ coordinates and funds delivery of these programs through financial counsellors and partnerships with community organisations.¹¹⁶
- StartSmart, a group of youth financial literacy programs developed and funded by the Commonwealth Bank Foundation.¹¹⁷

8.11 The potential exists for an enormous number of ongoing partnerships to promote financial literacy and benefit disadvantaged consumers.

¹¹² Corporations Act s 912A(1)(g) and (2)(b)(i).

¹¹³ See

<http://www.westpac.com.au/internet/publish.nsf/content/wiwccp%20enterprise%20partnerships>.

¹¹⁴ See <http://www.nabgroup.com/0,,33873,00.html>.

¹¹⁵ See <http://www.anz.com/aus/aboutanz/Community/Programs/Saver.asp>.

¹¹⁶ See <http://www.anz.com/aus/aboutanz/Community/Programs/MoneyMinded.asp>

¹¹⁷ See <http://www.commbank.com.au/foundation/>.

Question 8(b)

Would there be benefits from government support for a consumer advocacy body and would they outweigh the funding and other costs involved? Should such a body's role be limited to advocacy, or should it also be responsible for bringing forward consumer complaints? Do consumer advocacy bodies adequately represent the interests of all consumers? If not, what other means could be used to elicit the views of consumers? Is there a need for greater research into consumer and market behaviour to inform policy development? If so, who should be responsible for carrying out and resourcing such work?

ASIC response

8.12 The consumer protection policy framework in Australia has always been made up of three equally important partners: government, industry and the consumer sector. In thinking about the framework going forward it is important that attention is also paid to the non-government elements of the framework.

8.13 ASIC has some experience of working with a consumer body in the financial services context. We have established an ASIC Consumer Advisory Panel with members representing consumer legal centres, consumer associations and financial counsellors. ASIC's Consumer Advisory Panel, which meets quarterly, advises ASIC on emerging consumer issues and comments on our consumer protection activities. We receive great value from our Consumer Advisory Panel, and especially from those organisations involved in casework. People in these organisations are often the first to see new issues, especially those that impact upon disadvantaged consumers who are less likely than other consumers to contact a government regulator.

8.14 For example, through case work conducted by members of our Consumer Advisory Panel, we became aware of problems with exploitative 'book-up' practices in Indigenous communities. In response to this input, we developed *Dealing with book up: a guide*, a comprehensive resource for government and non-government agencies, community workers and financial counsellors developing responses to book-up practices.¹¹⁸

¹¹⁸ ASIC, *Dealing with book up: a guide* (December 2005).

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8.15 Sometimes new issues affecting vulnerable and disadvantaged consumers identified by case work organisations also impact on consumers generally. For example, case work organisations participating in our Consumer Advisory Panel have also drawn our attention to unfair debt collection practices and regulatory gaps in responding to these practices. In response to these concerns, ASIC and the ACCC reached a formal agreement about the role of each agency in regulating debt collection activities and issued two jointly produced publications aimed at improving standards in the debt collection industry and assisting consumers dealing with debts and debt collection: *Debt collection guideline: for collectors and creditors* and *Dealing with debt: your rights and responsibilities*.¹¹⁹

8.16 Our Consumer Advisory Panel also alerted us to issues with the mortgage broking industry. In response to this intelligence, we commissioned a report on mortgage brokers¹²⁰ and a consumer guide, *Using a mortgage broker*.¹²¹

8.17 ASIC is currently monitoring developments in equity release products in response to feedback from the Consumer Advisory Panel. We have also produced educational material about reverse equity products for older people.¹²²

8.18 Last financial year the Consumer Advisory Panel also made specific recommendations to fund research. Projects funded were:

- a report on the UK 'Treating Customers Fairly' initiative, and
- a survey of the experiences of consumers re-financing personal and household debt.

8.19 The functions of the UK National Consumer Council (NCC) are much broader than the functions of ASIC's Consumer Advisory Panel. They include:

- facilitating collaboration between service providers and consumers
- chairing forums to capture consumer views
- consumer education to enable consumers to participate in markets effectively
- educating providers about issues faced by disadvantaged consumers
- influencing decisions about the delivery of services (e.g. the NCC has partnerships with leading financial services providers working to improve delivery of basic banking services)
- campaigns to improve market practices

¹¹⁹ ASIC and ACCC, *Debt collection guideline for collectors and creditors* (2005) and ASCI/ACCC *Dealing with debt: your rights and responsibilities* (2005).

¹²⁰ Consumer Credit Legal Centre NSW, *A report to ASIC on the finance and mortgage broker industry* (2003).

¹²¹ ASIC. *Using a mortgage broker* (2003).

¹²² See <http://www.fido.gov.au/fido/fido.nsf/byheadline/Reverse+mortgages?openDocument>.

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- consumer research, and
- participating in law reform processes.

The National Consumer Council also have standing to make 'super complaints' to the Office of Fair Trading that a feature of a market is not in the interests of consumers. The Office of Fair Trading is required to publish a response within 90 days.¹²³

8.20 In Australia all regulatory proposals are required to be assessed to establish whether they are likely to involve an impact on business and individuals and the economy and to assess compliance costs. ASIC supports this emphasis on analysing the impact of proposals for regulatory reform. We think it is also important that regulatory impact analysis consider the consumer benefits of proposals to introduce or remove regulation and the consumer detriment of proposals. However, very little research has been done on identifying and quantifying consumer benefit and detriment. In part this is because of data shortages. A consumer advocacy body with a research function could help to fill this data gap in the assessment of regulatory proposals.

8.21 Further, in conducting consumer research in financial services, ASIC relies on frontline consumer agencies such as consumer legal centres. The experience of caseworkers in these agencies is potentially an important source of evidence of the impact on consumers of regulation and regulatory gaps.

8.22 We increasingly find that in the current environment, consumer and/or welfare legal centres and financial counselling agencies do not have sufficient resources to provide policy input or even provide us with data about their case work. Quality consumer research about consumers' experiences that identifies issues and policy options and provides data about the consumer benefit and detriment of proposals can't be fully effective unless researchers can access this information. We think there is a real need to resource frontline agencies with policy capability so that they are able to provide input into consumer research.

8.23 Any national consumer advocacy body that can't access reliable data from front line caseworker agencies will be the poorer for it.

¹²³ Enterprise Act 2002 (UK).

Section 9: Jurisdictional responsibilities

9.1 Two issues involving jurisdictional responsibilities that arise in financial services are:

- the division of responsibility between the ACCC and ASIC, and
- the regulation of credit at the state and territory level.

Question 9(a)

What are the main areas of duplication, overlap and inconsistency in consumer regulation across jurisdictions (and with New Zealand)? How significant are the costs of this inconsistency, overlap and duplication relative to any benefits provided?

ASIC response

9.2 The ACCC is the general consumer protection regulator at the federal level. Responsibility for consumer protection in financial services was transferred from the ACCC to ASIC in 1998 as part of the Government's Financial Systems Inquiry.

9.3 There is some jurisdictional overlap where an activity includes both a financial and another type of service. Examples include debt collection and some property promotion activities. The ACCC submission to this Inquiry proposes that it should have concurrent jurisdiction with ASIC over financial services.¹²⁴

9.4 A number of mechanisms and processes facilitate effective coordination of surveillance and enforcement activity between ASIC and the ACCC in relation to activities that include elements of financial services and other services:

- Each agency can delegate its powers to the other agency, and there is provision for standing cross-delegations.¹²⁵
- There is close and regular liaison at the Commission, Regional Commissioner and officer level.

¹²⁴ ACCC, *Submission to the Productivity Commission inquiry into Australia's consumer policy framework* (June 2007) at 141.

¹²⁵ ASIC Act s 102(2)(e); Trade Practices Act s 26.

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- ASIC and the ACCC have entered into a Memorandum of Understanding that reinforces this cooperative working relationship. The MOU sets out detailed processes for liaison, cooperation, assistance, referral of matters, delegation of powers, joint enquiries and exchange of confidential information.¹²⁶
- ASIC and the ACCC also liaise formally through our joint participation in the Senior Officials of Consumer Affairs meetings and associated working parties.

9.5 We are satisfied that these arrangements work effectively in practice to manage the jurisdictional overlap between the ACCC and ASIC. A recent example of the current arrangements working well in practice is the matter of *ACCC v Original Mama's Pizza and Ribs Pty Limited*.¹²⁷ The ACCC was responsible for the conduct of this matter in accordance with the terms of a specific delegation provided by ASIC. Regular communication and liaison meant that jurisdictional and legal issues were raised, discussed and resolved effectively. ASIC understands that the ACCC agrees that the current arrangements worked effectively and efficiently in this case.

9.6 ASIC and the ACCC also reach agreement on jurisdictional responsibilities for particular industries. For example, in November 2004 ASIC and the ACCC jointly released a brochure setting out each agency's jurisdiction over complaints about unfair debt collection practices.¹²⁸

9.7 Depending upon the model, a number of practical problems could arise if the ACCC and ASIC were to have concurrent financial services jurisdiction:

- There would be a need for time-consuming and complex interaction between both agencies about every complaint received by each agency in order to ascertain whether each complaint was being dealt with by the other agency and allocate complaints made to both agencies.
- Enforcement action by the ACCC would preclude ASIC from exercising other aspects of its enforcement powers, for example instituting criminal proceedings for breaching a specific Corporations Act obligation, banning a licensee, suspending or cancelling a licence, imposing licence conditions or winding up an illegal scheme. In many cases involving misleading or deceptive conduct, these are more effective enforcement measures for consumers generally.

¹²⁶ ASIC MR 04-420 *ASIC and ACCC sign new MOU* (December 2004).

¹²⁷ Federal Court of Australia, matter No NSD 2333 of 2005.

¹²⁸ ASIC MR 05-313, *ASIC, ACCC promote fair debt collection practices and ACCC and ASIC brochure, Complaints about debt collection activity- the responsibilities of government agencies* (2004).

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- In making enforcement decisions, ASIC has the benefit of detailed knowledge of specific markets. We frequently complement enforcement action with follow-up compliance work with individual financial services providers or industry generally and by issuing guidance and policy. The ACCC does not have the ability to do this.
- Lastly, the financial services industry would be faced with the risk of inconsistent administration and duplication of consumer protection regulation.

Section 10: Gate-keeping and review arrangements

10.1 ASIC supports the current regulation making and review processes administered by the Office of Best Practice Regulation. We support the assessment of the compliance costs and other impacts to business and industry of any proposed regulation, and weighing that against the benefits expected. However, we believe that the assessment of costs to consumers of regulation should be given equal emphasis. We note that the assessment of costs and benefits to consumers of regulation is difficult. We also note that it is difficult to assess the cost of the option of not intervening. There are more accurate mechanisms available for assessing direct costs of imposing regulation than for either determining benefits or determining the cost of not intervening. ASIC believes it is important either to develop better mechanisms for measuring the impact of regulation on all stakeholders and the impact of not dealing with an issue, or building approaches which take account of the difficulty of determining those impacts.

Question 10(a)

How effective are the current regulation-making and review processes (at both the Commonwealth and state and territory level) in facilitating the development of best practice consumer regulation? Are there ways to ameliorate some of the difficulties in measuring the benefits and costs of consumer regulation without compromising the integrity of the assessment process?

ASIC response

10.2 The Federal Government has adopted a comprehensive system, administered by the Office of Best Practice Regulation, to assess the costs and benefits of all regulatory proposals. ASIC supports this gate-keeping initiative.

10.3 Analysing the costs and benefits of proposed consumer protection regulation involves considering the impact of the proposal on competition, compliance costs and the impact on consumers as well as impacts on business.

10.4 Identifying and quantifying consumer detriment and the benefits to consumers of regulation is difficult and this limits the effectiveness of cost-benefit analysis as a gate-keeping arrangement for the introduction of new regulation.

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10.5 A 2000 study conducted by the UK Office of Fair Trading found that the cost of consumer detriment was £8.3 billion or 1.1% of GDP.¹²⁹ In 2006 Consumer Affairs Victoria published a research report that found that the cost of consumer detriment in Victoria was \$3.15 billion per year, or 1.5% of gross state product. The report includes a breakdown of costed consumer detriment by category of product and service. Consumer detriment in banking and financial services cost \$308.7 million, or almost 10% of the total consumer detriment.¹³⁰

10.6 Developing tools to identify and quantify consumer detriment and benefit for specific proposals to introduce new regulation or remove existing regulation requires rigorous research and analysis of consumer experience. In Australia there is no overarching body with responsibility for this, and the frontline agencies that hold evidence of consumer detriment in their case work files are often not adequately resourced to collaborate on policy research.

10.7 ASIC supports the need for rigorous cost–benefit analysis before new legislation is introduced (or existing regulation is repealed). We note though that to date the focus of OBPR's processes has been on the costs to industry. The other side of the equation, the benefits (and costs) to consumers, has not been adequately focused upon.

10.8 Through our Consumer Advisory Panel, ASIC has recently commissioned a major piece of research into how to quantify the cost of consumer problems and then measure the consumer benefit or detriment of various regulatory options. The Centre for International Economics is doing this for us. We intend to make the research widely available when it is completed, as our hope is that it will be helpful to a range of consumer regulators beyond financial services. We will also provide this inquiry with a copy after it is completed.

10.9 The definition of 'regulation' used by the Office of Best Practice Regulation is any rule endorsed by government where there is an expectation of compliance, including quasi-regulation such as codes of conduct, guidance notes etc. This definition is very wide, and could potentially cover co-regulatory measures such as industry codes of conduct endorsed by government. One commentator has asked how likely it is that non-government bodies would be persuaded to undertake the application of the Business Cost Calculator or the creation of an RIS and how appropriate these tools are for industry standards which are often aspirational and enforced by education, negotiation and facilitation.¹³¹

¹²⁹ United Kingdom, Office of Fair Trading, *Consumer Detriment* (2000).

¹³⁰ Consumer Affairs Victoria, *Consumer Detriment in Victoria: a survey of its nature, costs and implications* (Research Report 10, 2006).

¹³¹ D Kingsford Smith, "Measuring Regulatory Effectiveness: What, How and Why?" Work in Progress. 2 April 2007.

Question 10(b)

Beyond procedural inertia, and/or delays in modifying regulations to take account of changed market circumstances, are there institutional factors that have helped to sustain regulation that does not provide a net benefit to the community? How could these be addressed? What other improvements could be made to current gate-keeping and review arrangements?

ASIC response

10.10 In the financial services sector, our legislation is still relatively new and has been the subject of ongoing review and refinement to improve its operation. This approach appears to be working well.

Section 11: Regulatory and oversighting bodies

Question 11(a)

Do consumer regulators have the appropriate structure, resources, skills and powers? Is there scope to consolidate industry regulators, or to subsume their functions within generic bodies?

ASIC response

11.1 The appropriate structure for consumer protection regulators is a matter of high level policy for Governments. ASIC does not seek to express a view on this issue, but makes the following observations which we think are relevant.

11.2 ASIC's consumer protection activity including our education, compliance and enforcement work, complements our other regulatory functions. From time to time ASIC will commence enforcement proceedings for breaches of specific Corporations Act obligations instead of or as well as actions for breach of the consumer protection provisions in the ASIC Act.

11.3 Consumer protection regulation within financial services requires detailed, specialist knowledge of complex industries, specific markets and products and specialised regulatory regimes.

11.4 We often work with industry members and peak bodies to achieve broader compliance and change of practice in conjunction with enforcement activity against specific entities.

11.5 Similarly, we often complement specific enforcement activity with a consumer education campaign. This holistic approach is best achieved within a specific financial services regulator with compliance, enforcement and consumer protection functions.

Question 11(b)

Are there tensions or problems where regulators are involved in both policy making and enforcement, and/or in enforcement and advocacy, and how might these be addressed? Should consumer policy be administered separately from competition policy or should institutional arrangements reflect the synergies between the two?

ASIC response

11.6 ASIC works closely with the federal government minister responsible for financial services regulation, the Parliamentary Secretary to the Treasurer, providing independent, expert advice on the impact of law reform proposals. We support the current structure which provides a separation between responsibility for policy-setting and the administration of the law. We consider that it is useful for the regulator to be involved in the policy development to provide advice on implementation as well as an independent perspective which complements the voices of industry and consumers.

Question 11(c)

Are the Ministerial Council arrangements working well? If not, what changes are required? Would changes to other policy oversighting arrangements help to deliver better outcomes for consumers?

ASIC response

11.7 There has been noticeable improvement in the operation of the Ministerial Council for Consumer Affairs and coordination with other consumer regulators over the last 20 years. However, in our view there is still room for significant improvement in terms of timely sharing of information and better coordination of resources to reduce duplication, particularly in the development of educational resources.

Appendix A

Consumer protection research undertaken by ASIC and ASIC's Consumer Protection Advisory Panel 1999-2007

ASIC's consumer protection work includes conducting consumer –oriented research to inform all aspects of ASIC's functions. ASIC's Consumer Advisory Panel also conducts consumer research.

Published research is available at www.asic.gov.au/publications.

1. Current ASIC research includes:

- 1.1 **Profile of illegal/misleading scheme investors** –research profiling investors who have invested in illegal and misleading schemes to better understand who invests in such schemes and why.
- 1.2 **Tracking survey of consumers who call Info Line** – research tracking callers to find out why they contact ASIC and how they find out about Info Line.
- 1.3 **Investor profiling** – qualitative and quantitative research to identify the demographic characteristics of investors, and understand what motivates or influences consumers when they are considering investment options.
- 1.4 **Advertising monitoring** – ongoing research monitoring television, radio and print media advertisements for financial products and services to identify misleading or deceptive and bait advertising before investors suffer loss, and identify market trends and new products and product features.
- 1.5 **Reverse mortgage research** – qualitative research examining the impact on consumers of reverse mortgage arrangements, including loss of equity and transaction costs.
- 1.6 **Bad apples** – facilitating a discussion forum for financial services industry bodies on the need for reference checking within the financial services industry.

2. Completed ASIC research includes:

- 2.1 **Making home insurance better** (January 2007) – research into steps taken by insurers to address problems with home underinsurance.
- 2.2 **Monitoring superannuation fees and costs** (November 2006) – research into the fees and costs for balanced investment options.
- 2.3 **Shadow shopping survey on superannuation advice** (April 2006) – research into actual superannuation advice including compliance with

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quality of advice and disclosure obligations and the impact of commissions on quality of advice.

- 2.4 **Monitoring advertising in superannuation** (January 2006) - this research monitored superannuation advertisements over 17 months during the lead up to and following the introduction of choice of superannuation funds legislation on 1 July 2005.
- 2.5 **Equity release products** (November 2005) – research examining the equity release products market, features of equity release products and issues for consumers considering entering into equity release arrangements.
- 2.6 **Collecting statute-barred debts** (September 2005) – research examining industry practices in relation to the collection of statute-barred debts.
- 2.7 **Getting home insurance right** (September 2005) – research examining the underinsurance of homes following the 2005 Canberra bushfires.
- 2.8 **Soft dollar benefits** (June 2004) – research examining industry practices in relation to benefits other than commissions paid for selling financial products.
- 2.9 **Preferential remuneration** (April 2004) – surveillance of payments of preferential remuneration by financial services providers to financial advisers.
- 2.10 **Financial literacy in schools** (June 2003) – research examining levels of financial literacy education in Australian secondary schools.
- 2.11 **Quality of financial planning advice** (February 2003) – a joint survey with the Australian Consumers Association into the quality of advice provided by financial planners.
- 2.12 **Tax-driven, mass-marketed primary production schemes** – research examining the quality of advice and disclosure provided to investors in primary production managed investment schemes. ASIC's report of this research was published in February 2003.
- 2.13 **Disclosure of fees and charges in managed investments** (September 2002) – research into approaches to disclosure of fees and charges in Australia and overseas containing best practice recommendations.
- 2.14 **Hook, line and sinker: Who takes the bait in cold calling scams** (June 2002) research into the demand-side of cold calling which examined who made cold calls and how investors came to trust and accept their representations.

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- 2.15 **International cold-calling investment scams** (June 2002) – research examining the scope of share investment cold calling.
- 2.16 **Account aggregation in the financial services sector** (May 2001) – research into account aggregation services, which identified a wide range of consumer protection issues.
- 2.17 **Life insurance disability insurance campaign report** (February 2001) – surveillance research examining how life companies train and supervise agents and the quality of advice about disability insurance.
- 2.18 **Consumer understanding of flood insurance** (June 2000) – research examining insurance policies and consumer understanding of flood cover.
- 3. **Research completed by ASIC's Consumer Advisory Panel includes:**
 - 3.1 **Stock-take of consumer education in financial services** (July 1999) – a review of information and education resources available to Australian consumers of financial products and services, which identified shortfalls and gaps.
 - 3.2 **What is effective consumer education?** (December 2001) – a literature review of research on consumer education.
 - 3.3 **Book up: Some consumer problems** (March 2002) – research examining the use of 'book up' in stores which identified a number of poorly operated book up systems.
 - 3.4 **Good practice in consumer education for indigenous people** (September 2002) – research into good practice to achieve effective consumer education for indigenous people.
 - 3.5 **Mortgage brokers** (March 2003) – research examining the structure and regulation of the mortgage broker industry and issues for consumers.
 - 3.6 **Consumer decision making at retirement** (July 2004) – research examining the decision making processes undertaken by people at retirement.
 - 3.7 **The UK Financial Services Authority's 'Treating Customers Fairly' initiative** (July 2006) – research reviewing the UK Financial Services Authority's 'treating customers fairly' initiative and the potential merits of introducing a similar initiative in Australia.

Appendix B

Summary of ASIC consumer protection enforcement activity

ASIC's consumer protection enforcement activity covers a range of matters including breaches of the ASIC Act in relation to the provision of credit products, action against unlicensed providers and against licensed advisers, hawking, false and misleading statements in advertising and unconscionable conduct.

This appendix summarises ASIC's consumer protection enforcement activity for the three years 2006/2007, 2005/2006 and 2004/2005. Details of the individual actions can be found in ASIC media releases on www.asic.gov.au.

2006/2007

Summary

In 2006/2007, ASIC completed 78 consumer protection enforcement actions. The break down of this activity by type (criminal, civil, administrative) was as follows:

- 14 criminal actions against 14 defendants
- 40 civil actions against 146 defendants
- 24 administrative actions against 28 defendants.

Detailed breakdown

Credit

- 2 administrative matters, both resulting in individuals being banned.

Unlicensed Conduct

- 8 criminal convictions resulting in 3 prison sentences, 2 suspended sentences, 2 community service orders and one offender being fined.
- Civil orders against 134 individuals and companies
- 5 individuals banned
- Enforceable undertakings accepted from 2 entities
- Negotiated outcomes with 4 entities

Licensed Intermediaries

- 3 criminal convictions resulting in 2 prison sentences and 1 suspended sentence
- 18 individuals banned and 1 entity had its licence revoked
- Enforceable undertaking accepted from one entity

Advertising (Hawking, False and Misleading Statements)

- Civil orders against 9 individuals and companies
- Enforceable undertakings accepted from 1 entity
- Negotiated outcomes with 1 entity

2005/2006

Summary

In 2005/2006, ASIC completed 91 consumer protection enforcement actions.

The breakdown of this activity by type was:

- 20 criminal actions against 23 defendants
- 53 civil actions against 182 defendants
- 18 administrative actions against 20 defendants.

Detailed breakdown

Credit

- Civil orders against 2 individuals
- Enforceable undertakings accepted from 2 entities

Unlicensed Conduct

- 7 criminal convictions resulting in 4 prison sentences, 2 community service orders and 1 good behaviour bond
- Civil orders against 136 individuals and companies
- 3 Individuals banned and 1 entity was refused a licence
- Enforceable undertakings accepted from 2 entities
- Negotiated outcomes with 2 entities

Licensed Intermediaries

- 5 criminal convictions resulting in 1 prison sentence, 3 suspended sentences and a fine being imposed on one offender
- Civil orders against 4 individuals and companies
- 5 individuals banned, 1 entity had its licence revoked
- Enforceable undertakings accepted from 3 entities
- Negotiated Outcomes with 2 entities

Advertising (Hawking, False and Misleading Statements)

- 2 criminal convictions resulting in 1 prison sentence and 1 good behaviour bond
- Civil orders against 16 individuals and companies
- 5 individuals banned

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- Enforceable undertakings accepted from 1 entity

2004/2005

Summary

In 2004/2005, ASIC completed 57 consumer protection enforcement actions including:

- 16 criminal actions against 19 defendants
- 34 civil actions against 99 defendants
- 7 administrative actions against 9 defendants.

Detailed breakdown

Credit

- 3 criminal convictions resulting in 3 prison sentences
- Enforceable undertakings accepted from 2 entities

Unlicensed Conduct

- 4 criminal convictions resulting in 2 fines, 1 community service order and 1 suspended sentence
- Civil orders against 70 individuals and companies
- 5 individuals banned
- Enforceable undertakings accepted from 1 entity

Licensed Intermediaries

- 3 criminal convictions resulting in 2 prison sentences and 1 suspended sentence
- Civil orders against 6 individuals and companies
- 2 individuals banned
- Enforceable undertakings accepted from 2 entities

Advertising (Hawking, False and Misleading Statements)

- 3 criminal convictions resulting in 2 prison sentences and 1 suspended sentence
- Civil orders against 17 individuals and companies
- Enforceable undertakings accepted from 3 entities

Unconscionable Conduct

- 2 individuals banned