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22 August 2007

Consumer Policy Inquiry
Productivity Commission
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Dear Sir,

The Australian Bankers' Association (ABA) is the peak national body representing banks that are authorised by the Australian Prudential Regulation Authority (APRA) to carry on banking business in Australia.

The ABA has twenty five members including the four large Australian banks, other retail banks and foreign banks that are active participants in the Australian consumer banking market.

It is timely that the Productivity Commission has been requested by the Treasurer to undertake this inquiry into Australia's consumer policy framework and the ABA welcomes it.

The Issues Paper raises a series of questions that the ABA has attempted to deal with by making some more general observations and recommendations rather than attempting to answer each question.

From a financial services perspective the consumer policy framework includes a mixture of State and Federal legislation and codes. The principal instruments are listed below.

Commonwealth Legislation

- Corporations Act 2001 and in particular Chapter 7 regulating retail financial services other than credit.
- Australian Securities and Investments Commission Act 2001 investing ASIC regulatory power in relation to the financial services regulated under Chapter 7 of the Corporations Act together with a

broad regulatory power in relation to market conduct associated with retail credit facilities.

- Trade Practices Act 1974.
- Banking Act 1958 that provides the basis for the prudential regulation of banks and other authorised deposit taking institutions.
- Privacy Act 1988.
- Do Not Call Register Act 2006.

State and Territory Legislation

- Consumer Credit Code (UCCC) - nationally uniform template consumer credit legislation.
- Contracts Review Act 1980 (NSW) regulating unjust contracts.
- Fair trading acts, for example the ACT Fair Trading Act that regulates offers for credit card credit limit increases and Part 2B of the Victorian Fair Trading Act 1999 that provides that an unfair term in a consumer contract is void.

Self Regulation

- Code of Banking Practice - developed by the ABA and currently to be reviewed.
- Electronic Funds Transfer Code of Conduct – developed by ASIC and adopted by all authorised deposit taking institutions but only a handful of other providers of electronic fund transfer facilities.

At first glance, the perception could be that the consumer policy framework for financial services is disjointed particularly in a legislative sense because legislative responsibility lies unevenly between the Commonwealth and the States and Territories, a total of nine governments and even more regulators some of them overlapping with Commonwealth regulators.

Regulatory challenges

The ABA submits that the challenge for a federal system is first integrate and coordinate its processes of regulatory policy development to ensure there is national consistency in regulation. It is not necessary to concentrate all legislative power and the entire framework under the jurisdiction of one government i.e. the Commonwealth provided there is national consistency between jurisdictions.

Secondly, regulatory policy and processes should be sound. There are examples where regulatory policy and the processes for its development have been flawed and there is the prospect of those errors being continued. Altering the regulatory policy framework, of itself, will not encourage good regulatory policy development

and risks simply transferring the issue into a different forum or framework to be repeated all over again.

Thirdly, good regulatory policy requires a robust set of processes that ensure that any decision to introduce regulation is preceded by adequate assessment of the perceived issues to be addressed, thorough consultation on the issues, the avoidance of pre-emptive regulatory interventions that fail to achieve their objectives and the need to apply the right solution design to address the problem.

The ABA's approach to this inquiry into the consumer policy framework is to concentrate on the failings within the current consumer policy framework in relation to regulatory policy, its development and its processes. The failings have occurred principally at State and Territory (jurisdictions) level (but not necessarily by all jurisdictions) and also at Commonwealth level and include:

- a lack of cohesion between jurisdictions leading to national disuniformity;
- inadequate consideration of existing regulation (legislative and self regulatory) affecting specific sectors, for example the financial services sector;
- an approach to consumer protection regulation that is presumptive of regulatory solutions;
- inadequate identification and understanding of the perceived market failure intended to be addressed by regulation;
- lack of adequate consultation and consultative processes that are based on a pre-determined policy outcome; and
- inadequate recognition of alternative options, including self regulation or no action at all.

The Rationale for Consumer Policy

The ABA supports the principle that well informed consumers leads to the more efficient and competitive provision of goods and services and is fundamental to good consumer policy development.

Applying this principle means there should be clear, concise and effective regulatory provisions that foster comparable standards of information upon which consumers may base decisions and a recognition of the scale of operation of large nationally operating financial institutions such as banks.

Consumer regulation should be nationally uniform or at least nationally consistent. Uniformity, or consistency, in regulation is an aid to national regulatory compliance that permits banks and other large organisations to standardise information, contractual requirements and practices under legislation consistently across Australia. This is a benefit for consumers as well as an efficient application of the relevant regulation by industry.

In these ways both objectives, well informed consumers and efficient, compliant, and competitive delivery of financial services, can be achieved.

The Approach to Consumer Protection Policy

The starting point for considering the need for regulatory intervention is that there is a clear market failure.

Next, having clearly identified the market failure, an assessment of the options that are available to address the market failure having regard to the national implications of intervention is needed.

If the market failure is information, it is important to ensure consumers are provided with the right amount and content of information necessary to assist them to make rational decisions.

In January 2006 the "Rethinking Regulation: Report of the Taskforce on Reducing Regulatory Burdens on Business" was released. The Taskforce was chaired by the Commission's Chairman, Gary Banks. The Australian Government's response to the Taskforce report endorsed, relevantly, recommendation 7.1 which provided -

"Endorse the Principles of Good Regulatory Process

The Australian Government should endorse the following six principles of good regulatory process;

- Governments should not act to address "problems" until a case for action has been clearly established.
- This should include establishing the nature of the problem and why actions additional to existing measures are needed, recognising that not all "problems" will justify (additional) government action.
- A range of feasible policy options – including self regulatory and co-regulatory approaches – need to be identified and their benefits and costs, including compliance costs, assessed within an appropriate framework.
- Only the option that generates the greatest net benefit for the community, taking into account all the impacts, should be adopted.
- Effective guidance should be provided to relevant regulators and regulated parties in order to ensure that the policy intent of the regulation is clear, as well as the expected compliance requirements.
- Mechanisms are needed to ensure that regulation remains relevant and effective over time.
- There needs to be effective consultation with regulated parties at all stages of the regulatory cycle."

The ABA strongly endorses this approach.

The Issues Paper raises a series of questions of a theoretical, economic nature such as the rationale for government intervention to empower and protect consumers and the emergence of new theories about the role and nature of regulation.

Fundamentally, the ABA's view is that Australia's consumer policy framework can work better without grafting onto flawed processes new theoretical models where the same problems are liable to be repeated.

The Development of Consumer Policy

An effective national consumer policy framework should serve the two fundamental objectives of well informed consumers and efficient, compliant, and competitive delivery of financial services. In practical terms the ABA believes that better consumer regulatory policy will result if the following process steps, at least, are observed:

- (1) An open and genuine consultation with industry (this is not meant to exclude other stakeholders but rather to ensure there is a balanced, unbiased consultation with industry) is undertaken to assess the nature and extent of any perceived market failure;
- (2) Research is undertaken that establishes the existence of a substantial market failure that is considered warrants some form of intervention;
- (3) Full consideration of all intervention options including non-regulatory options;
- (4) Assessing any regulatory proposal to ensure that it will address the proven market failure;
- (5) Any regulatory intervention is supported by a robust regulatory impact assessment that includes a rigorous cost benefit analysis.

The Current Consumer Policy Framework

The community generally is free to make good and bad decisions. Failure, or bad decision-making, is not preventable but it can be minimised.

Financial literacy programs by the ABA and its member banks are working to raise the general standards of financial literacy among Australians as a preventative strategy to poor decision-making.

There would be general agreement that outcome orientated regulation of general application, for example section 52 of the Trade Practices Act (repeated in the ASIC Act in relation to financial services) proscribing deceptive and misleading conduct has served the community well. This type of regulations benefits industry because it does not instruct industry how to comply; only that it must comply and it is for industry to develop its own compliance arrangements accordingly.

However, not all regulations are as widely recognised as beneficial. The ABA believes there is scope to reduce the regulatory burdens on business with corresponding increased certainty for consumers through this form of regulation. This type of regulation reduces the capacity for regulatory arbitrage (for example, the mandatory comparison rate) and "special pleading" leading to a more competitively neutral regulatory environment.

A similar but slightly different approach with the same objectives is principle-based regulation where, again, business is assigned the function of developing its compliance arrangements according to the business' operational environment.

The Commission may wish to form a view about the division of legislative responsibility between the Commonwealth and the jurisdictions for consumer protection in financial services.

An area where this division exists and has been the subject of some debate concerns the regulation of consumer credit currently regulated under the UCCC pursuant to the uniformity agreement between the jurisdictions. National uniformity under the UCCC has been largely successful in those areas of agreed uniformity under the agreement. However, some jurisdictions choose fair trading legislation as a means of regulating an aspect of consumer credit, for example the ACT example referred to above, and so circumventing the uniformity agreement.

Examples of failures in consumer regulatory development

1. Mandatory Comparison Rate

The introduction of the mandatory comparison rate (MCR) occurred in July 2003 by amendment to the uniform Consumer Credit Code (UCCC). The MCR was conceived as a simple legislative solution for consumers to better understand the cost of credit facilities. The MCR ignores other relevant factors that drive a consumer's credit decision and assumes a consumer's decision is based only on price. The costs to the consumer credit industry were significant to implement and comply with the MCR and these costs are continuing. The MCR has produced distortions in the consumer credit market because certain credit providers have developed fee models or designs that avoid the need to disclose the MCR or that achieve disclosure of a lower MCR than otherwise would have been the case.

Consumers, the intended beneficiaries of the MCR, were confused about the nature of the disclosure and its value. They misunderstood what the MCR disclosed. Bank surveys of customers revealed examples where customers believed a bank's disclosure of the MCR was the (higher) annual percentage rate of a competitor financial institution.

The regulatory development process at the time was not based on written policy papers and a regulatory impact statement was not prepared. A National Competition Policy Review of the UCCC in 2000 did not specifically recommend introduction of the MCR.

Research undertaken by Hawkless Consulting on behalf of the Ministerial Council on Consumer Affairs (MCCA) since the MCR was introduced was unable to establish that the MCR had met its objectives.

The MCR legislation included a "sunset" provision, 30 June 2006. Two extensions of the sunset period were made by the MCCA, for one year in 2006 and a further two years to 2009, despite the research available to it from its own consultants Hawkless Consulting. The decision to further extend the MCR for two years to 30 June 2009 made without further consultation with industry. The decision included a statement that this extension could be shortened should the MCCA consider this appropriate.

In the meantime, credit providers have been reminded by the regulators that they must continue to comply (and incur further costs while consumers continue to receive the confusing MCR disclosure) with the MCR legislation.

In these two respects the consumer policy framework has failed consumers and industry.

2. Regulation of Finance Brokers

This failure is about inaction, not flawed action.

It is an unfortunate reflection on Australia's consumer policy regulatory framework that for over 5 years despite the widely agreed need for nationally uniform regulation of finance brokers, a need supported by the finance broking industry, has not occurred. Instead, because of delays in the process of securing the agreement of all jurisdictions through the MCCA, individual jurisdictions are taking their own steps to fill the void. This is likely to lead to disuniformity of regulation across the country. This is neither in the interests of consumers nor the finance broking and consumer credit industries.

3. Financial Services Reform Legislation

Referred to generally as the FSR, this legislation is found in Chapter 7 of the Corporations Act. The FSR was an ambitious legislative initiative by the Commonwealth supported with a limited referral of power by the jurisdictions. The origins of the FSR are found in the report Wallis Inquiry (Financial System Inquiry Final Report March 1997) that recommended that financial services regulation should be based on functional equivalence rather than on an institutional basis. The Commonwealth Government's response to the Final Report endorsed this approach.

There was extensive consultation with industry and consumer advocates. A number of Parliamentary inquiries were conducted on discrete aspects of the proposed regime. Concerns by banks and other financial services providers that the FSR regime lacked scale and proportion were not addressed in the early stages. Concerns expressed by the ABA and other financial services associations that a "one sized fits all" functional approach would mean complexity,

inconvenience and excessive documentation for consumers for simple well understood financial services products, such as basic deposits products, materialised once the regime had been implemented.

To the Commonwealth's credit, significant steps have been taken to re-align the FSR regime to deal with these and other issues of complexity. The ABA, other financial services associations and consumer groups have welcomed the Government's initiatives in this regard. Recognition of the notion of simpler regulation in financial services seems to be a product of the FSR process.

However, it should not be overlooked that banks and the financial services industry incurred very significant costs in introducing and complying with the requirements of the FSR regime and continue to incur significant costs in availing themselves of the simplified but welcome arrangements.

4. Telemarketing and the Do Not Call Register Act 2006

The policy objective of empowering consumers to elect whether they should be subjected to telemarketing "cold" calls is unquestionably valid and is supported by the ABA.

In the case of financial services this policy objective was achieved first with the enactment of the private sector provisions of the Privacy Act in 2000 (National Privacy Principle 2.1 (c)) and the anti-hawking provisions of the FSR (section 992A) which regulate the types of calls that can be made to customers and the protocols for making such calls.

At about the same time the Victorian and New South Wales parliaments enacted their own telemarketing laws. The provisions of those States' enactments were not uniform as between each other and materially differed with the FSR legislation. Some collaborative work has been undertaken by Victoria and New South Wales since then to harmonise their respective telemarketing laws.

The Do Not Call Register Act 2006 commenced on 31 May 2007 despite the lack of certainty over key aspects of the regime that are still under consultation with the relevant department and the regulator. This has left banks and other key industry organisations in a state of uncertainty as to the precise details of their compliance arrangements. The Act adds a further dimension to the regulatory compliance burden of financial services providers that are already subject to the Privacy Act and the FSR (and the Victorian and New South Wales telemarketing laws).

The ABA submitted unsuccessfully on several occasions that the combination of the Privacy Act and the FSR delivered for customers and prospective customers of banks and other significant financial services firms comparable protection against unwanted telemarketing calls.

The approach and processes taken by the Commonwealth in this case failed the Commonwealth Government's own good regulatory process test it endorsed in its

response to the "Rethinking Regulation: Report of the Taskforce on Reducing Regulatory Burdens on Business".

The Do Not Call Register regime is to be partially funded by industry and has involved additional compliance costs for banks.

5. SPAM Act 2003

The SPAM Act is another example of a quite similar experience for banks as occurred with the introduction of the Do Not Call Register Act. Perhaps the key distinguishing feature with the Spam Act was that the ABA and banks were not circulated at all prior to the commencement of the Act or in the consultative processes in the development of the legislation.

The SPAM Act involved technical requirements that banks had to develop and implement to provide a functional unsubscribe facility for email recipients to use if they wished and replaced the more familiar "opt out" regulatory approach in other legislation with, in effect, an "opt in" approach.

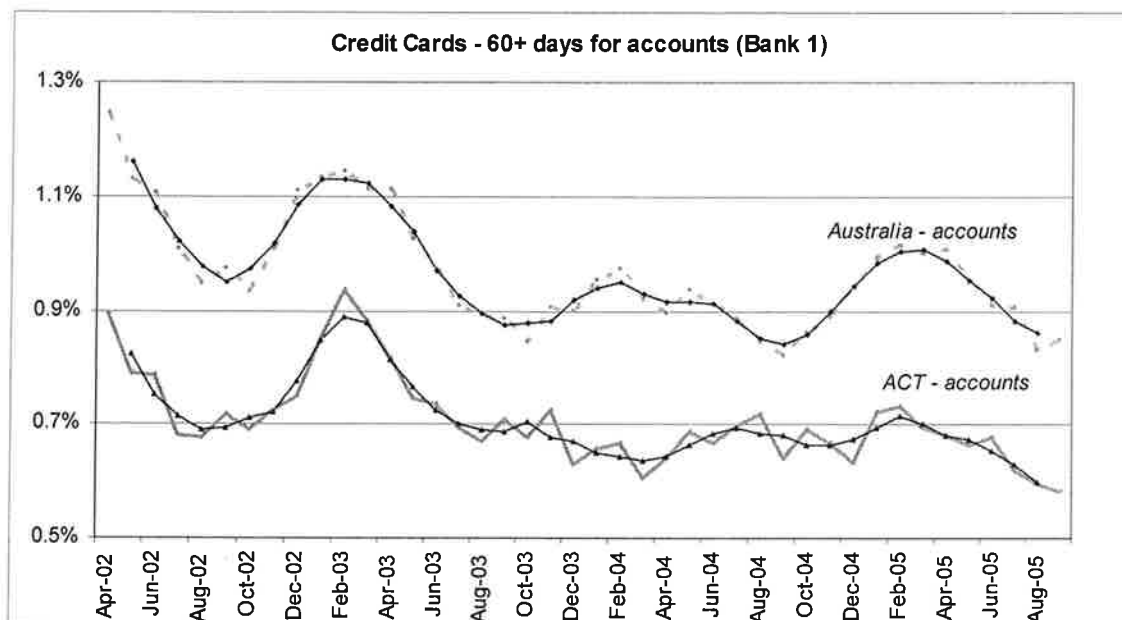
6. Australian Capital Territory Fair Trading Act

Prescriptive regulation that assumes what is best in the interests of consumers can have the opposite effect. Often where this occurs there has been inadequate identification of the market failure sought to be addressed and an equally inadequate assessment of the likely success of the supposed remedy.

An example is afforded by the 2002 amendment to the Fair Trading Act of the Australian Capital Territory. The mischief the amendment was aimed to remedy was that unsolicited offers by credit providers to their credit card customers of increased credit card limits were leading consumers into unacceptable levels of credit over commitment. The assumption was that credit providers were not carrying satisfactory credit assessments of customers before making these offers. The amendment imposed a manual credit assessment process on credit providers before an offer of a credit limit increase could be made.

Early in 2006 the ABA asked member banks for data on 60+ days arrears on credit cards in the ACT and for the rest of Australia. The aim was to test the effectiveness or otherwise of the amendment. In terms of the number of credit card accounts, the 60+ day's arrears data for ACT generally tracked in line with the rest of Australia. It is important to note that before the amendment the ACT historically had had lower rates of arrears on credit cards than the rest of Australia.

The data from member banks is summarised in the chart below. The significance of the chart is that there appears to have been no impact on the relative rates of arrears of the ACT compared with the rest of Australia.



But there was evidence of consumer disadvantage attributable to the ACT amendment. During the 2003 Canberra bushfires and afterwards consumers were unable to obtain immediate advances of credit on their credit cards due to the regulatory impediments under the ACT Fair Trading Act. More recently, media reports in the ACT cited consumer complaints about the “red tape” they had to go through to accept a credit limit increase on their credit cards.

It is surprising to note that some other jurisdictions are nevertheless attracted to the legislative model that was implemented in the ACT in 2002.

7. Proposals for Unfair Contract Terms Legislation

Since 2004 the MCCA has been proposing the adoption of national unfair contract terms legislation. Victoria implemented unfair contract terms legislation in 2003 but not extending to credit contracts regulated under the UCCC. Earlier this year a New South Wales Parliamentary Committee voted to support the introduction of unfair contract terms legislation in New South Wales based on the Victorian model.

The ABA’s members have not been affected as yet by the Victorian legislation but the legislation remains a source of concern for its potential application to banking and financial services institutions. In general, banking services contracts with consumers are substantially regulated under legislation or codes that ensure that:

- (1) consumers receive notice of any unilateral variation in the price or characteristics of banking services;
- (2) where there is a breach of contract the party in breach is liable;
- (3) in the absence of breach by the customer (for example default in repayment of a loan where interest will continue to accrue until the

loan is repaid), the provision of the relevant banking services and payment are mutual obligations; and

- (4) the customer retains the right to terminate the contract at will.

In the UK, the unfair contract terms legislation has been used recently by the UK Office of Fair Trading to implement a form of price control on banks by placing a monetary cap on what the OFT describes as credit card "default fees". Consumer advocates in Australia are calling for similar legislation here.

The Victorian model and the model in the UK would place at risk standard banking contractual documentation that is so important for managing regulatory compliance risk, cost efficiency. It also places unilateral variation clauses in banking contract that are necessary for the reasonable and efficient operation of ongoing banking products and services.

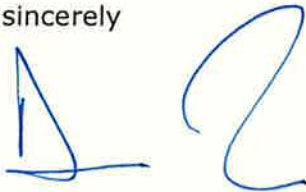
Australia's record on consumer protection regulation can be characterised in at least two ways. There has been some effective regulation, an example being section 52 of the Trade Practices Act because it has been principles based focussing on the outcome. But in other cases there has been a presumption of consumers' needs and interests and prescriptive in approach without necessarily achieving the right outcome, an example being the MCR.

The theme running through the above examples is about processes and a regulation driven culture as for solving all public policy issues. "Regulation" is far too commonly the only call in response to a public policy issue.

The ABA would like to meet with the Commission to discuss the matters raised in this letter and matters that the Commission would particularly like to hear about from the ABA in light of submissions already received by the Commission.

Please contact me with a view to arranging a meeting to have that discussion.

Yours sincerely



David Bell