ASIC

Australian Securities & Investments Commission

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8 February 2008

Mr Gary Banks
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Dear Gary

Productivity Commission Review of Australia's Consumer Policy Framework

ASIC welcomes the opportunity to comment on the Productivity Commission's Draft Report on Australia's consumer policy framework. The review is timely and important and ASIC is pleased to be involved in it.

ASIC's detailed submission is attached. This submission follows ASIC's first submission to the review, dated 10 August 2007, which set out:

- ASIC's role as a consumer protection regulator and how ASIC performs the role;
- high level views on the broad issues raised in the Productivity Commission's January 2007 Issues Paper; and
- detailed comment on developments and issues ASIC has encountered as a consumer protection regulator responsible for administering the *Australian Securities and Investments Commission Act 2001* and Chapter 7 of the *Corporations Act 2001*.

The Productivity Commission's draft recommendations raise significant policy issues that are matters for the Australian state and territory governments. Because they are properly matters for government, this submission does not comment on the merit of those policy recommendations.

Rather, this submission provides further information and specific comments on some practical implications of the Productivity Commission's draft recommendations for consumer protection in financial services. In particular, this submission comments on the following draft recommendations:

- Draft Recommendation 4.2: The new generic consumer law should apply to all transactions, including financial services.

- Draft Recommendation 5.2: Transfer responsibility for consumer credit to ASIC immediately
- Draft Recommendation 7.1: Introduce a prohibition on unfair contract terms
- Draft Recommendation 9.2: Consolidate financial services EDR schemes
- Draft Recommendation 9.6 and 11.3: Enhanced support for legal aid, financial counselling and consumer advocacy
- Draft Recommendation 10.1-10.3: Additional enforcement tools
- Draft Recommendation 11.1: Urgent reform of financial services disclosure requirements
- Draft Recommendation 11.2: Evaluate effectiveness of consumer education measures.

We would be happy to meet with you to discuss any aspect of the submission or to provide more detail on request.

Yours sincerely

Jeremy Cooper
DEPUTY CHAIRMAN

attach

Australian Securities and Investments Commission

Productivity Commission Review of Australia's consumer policy framework: second ASIC Submission

February 2008

Contents of this submission

1 This submission provides further information and specific comments on some practical implications of the Productivity Commission's draft recommendations for consumer protection in financial services, namely:

(a) Draft Recommendation 4.2: The new generic consumer law should apply to all transactions, including financial services

(b) Draft Recommendation 5.2: Transfer responsibility for consumer credit to ASIC immediately

(c) Draft Recommendation 7.1: Introduce a prohibition on unfair contract terms

(d) Draft Recommendation 9.2: Consolidate financial services EDR schemes

(e) Draft Recommendation 9.6 and 11.3: Enhanced support for legal aid, financial counseling and consumer advocacy

(f) Draft Recommendation 10.1-10.3: Additional enforcement tools

(g) Draft Recommendation 11.1: Urgent reform of financial services disclosure requirements

(h) Draft Recommendation 11.2: Evaluate effectiveness of consumer education measures.

Contents

A Concurrent ACCC-ASIC jurisdiction over financial services

2 The Productivity Commission draft report recommends introducing a generic consumer protection law that would extend to financial services to be administered by the ACCC. ASIC would remain the primary financial services regulator (DR 4.2). This is a policy matter for Government. Nevertheless, if it proceeds, ASIC is confident that the two agencies can work together to develop and implement effective arrangements to coordinate regulatory activity, avoiding unnecessary overlaps or gaps and ensuring that it is clear for consumers and other stakeholders which agency to take up their complaint or issue with in the first instance.

B Consumer Credit Regulation

3 The Productivity Commission draft report recommends that responsibility for regulating finance brokers and other credit providers should be transferred to the Australian Government, with the regulatory requirements being encompassed within the regime for financial services administered by ASIC. As part of this transfer:

(a) the Uniform Consumer Credit Code and related credit regulation, appropriately modified, should be retained. The Australian state and territory governments should determine the precise requirements and how to incorporate them within the broader financial services regime;

(b) a licensing system should be introduced for finance brokers that amongst other things requires them to participate in an EDR scheme; and

(c) a registration system should be introduced for credit providers not already required to hold an AFSL, that requires them to participate in an EDR scheme (DR 5.2).

4 The draft recommendations seek to address issues with the current regulation of credit, many of which were outlined in ASIC's previous submission.

5 We offer the following comments about the practical implications of the recommendations and questions that would arise in their implementation to assist the Productivity Commission formulate its final position on these issues.

Background

6 While currently primary responsibility for regulation of credit remains with the states, since taking on the federal jurisdiction for credit in 2002, ASIC has sought to play a significant role in relation to emerging issues in credit. ASIC has sought to achieve outcomes through a targeted combination of research, compliance and enforcement work, work with industry bodies and consumer education. In particular:

(a) The report ASIC published in 2004 on emerging issues in mortgage broking drew attention to the need to regulate brokers. Follow up enforcement/compliance action, particularly around misleading and deceptive advertising helped prompt industry development of a code of practice and dispute resolution mechanisms;

(b) ASIC's two reports on equity release products have drawn regulatory and consumer attention to the issues surrounding these emerging products. We followed this up with enforcement and compliance work leading to significant industry self regulatory initiatives;

(c) ASIC's joint work with the ACCC on a debt collection code and associated enforcement work has had an impact on the level of complaint about credit related debt collection;

(d) ASIC has targeted misleading advertising that had the potential to distort consumer decision making, particularly in relation to home loans and credit cards (two products where competition has been greatest);

(e) ASIC will shortly be releasing a report on the fringes of the market, of consumers refinancing their mortgage under financial stress. Again we have taken targeted enforcement action on this problem, which is ongoing.

Licensing system under the Corporations Act

7 ASIC administers the licensing system for financial services providers regulated under Chapter 7 of the Corporations Act. This system imposes a range of requirements on financial services providers, including:

(a) Gatekeeping requirements that providers must meet in order to obtain a licence e.g. certified copies of qualification certificates, bankruptcy and criminal history checks and business references for each responsible manager nominated to ASIC- see Regulatory Guides 1,2 and 3 *ASIC Licensing Kit.*

(b) Standard licence conditions e.g. financial requirements for licensees – see Pro Forma 209 *Australian financial services licence conditions.*

(c) Ongoing consumer protection obligations e.g. the supervision, risk management, training, disclosure and financial requirements under Chapter 7 of the Corporations Act and mandatory membership of an ASIC-approved external dispute resolution scheme (EDR scheme).

8 The consumer and compliance risks that arise in the context of credit products are different from, and in many respects less significant than, the risks to retail investors arising from investment products. A consumer who enters a credit contract holds the lenders funds and makes long term promises to repay in the future, with interest. In contrast, when a retail investor acquires an interest in an investment product, it is the product provider that holds the investor's money and makes the long-term promises about its management and repayment. In addition with investment, there is a very large range of different permutations of risk, cashflows, taxation, capital appreciation and potential financial loss for the investor to consider.

9 The Chapter 7 licensing regime reflects the risks arising from the fact that product providers take investors' funds and make long-term promises in

relation to their management. For example, Chapter 7 includes financial requirements, which are designed to ensure that financial services providers have sufficient resources to conduct their business and that there is a financial buffer that decreases the risk of a disorderly or non-compliant wind-up if the business fails. It is likely that there will be scope to modify and potentially simplify the licensing regime in applying it to credit. A brief analysis of what obligations flow from the financial services licensing regime and comment on the extent to which they might apply to credit and the potential for modification is set out in Annexure A. ASIC considers that there is the potential for tailoring and simplification.

What requirements will apply?

10 In refining this draft recommendation, it will be necessary to consider what requirements would apply under the proposed regulation of credit providers and finance brokers. Annexure A identifies the main regulatory requirements under Chapter 7 and comments on their relevance to the regulation of credit. To take one example, under the Corporations Act regime, the regulator has a significant role in setting training and competency standards. In the mortgage broking industry, in the absence of regulation of these matters, industry bodies have done extensive work on setting such standards. In adapting the Corporations Act regime to credit, it makes sense to look to what industry has done in this area.

11 As noted in the attachment, there is scope for the regime to be simplified and made less onerous in the context of the different and lesser consumer and compliance risks that credit involves.

Prohibition on acting for more than one licensee

12 Under Chapter 7 of the Corporations Act, a financial services provider must either hold an AFSL or be an 'authorised representative' of a licensee. One person cannot be an authorised representative of two or more licensees unless the licensees consent or are related: Corporations Act s 916C. Licensees are responsible for the conduct of their authorised representatives. This means that finance brokers will, in practice, either need to obtain their own licence, align themselves with another licensed broking organisation willing to accept responsibility for their conduct, or act as a representative of a small number of credit providers (as getting consents from a large number of unrelated credit providers is likely to be cumbersome). Existing industry structures would need to be examined and considered in determining whether and how this and other details of the regime are applied to brokers.

Separate registration and licence systems

13 The draft report recommends introducing a registration system for credit providers that do not hold an AFSL on the basis that registration is a more cost effective way to achieve mandatory EDR scheme membership than a 'full blown' licensing system (p 91).

14 The following factors are relevant to a consideration of the appropriateness of creating two systems in credit, one for licensing of intermediaries and one for the registration of credit providers:

(a) the states have released (Nov 07) an exposure draft of proposed national uniform regulation of brokers including licensing. This approach has been through a regulatory impact process and has considerable support from government, industry and consumer groups;

(b) the goal of consistency and uniformity in the regulation of financial services remains relevant. Over time, there is significant potential for convergence across entities providing and/or advising on credit and other financial services and in some areas, e.g. margin lending, the transaction itself might combine a credit aspect with another financial service;

(c) the different compliance and consumer risks that credit raises, noted above, and the potential they raise for the tailoring of the licensing regime to the credit environment, making it simpler and more streamlined; and

(d) the need to avoid unnecessary compliance and regulatory costs.

15 ASIC acknowledges the importance of avoiding unnecessary compliance costs. However, if implemented, these recommendations would result in the establishment of dual licensing and registration systems with different compliance burdens for different types of financial services providers competing in the consumer lending market. Work done in advising a consumer or arranging a loan by an in-house employee of a credit provider would potentially be subject to a different regime from the same conduct done by a broker. This issue would be at its most acute where an entity or corporate group combines credit provision and mortgage broking with individual staff engaged in both activities. In the long term, there is a risk that this situation would lead to regulatory arbitrage.

16 Another alternative might be to have a modified version of the licensing regime apply to all participants in the provision of credit. Adjusted for the lesser consumer and compliance concerns that arise in relation to credit, a licensing system could be sufficiently streamlined so that the difference between licensing and registration is less acute both in terms of compliance and regulatory costs. Determining whether such an approach is feasible and

appropriate would require a detailed examination of the elements of a licensing regime that should apply in a credit context.

Finance brokers and credit providers

17 ASIC is not aware of any reliable public data on the number of finance brokers or credit providers operating in Australia. This is due to the current lack of a nationwide licensing or registration system for either brokers or credit providers. Among both credit providers and intermediaries, there is a number of large individual entities or groups and then mid-sized players. In both fields, there is a long tail of much smaller players which, though not responsible for a large proportion of overall lending, might require a disproportionate amount of regulatory time and resources.

18 The draft report suggests that around 90% of personal lending is provided by firms that hold AFSLs (p 90). However, under the licensing system administered by ASIC, financial services providers hold a licence that authorises them to provide specific financial services for specific financial products. ASIC's experience is that most large financial services providers generally operate a structure involving a number of different, specific purpose, corporate entities, each holding a separate AFSL with different authorisations. This means that while most consumer lending is likely to be provided by entities that belong to a corporate group that includes entities that hold one or more AFSLs, the lender itself might not hold an AFSL.

Coverage

19 Careful and detailed consideration of issues of coverage will be central to any implementation of the draft report's recommendations on the transfer of credit to the federal level. There is a significant history of problems on the boundaries of the UCCC with evidence of exploitation of exemptions or loopholes to bring lending outside the coverage of the regulation. This has included use of business purpose declarations for manifestly consumer transactions, manipulation of loans so that they appear to be for investment purposes, repeatedly rolled-over short-term loans, bills of exchange and so called 'interest free' loans. Appropriate treatment of all of these issues will need to be considered in any transfer. For the regime to be effective, it will need to be clear what is within and what is outside the transferred regime and, where transactions are outside the regime, what law applies and what agency has regulatory responsibility.

Small business borrowers and consumers borrowing to invest

20 The UCCC does not apply to credit provided to small business. On the other hand, Chapter 7 does protect small business consumers and investors. If responsibility for consumer credit moves to ASIC, there is a case for consistent coverage of small business consumers. Similarly, there is a case for examining coverage of lending for investment purposes, such as margin loans and loans for purchasing investment properties. Such loans are also presently excluded under the UCCC.

Margin loans

21 As discussed at page 19 of ASIC's first submission to this review, margin lending is increasing in Australia. According to the latest available RBA data, there were 193,000 investors owing $35.9 billion in margin loans at the end of September 2007, a 37.32% increase year-on-year. These products, although very closely linked to the investments they fund, are not regulated under Chapter 7 of the Corporations Act, because they are credit facilities.

22 The UCCC applies to credit provided or intended to be provided wholly or predominantly for personal, domestic or household purposes (and not business or investment purposes). The consequence of this is that margin loans used to purchase securities are not regulated by the UCCC.

23 Margin lending carries heightened risks for investors because it magnifies the extent of any losses suffered if the value of an investment financed by a margin loan falls. Consumers may not necessarily be aware of the extent to which margin lending contracts place the risk of changes to market conditions on them, particularly the ability of the lender to unilaterally withdraw the facility forcing full repayment, often in adverse market conditions. There is therefore a case for regulating margin lending to promote informed decision making by investors about these risks. Regulation could be under the UCCC, if it were extended to cover investment lending. Preferably, margin lending could be regulated under Chapter 7, on the basis that margin loan facilities are closely tied to the underlying investments that they fund.

24 The UCCC imposes disclosure obligations but does not require disclosure of these types of risks, which are unrelated to the price of the product. If the UCCC were extended to cover investment products, additional measures would be necessary to ensure adequate disclosure of product risks. Chapter 7 does require product issuers to disclose significant product risks and would be a suitable means by which such disclosures could be mandated for retail consumers.

Disclosure

25 The Productivity Commission recommends that the UCCC be appropriately modified and incorporated into the broader financial services regime. ASIC's first submission to the review at paragraphs 3.42 – 3.48 commented that the approach to disclosure under the UCCC tends to be highly prescriptive, yet narrowly focussed and that it might be beneficial to consider adopting a more flexible, principles-based approach to disclosure. ASIC remains of the view that there are lessons to be learned from the more flexible, principles- based approach in assessing what modifications to the UCCC are appropriate. The UCCC is now roughly 12 years old. While ASIC recognises that its use is well and truly entrenched in the industry and there would be substantial costs in changing it, the UCCC is at odds with the style of disclosure that consumers are accustomed to getting in, for example, insurance, superannuation and so on.

Quality of advice

26 Similarly, Chapter 7 imposes a quality of advice requirement for financial advice which is based on the adviser making reasonable inquiries about the personal circumstances, financial situation, objectives and needs of retail clients and taking these factors into account when formulating advice.

27 Given the differences between credit and investment in terms of consumer and compliance risks discussed above, it will be necessary to consider whether, and if so how, to modify this requirement in respect of advice about credit. Several states and territories have introduced minimum requirements for finance brokers. For example, in Western Australia brokers must not negotiate or arrange a loan that they do not genuinely and reasonably believe is appropriate for the borrower. The Ministerial Council on Consumer Affairs proposal for the national regulation of finance brokers requires brokers to assess the consumer's capacity to repay. In contrast to the situation with advice on investment, appropriateness of advice in credit does not raise difficult questions around attitude to risk and overall long term financial needs to the same degree.

Substantive regulatory measures under the UCCC

28 As ASIC pointed out at paragraphs 3.62 – 3.69 of its first submission, there are a number of regulatory measures in the UCCC that address particular consumer or compliance risks in credit that are not included in Chapter 7. These measures go beyond disclosure to the substance of credit products and contracts. For example, the UCCC:

(a) prescribes how interest is calculated;

(b) imposes procedural requirements that protect consumers who have defaulted;

(c) provides for hardship applications; and

(d) prohibits some terms.

29 Three jurisdictions have also introduced interest rate caps.

30 In determining how to incorporate the regulation of credit within the broader financial services regime, it will be necessary to consider the role of these substantive regulatory measures.

C Unfair contract terms

31 The Productivity Commission's draft report recommends introducing a limited prohibition on unfair contract terms (DR 7.1). If this recommendation were to be adopted, it would increase the regulatory tools available to ASIC and other consumer protection regulators.

32 The proposed prohibition would be limited in four ways:

(a) it would only apply to standard form contracts i.e. not to individually negotiated contracts;

(b) it would not apply to terms covering standard contract prices;

(c) it would only apply where a consumer has suffered evident detriment; and

(d) it would only apply where an unfair term is contrary to the overall public benefit.

Scope

33 The draft report identifies standard form consumer credit contracts as one area of concern in terms of unfair contract terms (p 116).

34 In relation to (a) above, the financial services industry relies on standard form contracts to sell financial products and services to retail consumers and investors. In addition to consumer credit contracts, there is a wide range of other standard form contracts in the financial services industry including contracts for:

(a) basic deposit products e.g. savings accounts and term deposits;

(b) general insurance products e.g. car insurance, house and contents insurance policies;

(c) life insurance products e.g. risk-life policies and investment life policies;

(d) superannuation products;

(e) managed investment schemes and securities i.e. prospectuses; and

(f) financial planning advice.

35 While the proposed prohibition on unfair contract terms would theoretically apply to this broader range of products, ASIC considers that it most likely to have application in relation to some existing issues in credit contracts (as identified by the Productivity Commission) and potentially in relation to some issues in deposit products. In practice, we think it would not be regularly or widely applied to other financial services arrangements.

Impact of limitations on proposed prohibition on unfair contracts

36 The draft report concludes that the existing prohibition on unconscionable conduct is very costly, slow and uncertain to apply – actions often take years to progress and cost hundreds of thousands and sometimes millions of dollars for single cases (p 120 and appendix D). The unwieldy nature of the existing prohibition on unconscionable conduct is one reason cited by the Productivity Commission for introducing a prohibition on unfair contract terms.

37 The perceived benefits of an unfair contracts regime over the existing unconscionable conduct and unfair contracts regimes are:

(a) a more proactive approach, seeking to address unfair terms before they are relied upon and generate, potentially widespread, losses and disputes;

(b) the ability to deal with the use of a particular term across all contracts where it is in place;

(c) examination of the issue of the possible unfairness of the term in light of the overall market rather than the circumstances of a particular individual; and

(d) a focus on the removal of unfair contract terms rather than compensatory measures for cases where they have been relied upon.

38 However, limiting the proposed prohibition to situations where an unfair term has resulted in consumer detriment in a particular case, coupled with the potential for damages orders in relation to all consumers who have been subject to detriment, refocuses attention on individual circumstances, how the contract term has been applied in the past, and issues around loss and compensation. This may significantly negate the perceived benefits noted above.

D Complaints handling

39 The Productivity Commission recommends consolidating all existing financial services EDR schemes into a single umbrella scheme with independent arms (DR 9.2).

40 This recommendation is an extension of the current convergence process involving the three biggest EDR schemes: the Banking and Financial Services Ombudsman (BFSO), the Financial Industry Complaints Service (FICS) and the Insurance Ombudsman Service (IOS). ASIC supports the convergence process.

41 The Productivity Commission also comments that the converged EDR scheme should adopt a common monetary limit that matches the higher limits currently used by several ombudsmen (p 159-160).

42 On 26 November 2007, FICS announced that the monetary limits for investment complaints would increase from $100,000 to $150,000 and the limits for life insurance complaints would increase from $250,000 to $280,000. These changes will apply from 1 July 2008. FICS has also committed to keeping the monetary limit under review.

43 ASIC's view is that FICS should move quickly to increase its monetary limit for investment complaints to $280,000, in line with comparable schemes such as the BFSO.

44 ASIC also considers that a consumer or investor with a claim in excess of the monetary limit applied by any scheme should be able to waive the excess and have their claim met up to the monetary limit, rather than not receive any compensation at all. ASIC approves the existing financial services EDR schemes under Corporations Act s 912(2)(B)(i). Our policy on the approval process is set out in ASIC Regulatory Guide 139, *Approval of external complaints resolution schemes* and Regulatory Guide 165, *Licensing: internal and external dispute resolution*.

45 Licensees are required to have arrangements for compensating retail clients for losses they suffer as a result of a breach by the licensee or its representatives of their obligations under Chapter 7. These requirements apply from 1 January 2008 for new licensees and from 1 July 2008 for existing licensees.

46 Most licensees will meet this requirement by holding adequate professional indemnity insurance. ASIC Regulatory Guide 126 *Compensation and insurance arrangements for AFS licensees* sets out ASIC's policy on the minimum standards that constitute adequate professional indemnity

insurance. These requirements will apply during a two-year transition period. At the end of this period, ASIC expects licensees to have a higher standard of insurance. We will work with the insurance industry to encourage the development of products that achieve this higher standard.

47 Many financial services providers rely on professional indemnity (PI) insurance to meet determinations by their EDR scheme. Many FICS members hold PI insurance policies that reflect the current FICS monetary limits. These will need to be modified in light of the recent increases to FICS monetary limits. Further increases will also impact on PI insurance policies. ASIC will work with industry to ensure that PI insurance cover reflects increases in monetary limits.

48 Given industry reliance on professional indemnity insurance to meet EDR scheme determinations, it is likely that improving the coverage and scope of professional indemnity insurance will ultimately improve outcomes for consumers accessing EDR schemes.

49 ASIC plans to review our policy on the approval process, dispute resolution and PI insurance more widely in 2008. As part of the review, we will explore the question of monetary limits and requiring EDR schemes to enable consumer and investors with claims that exceed a scheme's monetary limits to waive the excess and have their claim met up to the monetary limit, rather than not receive any compensation at all.

E Counselling and advocacy

50 The Productivity Commission recommends that Australian Governments should provide enhanced support for legal aid, financial counselling, consumer research and the operating costs for a peak consumer body and the networking and policy functions of consumer groups (DR 9.6 and DR 11.3).

51 As a regulator ASIC is keenly interested in understanding the consumer experience of financial services. It relies on frontline consumer agencies such as consumer legal centres, consumer groups and financial counsellors to identify compliance issues and regulatory gaps as well as to provide data for consumer research. It can at times be difficult to get reliable information of this kind. To the extent that this is attributable to a lack of resources among the relevant agencies, this recommendation would help alleviate that difficulty.

F Enforcement

52 In relation to the approach to enforcement, ASIC supports the PC's recommendation for regulatory agencies to focus on systemic breaches and reporting focusing on the identification and addressing of regulatory issues.

53 The enforcement "toolkit" of powers set out in the report are, by and large, consistent with the range of enforcement powers that are available to ASIC. ASIC would expect that banning orders and substantiation notices would be required as part of a registration/licensing system for regulation of credit in Australia. ASIC is supportive of the PC's recommendation for a study of the merit of a cease and desist power. While a disgorgement remedy would be valuable in addressing certain conduct that breaches consumer protection provisions, in the majority of consumer protection cases it would not be appropriate for ASIC to take civil penalty action, due to the increased time and resources needed to prepare a civil penalty case. Difficulties include the defendants being able to claim privilege against self incrimination and exposure to a penalty, defendants not being required to file affidavits before ASIC's case is closed and not being required to serve evidence of other witnesses, including expert witnesses. While ASIC can envisage cases where having the ability to take civil penalty action could be useful, it is of the view that these cases will be exceptional.

54 ASIC has had some experience with representative proceedings through actions it has brought under s50 of the ASIC Act. This provision requires all individuals who are to be parties to the proceedings to provide their written consent. In ASIC's experience, it is administratively burdensome (and in some cases prohibitively so) to use s50 in a proceedings where there are a large number of potential plaintiffs. A provision that did not include this requirement of consent could be very effective in some cases, particularly where large numbers of people were affected and the best outcome would be obtained by prompt commencement of proceedings.

G Disclosure

55 The Productivity Commission recommends urgent reform of mandatory disclosure requirements in financial services (DR 11.1).

56 ASIC is actively working towards improving disclosure to retail investors. Our work in this area includes introducing specific disclosure requirements for unlisted, unrated debenture products and establishing a retail investor taskforce which will have a significant focus on disclosure issues.

Unlisted, unrated debentures

57 On 31 October 2007, ASIC released new requirements to improve disclosure to retail investors in the unlisted and unrated debentures market. The requirements are based on an 'if not, why not' style of reporting. Issuers are required to report to investors against specified benchmarks, for example benchmarks relating to credit ratings. Issuers that do not use these benchmarks are required to explain why. See Regulatory Guide 69 *Debenture – improving disclosure for retail investors*.

58 As part of its broader work in this area, ASIC has commissioned further and more detailed investor research to obtain better information about the characteristics, preferences and decision-drivers of investors in these products. This research will also involve consumer testing key messages and investor education materials among a sample of retail investors to evaluate their usefulness in helping investors assess investments using the enhanced disclosure.

Retail investor taskforce

59 In December 2007 ASIC established a retail investor taskforce. One of the objectives of the taskforce is to work with industry and other stakeholders to address the length and complexity of disclosure documents.

Layered approach to disclosure

60 The Productivity Commission recommends that disclosure requirements should require that complex information is layered, and endorses the previous Australian Government's proposals to permit some information required to be in Product Disclosure Statements (PDSs) to be incorporated by reference to a website (p 212).

61 A key issue for this disclosure model is whether the product issuer is held responsible for the content of the incorporated material. Under the Corporations Regulations reg 7.9.15DA, the product issuer is responsible for information that is incorporated into a PDS by reference (Corporations Amendment Regulations and (2007) (No 10)). ASIC supports this approach.

Comparison rates

62 The Productivity Commission also notes that recent research into the effectiveness of mandatory comparison rates for fixed term loans found that few consumers understood how to use the comparison rate (p 208). Mandatory comparison rates were introduced in 2003 in response to credit providers introducing multiple fees for credit products, particularly home loans. This meant that consumers were no longer able to compare the cost of products by comparing interest rates and it was becoming increasingly difficult for consumers to compare costs at all. However, neither the State and Territory governments responsible for administering these requirements, nor industry, have invested significant resources in promoting these requirements to consumers or educating the community about how to make the most of them. Promotional and educational activities are crucial to the success of such requirements. In other jurisdictions, where there has been more attention given to implementation and promotion, consumers appear to have benefited.

63 The Productivity Commission also strongly endorses increased consumer testing of the design of mandatory disclosure documents (p 210). ASIC strongly supports mandatory consumer testing of financial services disclosure documents.

H Education

64 The Productivity Commission recommends that Australian governments should commission a cross-jurisdictional evaluation of the effectiveness of consumer education measures, especially those that deal with higher risk issues or are expensive. ASIC welcomes this recommendation.

Attachment A

ASIC Submission on Draft Report of Productivity Commission Review of the Consumer Policy Framework

8 February 2008

Outcomes achieved by the Australian Financial Services licensing regime

Objectives behind the introduction of the Australian financial services licensing (AFSL) regime were to:

- *enable a single licensing regime* for financial services providers (persons who advise on, deal in or make a market for financial products, operate managed investment schemes or provide a custodial or depository service);
- *ensure minimum standards of competence and conduct* for financial service providers are met during and after the licensing process via the licensing conditions;
- *simplify the regulatory regime* by reducing the need for finance intermediaries and professionals to hold multiple licences to offer different financial products and services;[1] and
- *ensure consistent* levels of market integrity and consumer protection.[2]

Practical outcomes

The licensing regime is designed to achieve the following practical outcomes:

- licensees have adequate resources, systems and controls;
- licensees and their representatives are competent, skilled and experienced to provide the relevant services;
- licensees monitor, supervise and take responsibility for (including compensation as needed) their representatives;
- services are provided with reasonable care (particularly personal advice, which must be 'reasonable'); and
- clients are provided with key information regarding the licensee they are dealing with and the advice they receive.

To achieve these outcomes, the *Corporations Act 2001* (**the Act**) imposes the following ongoing obligations on licensees:

- the licensee and its senior managers must be fit and proper;
- provide financial services efficiently, honestly and fairly;
- have adequate arrangements to manage conflicts of interest;
- ensure representatives are adequately trained and competent, and comply with the law;
- maintain adequate resources to provide relevant financial services and supervise representatives;

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[1] Explanatory Memorandum to Financial Services Reform Act 2001

[2] Senator Helen Coonan, Second Reading Speech, 22/8/01

- maintain the licensee's own (ie its responsible managers') competence, skills and experience;
- maintain internal and external dispute resolution systems where clients are retail consumers;
- maintain adequate risk management systems (unless regulated by APRA);
- have adequate arrangements to compensate retail clients for losses;
- notify ASIC of significant breaches;
- ensure any personal advice is on a reasonable basis;
- provide key disclosure documents e.g. financial services guide (disclosing the service provided, commissions and relationships), product disclosure statement (identifying characteristics, fees and risks of the product in a clear, concise and effective way); a statement of advice (SOA) (containing the basis for recommendations given in personal advice, commissions and conflicts of interests); and
- properly handle client money (trust account and audit requirements).

The AFSL regime is ***modular and relatively flexible***. For example, the trust account and client property rules only apply where the licensee's business involves handling client money. Similarly, the financial requirements attaching to an AFSL depend on the actual activities being conducted by the licensee. The personal advice rules (reasonable basis, provision of an SOA) only apply when personal advice is given, and a number of exemptions apply to the SOA (general insurance, basic deposit products, further advice to the same client, 'minor' advice etc).

Appropriateness of outcomes for credit providers and intermediaries

Who are 'credit providers and intermediaries' and what do they do?

Based on the proposed National Finance Broking draft legislation,[3] they would include:

- credit providers (fixed term loans and credit cards) and their representatives;
- intermediaries who are suppliers of goods and services, who negotiate or secure credit for consumers to purchase those goods or services, or for some other purpose;
- debt and mortgage reduction services; and
- individuals and firms who assist consumers to acquire credit by accessing a list of providers.

Objectives of consumer credit regulation is identified in the Productivity Commission's draft report *Review of Australia's Consumer Policy Framework* as:

- to ensure consumers are appropriately informed when making credit decisions; and
- to protect consumers from any inappropriate conduct by credit providers or from making injudicious credit decisions.[4]

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[3] Released for consultation by the Ministerial Council on Consumer Affairs (November 2007)

[4] Productivity Commission, *Review of Australia's Consumer Policy Framework* (Appendix E, PC Report p390)

Potential Application to Credit

The table below analyses which aspects of the AFSL regime could meaningfully be applied to credit providers and intermediaries. We suspect that the debate may be more about the *degree* of regulation under each of these items, rather than whether they are relevant *per se*. For example, providers of advice on credit ought to be properly trained and experienced, but there may be debate about whether a detailed system such as the RG 146 regime (for retail financial advice) is appropriate.

AFSL requirement	**Relevant to credit**	**Comment**
fit and proper officers	✓	should not be onerous – usually requires police and bankruptcy checks etc. Needs to be made very clear that it is a negative vetting process, rather than ASIC 'approving' the business or its products
provide financial services efficiently, honestly and fairly	✓	should not be onerous
adequate conflicts management arrangements	✓	requires licensees to manage, disclose or avoid conflicts
ensure representatives are adequately trained and comply with the law	?	there may be an opportunity here to place more of the onus for setting appropriate standards on industry. In the absence of regulation, industry has [done much work] on this already
adequate resources to provide relevant financial services and supervise representatives	?	the resource issue would be less acute. Solvency concerns don't arise to the same degree
licensee's own competence & skills	?	less acute
internal and external dispute resolution systems	✓	the Productivity Commission expressly stated that dispute resolution requirements should apply
adequate risk management systems	?	less handling of client funds, fewer long term promises to consumers

adequate compensation arrangements	✓	potential claims generally smaller
breach notifications	✓	an obligation to notify ASIC if there is a breach of a financial services law
personal advice must be reasonable	✓	different and generally narrower range of circumstances to consider, eg attitude to risk less relevant for traditional consumer credit products. For these products, cost and features of credit are most relevant factors to consider. However, if credit products that involve significant risk e.g. margin loans are regulated, attitude to risk is relevant
FSG SOA PDS	? ? X	both the FSG and SOA requirements could be adapted to the credit market enabling them to be as simple as possible. Product disclosure likely to remain under adapted UCCC regime
client money rules	?	nature of credit means it would be the exception where this issue arose