Supplementary Submission to the Productivity Commission Review of Consumer Policy Framework

March 2008

Introduction

In December 2007 the Productivity Commission released a Draft Report on its Review of Australia's Consumer Policy Framework.

In February 2008 CHOICE made an initial submission in response to the Draft Report. CHOICE has also contributed to a joint consumer organisation group submission provided to the Commission in March 2008.

This submission present's CHOICE's views on the following matters:

- Scope and nature of the proposed generic law
- The need for a market inquiry process to be available to key regulators
- Further submission on supercomplaints
- Unfair contracts safe harbour provisions
- Home warranty insurance
- Implementation plan
- Ongoing work plan for consumer policy

Scope and nature of the proposed General Law

The draft report proposes that "Australian Governments should establish a new national generic consumer law to apply in all jurisdictions enacted through applied ("template") law arrangements." (Recommendation 4.1) The same recommendation suggests that the Trade Practice Act should be the starting point for drafting the law. Recommendation 4.2 further suggests that the draft generic law should apply to all consumer transactions. However the report is silent on the question of the extent to which all laws that apply to consumer transactions should be included in the generic law.

We are aware that some stakeholders – in particular some State governments – are concerned that the Draft Report recommends that the drafting of the general law should start from Part V of the current Trade Practices Act (the TPA). CHOICE supports the proposal that Part V of the TPA forms the starting point for the proposed generic law. However, CHOICE notes that there are a number of areas where the TPA has fallen behind best practice, and supports reforms to modernise and improve the TPA. The Commission itself implicitly acknowledges this in recommending significant

improvements to the enforcement powers of the ACCC and other regulators, some of those powers being available in the State Fair Trading Acts.We are concerned that innovations in the State Fair Trading Acts introduced in the past two decades should not be lost to the generic law. We note and endorse the comments on this point in the Joint Consumer Submission of March 2008.

We acknowledge that without a starting point the important work of developing the generic legislation will be slowed. We suggest that it would be useful for the Commission to explicitly identify those parts of the State Fair Trading Acts which are improvements on the TPA and recommend that they be included in the generic law.

The Draft Report does not fully specify the scope of the proposed generic law. Is 'generic' intended to convey the fact that the law would be adopted by all jurisdictions or to limit the law only to general provisions and not include industry specific or activity specific provisions currently included in State Fair Trading Acts? We believe that significant activity specific provisions (for example rules about door to door selling) should be included in the generic law.

In relation to industry specific provisions, there are several areas where CHOICE supports rationalisation either through inclusion in the generic law or through a nationally consistent regulatory approach. Examples include:

- any financial services laws which do not become the responsibility of the Commonwealth (note however that our preferred position is that all aspects of credit and property investment are regulated by the Commonwealth)
- any rules about interstate transactions including furniture removalists
- real estate and conveyancing law
- regulation of the taxi industry.

The regulation of motor vehicle sales and motor vehicle repairs is also likely to benefit from inclusion in the generic law or an equivalent harmonisation process.

We note the ACCC's comments on a single regulator in their submission in response to the Draft Report. While we agree with the ACCC's analytical framework (see our approach under *Implementation of recommendations* below), CHOICE was unclear about the implications of the following comment in the ACCC's submission:

> In addition to fair trading legislation, state and territory governments administer a range of other legislation designed to support the efficient operation of different markets. These include occupational and business licensing and laws affecting industry-specific markets such as building services and motor vehicle sales. State and territory governments undertake enforcement action under both their fair trading legislation and other related legislation in order to deliver outcomes for consumers. Having the ability to incorporate both areas of trader non-compliance into one investigation and achieve a dual regulatory outcome represents an efficient use of regulator resources at the local level due to the synergies arising from the

joint approach.[1]

It is unclear whether the implication of this comment is that having industry specific legislation in different states is a desirable component of consumer policy. Our starting point is that industries such as motor dealers and building services should be regulated in the same way across the country – this should improve efficiency and also fairness for consumers irrespective of their location. It would also assist in the development of one set of case law, one set of problems to respond to in policy development and so on. There is also likely to be less risk of regulatory capture if policy is managed at the Commonwealth level. While some industry specific regulation may be needed in particular sectors (financial services is an obvious example), in our view the regulation of these areas should be nationally consistent and where possible captured in the generic law.

Other reasons for our support for the maximum practical uniformity include:

- increasing the ability of consumers to understand the law by keeping it the same if they change their residence to another jurisdiction
- reducing the costs of educating consumers about the law – allowing national consumer education projects
- reducing business costs and thus if markets are working prices paid by consumers
- overcoming jurisdiction specific regulatory capture by the regulated industries.

Market Inquiries

In its Draft Report the Commission did not support the introduction of provisions that would enable regulators to conduct market studies or market inquiries. We believe that the UK experience demonstrates their usefulness beyond question. We do not see anything in the UK situation that would suggest that formal provisions of this sort would not offer small but significant improvements to the policy development process in Australia.

In many ways market inquiry provisions attempt to formalise and codify activities and powers which already exist. They are a means to codify good practice in public policy development.

The key ideas are:

1. to accept the role and value of regulators in the policy development process
2. to provide mechanisms to ensure that policy development processes used by regulators accord with best practice including transparency
3. to acknowledge and extend the powers that regulators have to take action in response to their findings.

Regulators role in policy development

Regulators including ASIC and ACCC play a role in providing advice to government on matters which fall within their Acts. As an example, ASIC conducts research into emerging problems in the retail financial services market. It has played this role very successfully over the past seven or eight years. Examples include work on book up in

[1] Submission DR176 11 February 2008 p 5.

Indigenous communities, mortgage brokers and more recently the report on reverse mortgages. In each of these cases, ASIC's research focused on the nature of the market problem for consumers and businesses, and the adequacy of current laws in addressing emerging market issues. Regulators also regularly advise governments on policies around enforcement powers and penalties based on market experience and litigation experience (eg criminal penalties for cartels).

This role should be formally recognised, rather than the current ambiguous and at times inconsistent approach to policy involvement by regulators. Of course there needs to be a clear understanding of the particular contribution to policy development and market analysis that regulators can perform. This is typically limited to the areas covered by their legislative and regulatory briefs. Regulatory agencies aren't policy departments, in that they do not have a "day to day" policy role in the way that policy departments have in government – this is important to ensure that there is independence in regulatory decision making. Furthermore, regulators typically have a greater emphasis on policy as it relates to the interpretation and application of laws and regulations, rather than a focus on developing new laws or removing outdated or unnecessary laws. The exceptions to this approach will typically arise where existing powers have been tested and have been found to be inadequate to deal with market problems. This means that their policy role is of a particular type, based on their close contact with the market through their complaints handling and enforcement activities and their ability to build a skilled workforce on consumer protection issues.

Pretending that regulators have no role in policy development is not a meaningful option. It will certainly not assist in improving modern market and consumer policies. Therefore it is better to ensure that regulators operate within a sound framework for market-based inquiries.

Good practice in policy development

Generally a better policy outcome is obtained when a policy development process is undertaken in a structured way, giving all stakeholders a clear idea of the issues to be addressed, an opportunity to make submissions with sufficient time to prepare them, an opportunity to talk to those submissions, and a requirement that the body undertaking the inquiry formally and publicly report on their findings.

While there will be cases where a more streamlined process is genuinely required – for example where the problem is serious and urgent and a policy solution is needed immediately – but these will be the exception rather than the rule.

Accordingly we believe that a formal market inquiry power setting out standard operating procedures would create an expectation that this is how policy inquiries are undertaken and address concerns about inappropriate over-reach by regulators or concerns about inconsistent involvement in policy matters.

Responding to market inquiries

Regulators have an existing set of powers to enforce consumer protection law and the ACCC has powers to respond to supply side competition issues.

Current regulators also have some – often *ad hoc* – power to make other broader interventions in the market. For example those that issue licences can often require market participants to accept particular licence conditions. ASIC has the power to regulate the standards that apply to external dispute resolution schemes. ACMA can require a code of practice to be developed on a subject and then approve or not approve a code that is proposed to it. These are all effectively forms of delegated regulatory power.

What is missing is a generic power to intervene to address demand side issues.

Any market inquiries provision should include appropriately tailored provisions to allow regulators to intervene in the market. The UK Enterprise Act offers an appropriate model.

Supercomplaints

In our original submission, our February 2008 submission in response to the draft report and in the joint consumer submission we advance arguments in favour of the introduction of a supercomplaint procedure into Australian law. We note and endorse the following submission by Energywatch UK:

> Given the vast resources available to business when making representations to governments and regulators we think it essential that strenuous efforts are made to ensure that consumers, and their advocates, are given support and access to policy and decision making mechanisms. Equalising the influence and power of the supply-side and consumers should be a fundamental principle of consumer policy. A serious intention for protecting and enhancing consumer welfare would, we think, provide opportunities for individuals and consumer bodies to influence the priorities and work plans of government bodies such as the ACCC, and report on the failures and impacts of policies and where markets are not working well for consumers.
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> One of the ways this can be done is through a formal referral of issues to regulators and government departments who are then required by law to respond. Bodies making these formal referrals or complaints should be required to set out a reasonably researched case for investigation based on a standardised set of questions. This approach encourages a responsible attitude to use of a publicly-funded resource. A similar scheme has operated in the UK for the past five years and has resulted in some significant outcomes for consumers in the supply of residential care, banking and insurance.
>
> Full inclusion of consumer representation into the decision making process is, we believe, the way forward for consumer policy and market regulation. We note that the Commission is not convinced by the argument for behavioral economics but believe that it does give some valuable insights into consumer behavior and, critically, some of the barriers to better decision making. We suggest that a better understanding of the consumer experience and the way choices are made would be of value to regulators tasked with preventing consumer detriment, promoting

> choice and educating consumers to act for themselves in markets. This understanding should extend to using behavioral economics to remedy the imbalance of information between consumers and suppliers: simply require more disclosure or more information will not transform consumers into better decision makers and it should not be used as 'catch all' remedy for market failures or unfair trading. Information has to enable good decision making, if it does not then it raises the risk of adding to the confusion of choice and to the cost of goods and services.

Unfair contracts, safe harbour provisions and use of Codes to promote fair contracts

For CHOICE general views about the unfair contracts proposals in the Draft Report see our submission of February 2008. This submission provides a more detailed response to the safe harbour provision contained in the draft report in response to discussion at the CHOICE presentation to the Commission on 21 February 2008. These remarks qualify our tentative support for those provisions in our February submission.

The Draft Report recommended safe harbour provisions for individual businesses in relation to unfair contracts (recommendation 7.1). The Draft Report (Vol 2 p124) contemplates two possibilities: that regulators have the power to rule out particular terms *ex ante* as unfair (as in the UK and Victorian legislation) or a requirement that an individual consumer or consumers be shown to have suffered detriment.

We have argued in our February submission that the requirement to show actual consumer detriment prior to taking regulatory action would undermine the ability of the proposed legislation to improve market efficiency. It would also undermine the ability of regulators to engage in preventative or proactive regulation - risk-based regulatory practices that effectively minimise market problems arising in the first place - as distinct from taking an approach that only involves "sweeping up the mess" after the detriment has occurred. There are costs involved in both these approaches, but it is important not to underestimate the often considerable regulatory, transaction and legislative costs that arise in the face of reactive, "after the event" regulation.

We note that the first approach results in certainty – businesses know what terms are not allowed. This is hardly novel – a range of consumer protection legislation outlaws particular terms; other legislation requires terms to be framed in a particular way. The latter is an even more restrictive version of the former (for example the specifications in the Uniform Consumer Credit Code on how to calculate a payout figure on a credit contract mean that not only the unfair Rule of 78 may not be used – it was formerly permitted – but nor may firms devise an alternative to that specified in the UCCC).

As noted above the Commission further proposed a method for a business to seek approval in advance for particular terms: the safe harbour provision. The ACCC in its submission in response to the report has raised a number of concerns with the safe-harbour proposal set out in the Commission's draft report. We accept some of the concerns that the ACCC has raised around this point about the practicalities of dealing with many individual applications. However, CHOICE still sees scope for a version of "safe harbour" through more general industry mechanisms, such as codes, that could

provide comfort to firms that their contract terms are fair. Such mechanisms are effectively already in use in a number of Australian industries.

Restrictions on contract terms are not currently limited to legislation. Freedom to contract is currently limited *ex ante* on the grounds of fairness through various Code development processes.

Three examples of myriad ways in which this occurs include the following:

1. Codes under the Telecommunications Act
The Telecommunications Act empowers the Australian Communications and Media Authority (ACMA) to adopt Codes of practice. Once adopted these Codes become legally binding. The Codes are developed through (often tortuous) negotiation between consumer representatives and industry bodies. This is not a free bargaining process as industry players know that an acceptable Code must be developed. ACMA has power to create one of its own if none is forthcoming from the bargaining process.

Codes sometimes deal with standards matters (for example that the text message STOP be used to signal a consumers intention to leave any mobile subscription service), however very frequently they deal with contract terms (that suppliers must act on a STOP message and that they must do so within a short time frame). They also regulate certain charges. They are thus a form of *ex ante* fair contract provisions.

2. The Banking Code of Practice
This has been developed by the banking industry and consumer groups. While the Code's provisions themselves are not authorised under an enactment, that the fact that they are taken into account in decisions of the Banking and Financial Services Ombudsman (BFSO), and that banks must belong to the BFSO as a condition of their financial services licence, effectively gives the Code the status of quasi law. Again many provisions in the Code exist to ensure that contracts and conduct is fair.

It would be possible to devise a system where standard fair contracts can be developed for a particular product within an industry. The regulator would then only need to give its imprimatur to the Code to ensure that compliance with the contract terms specified in the Code would act as either presumptive or conclusive safe harbour.

The quality of industry codes
We believe that Codes have an important role to play, and that unfair contracts legislation could provide a useful framework.

We note that in their submission in response to the draft report the Communications Alliance argued that the consumer policy framework should place more emphasis on the use of self regulation. Energywatch has also - from a somewhat different point of view - argued for better use of Codes.

Communications Alliance points to the objectives of the Telecommunications Act (section 4) which among other things encourages: "The maximum use of industry self-regulation without imposing undue cost on suppliers".

If this is intended to mean that there should be a bias in favour of 'self regulation' over legislative action then we don't agree. There is no logical or empirical evidence to suggest that self regulation is always or even often more effective than other forms of regulation. Moreover what self regulation might mean is far from precise! There is a range of ways to achieve regulatory ends. In particular circumstances one tool is more likely to be appropriate than another.

Nevertheless we agree that Codes of Practice together with effective associated dispute resolution processes offer important ways to promote fairness and efficiency in consumer markets. There is a lot to be said for developing guidance for legislators about best practice in the legislative framework which encourages code development. Similarly there is a need for identified good practice for the process of developing, instantiating and managing codes. The task of developing such guidance would draw on the best provisions of current practice including parts of the Telecommunications Act, the Corporations Act and ASIC Policy Statement 139 among other material. We note Energywatch UK's submission that the Commission could usefully recommend that the Framework include best practice guidance on Code development (as well as a requirement that Ombudsman schemes comply with best practice).

We note however that the Telecommunications Act scheme is deficient in a number of ways. It does not sufficiently require the regulator to adopt only Codes which are balanced and have had a proper development process including independent chair, equal consumer and industry participation. Nor does it require the Code to be attached to a best practice external dispute resolution panel. The Telecommunications Industry Ombudsman (TIO) for example would not comply with ASIC Policy Statement 139.

Recommendation

A Guide for developing industry Codes should be developed – including guidance to policy makers about the conditions when codes are or are not appropriate (eg they are less appropriate if only partial industry coverage can be achieved) and the best legislative framework for supporting Codes. This should also cover good practice in the development and management of codes.

Unfair contract terms legislation should provide a presumption that a term of a contract which is consistent with a Code developed in accordance with the Code of Practice is fair.

Home Warranty Insurance

Home warranty/indemnity insurance is a product that consumers of building services pay for via their builder which provides very little, and usually no benefit.

In August 2004 *CHOICE Magazine* investigated home warranty insurance. That investigation found that in most states mandatory insurance was unreasonably limited to circumstances where a builder dies, disappears or becomes insolvent. CHOICE also found that the privatisation of the home warranty insurance coupled with changes to the insurance market had whittled away many consumer protection measures. We believe nothing has substantially changed since publishing this report.

CHOICE believes only the Queensland scheme currently operate in the best interests of consumers. In Queensland, the government underwrites home warranty risk. The Building Services Authority (BSA) regulates the industry and has overall responsibility for licensing, dispute management and home warranty insurance. In recent years, Queensland's home warranty insurance premiums have been well below those in most other states. And for the lower premiums they have to pay, Queensland consumers get much more comprehensive insurance than people in other states.

The current privatised home warranty scheme as it operates in most Australian states appears to primarily benefit insurers and larger building companies at the expense of consumers and smaller builders. A Queensland-style system offers much higher levels of protection for consumers as well as being easy to access for builders.

CHOICE lends its full support to the Commission's draft recommendation 5.5. We believe it addresses the issues as they exist in the industry. We further note that this issue has been the subject of numerous state and federal government reviews, including the comprehensive review undertaken by the then Trade Practices Commission. The issues in the industry are well understood and will be usefully progressed by the Commission's recommendation.

Implementation of Recommendations

A dominant theme of the Productivity Commission Draft Report is to achieve efficiencies through:

- shifting responsibility for some aspects of consumer policy from the states and territories to the Commonwealth Government
- providing for greater harmonisation in other areas.

Central to this is the proposed new national generic consumer protection law and institutional reform to support national consumer policy making.

Consumer policy in Australia has in the past suffered from a lack of prioritisation and diffusion of responsibility. The Productivity Commission review delivers a unique opportunity for the Commonwealth Government to demonstrate its commitment to consumer affairs. Decisive and prompt action on key recommendations by the Government will encourage support for a new national approach to consumer policy.

We argued in our first submission in response to the draft Report that the Commission should identify an implementation process. Such direction will aid the Commonwealth in taking up the challenge. There are also areas for action by State governments.

This section provides more detail on our views.

We think that there should be four phases, each of them starting immediately but with different end dates.

Stage 1: Immediate Action
A number of the recommendations in the draft report (and several recommendations that we have argued in this submission and our previous submission should be added to the final report) can be implemented rapidly by the Commonwealth without legislation.

- Introduce fair contract terms legislation (draft recommendation 7.1).
- Enhance the regulatory powers and responsibilities of the Australian Competition and Consumer Commission (ACCC) and other regulators as relevant (notably ASIC):
    - Provide new enforcement powers namely the right to seek civil pecuniary penalties, to apply to a court to ban an individual from specific activities, and to issue substantiation notices to traders, (draft recommendation 10.1). These changes should apply to all key Commonwealth consumer protection agencies, generally in identical terms, not just the ACCC and ASIC.
    - Require the ACCC to report on enforcement problems and their response (draft recommendation 10.3).
    - Enable the ACCC (and in our submission other Commonwealth regulators) to take representative actions (draft recommendation 9.5).
- Increase consumer input into policy development through funding the Consumers' Federation of Australia and making available funds for increased research into consumer markets (draft recommendation 11.3).
- Increase funding for financial counselling and legal aid in consumer matters (draft recommendation 9.6).
- Introduce the market inquiry powers to regulators and as recommended earlier in this submission and provide machinery for responding to super-complaints as recommended in our submission of February 2008.

At this stage the Commonwealth in partnership with the States should identify the bodies responsible for each of the tasks listed under the following three phases together.

Below we suggest that the Commission endorse an ongoing program of work on a number of current consumer policy problems. At this stage the Commonwealth should allocate to the most appropriate bodies each of the tasks in the ongoing work program.

Stage 2: Legislative action in the current year
A second group of recommendations can be implemented through legislative change that in most cases would be relatively uncontroversial.

Given any national generic law will take a little longer, the States and Territories could and should adopt identically worded provisions to amend their Fair Trading Acts to provide similar enforcement powers to these agency responsible for enforcing that Act and other consumer protection legislation.

Other legislative action required by the States should also be taken at this stage. This includes the proposals for several states to improve their statutory warranties.

Work on drafting the required State and Commonwealth bills could be commenced immediately. At the very least exposure drafts should be available within 6 months of the Commission's Final Report.

At this stage some of the more complex areas of consumer policy should be listed on the COAG agenda. These include:

- transfer regulation and enforcement of consumer credit and product safety to the Commonwealth (draft recommendations 5.2 and 4.3) and improve product safety regulation (draft regulation 8.2)
- consolidation of regulation in occupation licensing (draft recommendation 5.1 and discussion at p85, Volume 2 of draft report)
- cross jurisdictional evaluation of consumer information and education (draft recommendation 11.2)
- Improve small claims court and tribunal processes (draft recommendation 9.3)

Stage 3: Development of a generic law and transfer of credit to the Commonwealth
The transfer of powers from the states and territories and the development of the generic consumer protection law will require more detailed consideration. We recommended establishing a task force to undertake the task within a two to three year timeframe. While actually developing the text of the generic law will only be a little more complicated than the other legislative proposals (it will for the most part involve supplementing the TPA with the best provisions on particular topics found in current State law), three aspects may require additional time.

The first is to negotiate the precise machinery for ongoing policy development: how are matters identified, proposals developed, consultation conducted, decisions to act taken and how is legislative action implemented.

The second is designing legislation that will overcome the Constitutional problem of the Commonwealth having no power to regulate the commercial conduct of unincorporated firms.

The third is designing the enforcement and dispute resolution mechanisms that will operate in the absence of completion of the fourth phase of implementation below.

Stage 4: Developing effective national enforcement mechanisms
The Draft Report envisages consideration being given to a single national enforcement agency. Whether or not agreement on this can be reached, it is difficult to see the Commonwealth taking responsibility for all enforcement actions. It many not be constitutionally possible to enable the Commonwealth agencies to cover unincorporated traders. While such traders likely make up only a tiny fraction of the market, there is no doubt that some of those traders are responsible for some egregious breaches of consumer's rights (hawkers visiting remote Aboriginal communities come to mind).

Perhaps more realistic is a scheme where committed and properly funded State regulators continue to undertake consumer complaints and enforcement activities but within a more

coordinated national framework. This framework would involve the national regulator having jurisdiction over all corporate actors in all consumer protection areas, together with protocols/delegations covering responsibility for taking which enforcement action at a more 'local' level, with provisions for timely negotiation, decision making and reporting on outcomes and performance. Under such a framework some states/territories (particularly in smaller jurisdictions) may opt to largely vacate the field of consumer enforcement in favour of the ACCC and other relevant national regulators.

One advantage of maintaining local enforcement bodies in those state/territory jurisdictions that are prepared to commit meaningful resources to consumer protection is that they will strengthen the specialist consumer affairs policy development capacity. This may assist the State in participating in the MCCA policy development process.

CHOICE notes the ACCC's observations in relation to the synergies achieved by States in co-locating multi agency offices in regional cities and towns. However, while in some quarters this claim is taken to be self evidently true, we are far from convinced that it is uniform or even the majority experience. We note that the ACCC does not provide any actual evidence to support its view. Our knowledge of enforcement actions in the Northern Territory, and perhaps also in Aboriginal communities in South Australia, suggests to the contrary that the Commonwealth agencies (ASIC and the ACCC) have provided a superior regional response in at least some areas. The ACCC has failed to note that there is some potential for co-location of Commonwealth offices in small towns, although an analysis would need to be undertaken to determine the extent it was in fact practicable.

In sum, we think that with the right will and resources our enforcement landscape could be transformed in the way envisaged by the Draft Productivity Commission Report. Nevertheless we acknowledge that there are a number of practical, financial and political problems that would need to be overcome to achieve this. We think doing so is a lower priority than implementing many of the other recommendations proposed by the Commission.

Some creative alternatives may need to be explored. One is the creation of a system where the single national regulator contracts State agencies (not necessarily the State consumer protection regulator) in regional towns to undertake their work within their policy guidance and procedures supported by legislation empowering those agencies to do so.

We note the submission of Energywatch UK.

> We agree with the Commission's view that consumer policy would be strengthened by a national policy framework but suggest that this does not necessarily have to be the responsibility of one national body. The important element here is, we believe, a single vision rather than a single delivery mechanism. The strength of a national policy framework will be in bringing together a diversity of experience to reach a consensus on the way forward and the most appropriate agencies to deliver enforcement, compliance,

consumer education etc. We think that a single organisation has an increased risk of focusing on a limited set of interests and a restricted view of what is actually happening to consumers at the individual and local level.

Conflicts of Interest

CHOICE intends to undertake further work on the issue of conflicts of interest in retail markets in the coming year, but we have not had the opportunity to undertake extensive additional research in this area and expand on the comments that we have provided in previous submissions (including references to studies in this area provided in previous submissions). However, we would like to draw the Commission's attention to the work being undertaken by the Financial Services Authority in the UK under the major 'Retail Distribution Review' as an example of the work that CHOICE believes needs to be undertaken to start addressing structural conflicts of interest in retail markets. (Note that the FSA's work is not a 'Retail Disclosure Review').

In undertaking the Retail Distribution Review, the Chairman of the FSA has noted that

> 'we have a business model for the retail distribution of financial services, particularly investment products, which is unattractive to both reputable providers and customers of those services, and which is of doubtful appeal to the intermediaries who distribute those services… a business model which has so many unattractive features that many regard it as broken.'

He (along with other senior FSA officials) has pointed to the problem of conflicts of interest as the major problem in this market. Of course, the UK financial services market shares many similarities (and indeed many of the same firms) with the Australian market. And many observers have made similar observations about the Australian market in relation to the demonstrably damaging impact of conflicts of interest, as well as the massive inefficiencies (typically through overprovision) that conflicts can create. The recent comments by the Deputy Governor of the RBA are but one example (Opening Remarks to the 20th Australasian Banking and Finance Conference 12/12/2007).

However, in the UK we are seeing a different approach to dealing with conflicts of interest. Instead of taking the usual approach of trying to address the problem of conflicts through modifying disclosure (yet again), the FSA are proposing structural reforms to the UK Financial Services market. Indeed, the FSA have recognized past regulatory efforts to deal with conflicts of interest, particularly disclosure, as having failed, creating overlong documents that serve only to protect issuers and advisers. The FSA has provided several consultation papers and speeches on this review, and an 'Interim Statement' on the FSA's proposed approach is due in April.

CHOICE reiterates its suggestion to the Productivity Commission that a significant recommendation for further work would be a review of the regulation of conflicts of interest in retail markets in Australia, particularly markets involving relatively complex services. The approach now being taken in the UK in financial services demonstrates that such reviews can go beyond the limitations of a disclosure based approach to dealing with conflicts.

Ongoing work program

In our pre-hearing submission CHOICE indicated its preference for the Commission to identify further areas of consumer policy requiring attention.

Current Problem	***Proposed response***
Conflicts of interest. Professionals (eg doctors) and intermediaries (such as mortgage brokers, commission-based financial advisors) in many sectors face conflicts between advice that will benefit themselves versus advice in the interest of their clients. This is particularly acute for those advisers/intermediaries whose remuneration relies not so much on the profitability of their transactions, but on the volume of their transactions have an inbuilt incentive to oversell.	Investigate the extent and nature of conflicts of interest in retail markets, and also consumer decision making in response to conflicts of interests. Investigate how conflicts of interest can be effectively regulated in retail markets, especially service markets. Explore regulatory reform options to improve market structures that embed conflicts of interest. Assess enforcement options action against mis-selling by intermediaries. Improve accountability structures of firms and suppliers that distribute through intermediaries.
Bundling increases information asymmetry as it makes it difficult for consumers to determine the value of the deal as a whole compared to its component parts. Bundling of unrelated products has high transaction costs and leads to many consumers having to pay for goods they do not want, it locks consumers into particular suppliers, reduces consumers' access to remedies and it leads to costly and complex disputes.	Review anti-competitive demand-side practices, including loyalty programs, a form of bundling.
The Productivity Commission identifies irrational over-insurance, the influence of "shrouded attributes" and suboptimal risk appraisal. It reports on four biases (overconfidence, endowment effect, choice overload and present bias) that may have "particular policy interest" but does not develop these or their implication for consumer policy. For example, producers exploit consumer biases in many advertising practices are designed to lead consumers away from welfare-improving decisions.	Review practical implications of behavioural economics on consumer and competition policies, for example marketing practices that deliberately lead consumers to make less than optimal decisions
Firms often practice price discrimination between different buyers, particularly in services, but also more generally in industries with high fixed costs. A related problem is that many firms persist with poor practices, rectifying them only for consumers who complain. (e.g. high bank fees). In many cases price discrimination aggravates the situation of vulnerable and disadvantaged consumers.	Examine price discrimination, with a view to recommending how it may be regulated to avoid exploitation of vulnerable and disadvantaged consumers

The notion that there have been consumer benefits from competitive "reforms" in utilities needs empirical testing. These "reforms" include including breaking up vertically integrated monopolies, introducing contestability and privatization, all involving high finance costs and transaction costs.	Undertake benefit-cost studies of utility "reforms", particularly for the fungible utilities of electricity, gas and water.
Not all consumer codes have been developed with adequate consumer input. Insufficient rules around consumer codes have seen some industries, for example the Mobile Premium service industry, 'game' processes for their own advantage.	Develop a generic set of principles and procedural requirements for Codes that affect consumer contracts or conduct in consumer markets.
Labelling and marketing claims by suppliers about the environmental impact of products & services can be inaccurate, unverifiable or fail to disclose the full impact of the product or service.	Improve the standard of environmental labeling schemes and better enforce misleading and deceptive green claims
Consumers seeking to make sustainable consumption choices in energy intensive and/or environmentally damaging industries struggle to differentiate products & services.	Explore consumer information needed in critical markets to make more informed environmentally conscious consumption decisions
Penalty fees charged by financial institutions on transaction and credit accounts have inflated above underlying costs.	Grant ASIC/ACCC power to abolish unfair or inappropriate exit fees and penalty fees.
Consumers are struggling to understand and compare riskiness of retail investment products.	Introduce a risk rating system for investments targeted at retail consumers.
Banking customers have limited protection of their deposits in the event of a major crisis.	Explore a depositor protection scheme for prudentially regulated Authorised Deposit-taking Institutions.
Consumers who suffer financial loss from a disqualified or bankrupt or retired financial advisor to not have the benefit of professional indemnity insurance.	Introduce a compensation scheme for financial services to protect consumers where professional indemnity insurance will not.
Unhealthy food advertising to children influences their food preferences and food choices. Unhealthy food marketing makes parents' jobs hard by tempting children with salty, fatty or sugary foods.	Introduce regulations to prevent marketing of unhealthy food to children.
Health claims assist manufacturers to market their products on the basis of nutrient content or a potential health benefit. In particular health claims are most likely to be used on processed foods rather that the fresh foods we should all be eating more of.	Extend regulation and enforcement powers of health claims to the Commonwealth
Nutrition information required by governments and claims made by manufacturers to increase product sales compete for label space and the consumer's attention.	Develop and introduce a simplified food labeling system that includes some evaluation of the contribution of the food to a healthy diet.
Sophisticated and potentially misleading marketing strategies to increase drug sales can lead to leakage (drugs approved for one purpose being commonly used for another) and an increase in the cost of the Pharmaceutical Benefits Scheme (PBS).	Undertake an independent inquiry into all aspects of pharmaceutical marketing in Australia, its impact on medical practice and its contribution to cost pressures on the health system.

Complementary medicines make a range of claims about their effectiveness, but these claims are not always backed up with sound evidence. In some cases complementary medicines can harm consumers' health. Current regulatory action does not do enough to protect consumers.	Amend the Health Act to require pre-market evaluations of the efficacy and safety of complementary health products.