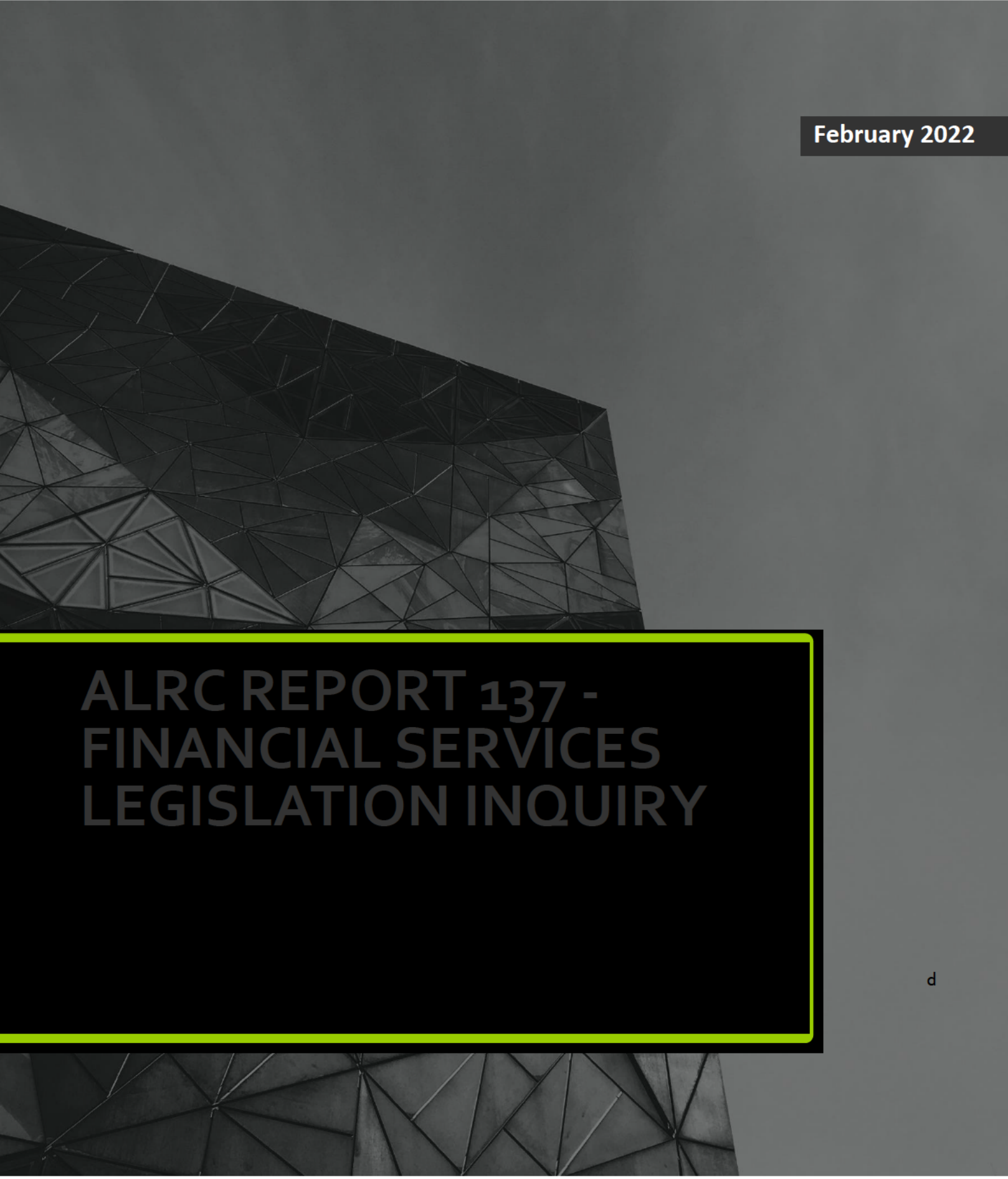

February 2022

ALRC REPORT 137 - FINANCIAL SERVICES LEGISLATION INQUIRY

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consumer action law centre

Financial Rights LEGAL CENTRE

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CHOICE

ALRC REPORT 137 - FINANCIAL SERVICES LEGISLATION INQUIRY

Submission to Interim Report A

Consumer advocates welcome the opportunity to provide feedback to the Australian Law Reform Commission (**ALRC**), in response to its Interim Report A published as part of its Financial Services Legislation inquiry (**ALRC Report 137**). This submission has been primarily authored by Consumer Action Law Centre, with support and endorsement by CHOICE, Financial Rights Legal Centre, and Super Consumers Australia.

The genesis for this inquiry was the findings and recommendations from the Financial Services Royal Commission (**FSRC**), particularly recommendation 7.3 (relating to the elimination of exemptions and qualifications to generally applicable norms of conduct in legislation governing financial services entities) and recommendation 7.4 (legislation governing financial entities should identify expressly what fundamental norms of behaviour are being pursued when particular and detailed rules are made about a particular subject matter).

Consumer advocates endorse the FSRC findings and recommendations about the need to simplify the law, particularly the need to abolish loopholes that facilitate regulatory arbitrage and poor business conduct. This submission does not respond to every proposal and question in ALRC Report 137, but makes comment in relation to:

- Definitions and licensing
- Disclosure
- Rule-making, and the approach to exemptions and exclusions
- Financial advice and debt advice
- Conduct obligations, particular the norm of fairness

A summary of recommendations is available at **Appendix A**.

TABLE OF CONTENTS

Definitions and Licensing

Uniform definitions of 'financial product' and 'financial service'

1. The ALRC notes that this inquiry is a 'technical review', but that it engages with policy throughout 'for the purpose of determining whether the policy settings are clear and, if so, whether they are appropriately expressed in the definitions and concepts used'. We note this upfront because we consider that any 'simplification' of legislative concepts, be they definitions, licensing requirements or substantive rules and requirements of conduct, necessarily engages with policy choices. Our commentary that follows thus raises questions of policy as they are central to legislative simplification and elimination of exemptions and qualifications in financial services legislation.

2. For example, through proposals A3 and A4, the ALRC Report 137 proposes that each Commonwealth Act relevant to the regulation of corporations and financial services should be amended to enact a uniform definition of each of the terms 'financial product' and 'financial service'. Consumer advocates broadly support these proposals—consistent definitions will make it simpler for consumers to understand their rights and entitlements under the law. Furthermore, a broad reach of these definitions are also a policy choice that will aid simplification of the law.

3. Consumer advocates note that the definition of 'financial product' in the *Australian Securities & Investments Act 2001* (**ASIC Act**) is the broadest conception and includes credit facilities. As noted by the ALRC Report 137, the purpose of this broad definition is to apply the ASIC Act general consumer protection provisions (Division 2, Part 2) to a broad scope of products. Furthermore, by virtue of section 12BAB(1AA), the definition of a financial product for the purposes of the ASIC Act consumer protection provisions is broadened to include a financial service. This is important to retain, so that the ASIC Act consumer protections apply consistently to products and services, in the same way that the Australian Consumer Law (**ACL**) applies to both goods and services. It is important that there are no gaps in the application of general consumer protections.

4. Unfortunately, consumer advocates consider that there does remain unnecessary complexity in the application of the general consumer law provisions of the ACL and the ASIC Act. The construction of the ASIC Act and the ACL, and the way the nexus between them is expressed, can make it difficult to assess which legislation a product or service may be covered by. The ACL is not clear on the issue, as the exclusion of financial services is located in the body of the *Competition and Consumer Act 2010* (section 131A), not in the ACL itself. The definition of a financial product or service must then be determined with reference to the ASIC Act and its Regulations. We note further that the ACL application legislation in states and territories does not appear to exclude financial products or services.

5. Moreover, the exclusion of financial services from the ACL means that some products potentially do not receive important protections (such as consumer guarantees), when in our view they clearly should. Under the ACL, consumer guarantees apply broadly to the supply of goods and services (whether or not there is a contract). In contrast, section 12ED of the ASIC Act provides for implied contractual warranties that financial services are rendered with due care and skill and are fit for purpose. The latter is subject to an exemption where the consumer does not rely on, or it is unreasonable for the consumer to rely on the supplier's skill or judgment. There is also an entire carve out for insurance.[1]

6. This creates a range of problems and inconsistencies. One relates to consumer leases, which are defined as a financial product by the ASIC Act Regulations.[2] This means that the consumer guarantee provisions

[1] Section 12ED(3), ASIC Act.
[2] Regulation 2B(3)(b)(ii)-(iv), ASIC Regulations.

would not apply to the goods acquired on consumer lease, whereas purchasers of goods generally benefit from consumer guarantees. At the same time, the ACL provides that the definition of 'supply' encompasses goods acquired on lease[3], so arguably it intends that consumer guarantees *do* apply. Given that the consumer base for consumer leases is generally low-income (and very often welfare-dependant), we submit this situation needs to be clarified.

7. Furthermore, given section 12ED provides for an implied contractual warranty, rather than a consumer guarantee, it does not give the regulator any power to act for a breach of this provision. Further, there is very limited judicial, regulatory or ombudsman guidance relating to section 12ED, so we question the extent to which it has been acted as a suitability requirement in practice. Consumer advocates consider that this inconsistency should be remedied so that consumer guarantees apply to all products and services, both those covered, by the ACL and the ASIC Act.

RECOMMENDATION 1. Retain the broadest definition of 'financial product' and 'financial service' for the purposes of general consumer protection provisions.

RECOMMENDATION 2. Address the complexity of the nexus between the Australian Consumer Law and the ASIC Act, to remove gaps in consumer protection.

RECOMMENDATION 3. Extend consumer guarantee provisions in the Australian Consumer Law to the financial products and services under the ASIC Act.

Incidental product exclusion

8. Consumer advocates agree with the ALRC that the incidental product exclusion in section 763E of the Corporations Act is an unnecessary source of complexity. It also contributes to inconsistencies and the exploitation of loopholes by firms.

9. While the purpose of the incidental product exclusion is designed to capture a range of transactions that have an element, but not the primary purpose, of for example managing financial risk, we consider that there are professional financial services firms which take advantage of the exemption.

10. An example involves the issuing of motor vehicle warranties, which are akin to insurance, but escape effective regulatory oversight because of the incidental product exclusion. The particular concern relates to dealer-issued warranties, which are said to be 'issued' by the dealer but are generally 'administered' by a professional financial services firm, the warranty provider. This appears to be a case of regulatory avoidance.

11. An example is the warranty of Integrity Car Care Pty Ltd (**ICC**). This warranty states: "This Warranty is issued by the Dealership in conjunction with the sale of a motor vehicle and is a contract between the Dealership and the contract holder whose name appears on the Schedule. The selling Dealership has appointed ICC to administer this Warranty Agreement" and "ICC is the claims and Warranty administrator for your Warranty and has been providing Warranty services since 1992. ICC has the authority to authorise repairs, settle claims and answer any questions you may have about your warranty on behalf of the Dealership".

12. This warranty appears to manage financial risk, and therefore would general be considered a financial product. However, it is argued that the incidental product exclusion applies because the product sold is issued by a motor vehicle dealer and it is incidental to its business of selling motor vehicles. This is despite a separate company seemingly being responsible for all aspects of the warranty administration, including decisions as to whether an event is covered by the warranty. The result (if this interpretation is correct) is

[3] Section 2, Australian Consumer Law.

that a range of consumer protections do not apply consistently to what otherwise would be a financial product.

13. In particular, the recently developed deferred-sales model for add-on insurance (set out in Part 2, Division 2, Subdivision 2A of the ASIC Act) requires a clear four-day pause between when a customer enters a commitment to acquire a principal product or service, and when they are offered or sold an add-on insurance product. The objective of this requirement was to promote informed purchasing decisions by consumers in add-on insurance markets. Firms can avoid the application of this protection by designing their product as 'dealer-issued' and applying the incidental product exclusion. We consider that this exclusion must be abolished as it promotes regulatory avoidance.

RECOMMENDATION 4. Abolish the incidental product exclusion in section 763E of the Corporations Act.

Functional definitions of 'financial product' and 'credit'

14. Consumer advocates generally support the ALRC proposals relating to functional definitions of 'financial product' and 'credit'. For credit, a functional definition of credit exists in legislation and covers any contract, arrangement or understanding where a debt is deferred—we support this definition, noting that it aligns with the community understanding of credit, subject to our comments regarding exemptions to this definition below (in paragraph 26 onwards).

15. The ALRC states that functional definitions will promote robust regulatory boundaries, understanding and general compliance with the law. We agree that this approach is more effective than an "if it's in, it's in; if it's not in, it's out" approach. Such an approach incentivises firms to construct and design products in a way that falls outside of the regulatory perimeter.

16. We are concerned, however, that the practical experience of innovation in the marketplace is that business activity that harms consumers often arises at or near the regulatory perimeter. This is because there is an incentive for business to innovate to avoid regulatory oversight, particularly businesses that do not have a strong focus on consumer outcomes.

17. This is particularly the case in respect of licensing frameworks, where the definitions that apply (i.e. credit regulated by the *National Consumer Credit Protection Act 2009* (Cth) (**NCCPA**)) are more limited than the functional definition of credit described above, as they incorporate exemptions from the functional definition. As stated below, there are many avoidance techniques that enable lenders to escape regulation of the NCCPA. A similar problem applies with licensing under Chapter 7 of the *Corporations Act 2001* (Cth). A notorious example involves the regulation of funeral insurance whereby the provider Aboriginal Community Benefits Fund was able to change the product to be styled as a 'funeral expenses' policy to evade licensing.[4] This was only addressed after it was considered by the Financial Services Royal Commission.[5]

18. For that reason, we would recommend a mechanism be adopted to continuously review and update the regulatory perimeter and whether the core definitions are covering activity that the community would expect. In the United Kingdom, the Financial Conduct Authority regularly publishes its "perimeter report".[6] This report identifies business activity and potential consumer detriment that might be occurring that is not covered by the regulatory remit of the FCA or is only partially covered. We recommend that the Australian regulatory framework adopt a mechanism such as this to regularly review and make recommendations for regulatory change to ensure that activity that should be regulated, is.

[4] FSRC, Interim report, Volume 2, p443.
[5] *Financial Sector Reform (Hayne Royal Commission Response—Protecting Consumers (2019 Measures)) Act 2020*
[6] See: https://www.fca.org.uk/publications/annual-reports/annual-report-regulatory-perimeter-2020-21

RECOMMENDATION 5. The regulatory arrangements should adopt a mechanism such as the UK FCA 'Perimeter Report' to identify any activity that falls outside of regulated definitions.

Consumer leases

19. In terms of a functional definition of credit, ARLC Report 137 notes that a 'consumer lease' may not be captured because leases do not involve a debt. Instead, 'leases are a rental arrangement under which goods can be retained so long as periodic payment is made by a lessee'.

20. This characterisation ignores the fact that the category of 'consumer lease' is largely an opportunity for regulatory arbitrage, that is, an opportunity for businesses to manipulate the structure of their contracts to exploit a difference between the substance of the transaction and its regulatory treatment. Consumer lease providers regularly design contracts which are in substance credit contracts but are only regulated as consumer leases. This has 'led to numerous instances of lessors actively misleading consumers about whether they would obtain ownership of the goods at the end of the lease'.[7]

21. While the National Credit Code (**NCC**) regulates both consumer leases and credit contracts, it distinguishes between these two categories based on whether the consumer has a 'right or obligation to purchase the goods'. If the consumer has such a right or obligation, the NCC regulates the transaction as a credit contract. If there is no right or obligation to purchase, the NCC treats the transaction as a consumer lease.

22. This type of regulatory arbitrage leads to consumer harm and higher costs. For example, there are no cost caps on consumer leases while there are for similar cash loans (small amount credit contracts).[8] The impact of this regulatory arbitrages has also been acknowledged by the Federal Government in a 2011 Regulatory Impact Statement which states[9]:

> *Different regulatory outcomes arise according to whether or not the consumer will be able to own goods at the end of a lease. This creates a tension for lessors between seeking to avoid regulation (by utilising a lease for this purpose), and not discouraging customers (who may only enter into a contract where they believe they will own the goods at the end of the contract). This causes an inherent structural tendency for consumers to be either actively mislead or not fully informed.*

23. Ali et al[10] have argued that the NCC should abandon the 'right or obligation to purchase' distinction and instead distinguish between 'true leases' and 'finance leases'. What differentiates a true lease from a finance lease is how the economic risks and benefits incidental to ownership of the leased goods are allocated between the lessor and the lessee.

- In a 'true lease', the business providing the lease retains title to the goods as well as most risks and benefits incidental to ownership. True leases are of a short term compared to the useful life of goods, as they are intended to be returned and leased out again to other consumers. Typically, the amount paid for lease will be less than the value of the product.
- In a finance lease, the lease provider retains title to the goods, but the lessee shoulders the risk, including depreciation. Finance leases usually last for the whole or a major part of the useful life of the goods, and the consumer pays an amount in excess of the value of the goods. This being so, the consumer is in substantially the same position as a person buying the goods on credit except that they do not obtain title.

[7] Ali P, McRae C, Ramsay I & Saw T, "Consumer leases and consumer protection: regulatory arbitrage and consumer harm", Australian Business Law Review, Vol 41, No5, pp240-269 at 241.
[8] National Credit Code, Sch 1 of NCCPA, section 23A.
[9] Phase Two of the National Consumer Credit Reforms: Consumer Leases and Enhancements to the National Credit Code Regulation Impact Statement June 2011 https://ris.pmc.gov.au/sites/default/files/posts/2011/09/03-National-Consumer-Credit-RIS.pdf
[10] Above n 7.

24. In practice, many consumer leases are finance leases given that the consumer generally leases the goods for their useful life, and, at the end of a term, the product is gifted or transferred for a small amount. In this way, they are not dissimilar to hire purchase arrangements, which are regulated by the NCC as 'credit contracts'.[11]

25. Ali et al also propose that finance leases should be regulated in the same way as credit contracts, and true leases should not be regulated by the Code at all. This would ensure regulation focuses on the substance of the transaction rather than its form and avoids having parallel regulation for different finance leases depending on the arbitrary distinction of whether or not they provide a right or obligation to purchase.

RECOMMENDATION 6. Regulate consumer leases that are 'finance leases' in the same way as consumer credit contracts, and do not apply a different level of regulation.

Credit law exemptions and loopholes: buy-now-pay-later, wage access, egregious lending models etc

26. As noted, the ALRC supports a functional definition of 'credit' (where there is a deferral of a debt). However, ALRC Report 137 does not deal with existing exemptions from the definition in the NCC that allow for products and business models that fall outside this functional definition. These exemptions include:

- Where there is no charge for the provision of credit – section 5(1), NCC
- Where the credit is provided for a term of 62 days or less, fees and charges do not exceed 5% of the amount of credit, and interest charges do not exceed an amount equal to 24% per annum (the 'short term credit exemption) – section 6(1), NCC
- Where the credit is providing under a continuing credit contract and only provide for an upfront fee (e.g. an establishment fee) or a periodic fee (e.g. an account-keeping fee) that is fixed, does not vary according to the amount of credit that is provided, and is less than specified amounts – section 6(5), NCC.

27. These exemptions have spawned a range of business models and credit products that escape regulation by the NCCPA and the NCC. These include buy-now-pay-later products, early wage access services, as well as other egregious lending models.

Case Study – Donna's story

Donna (name changed) is a single mother of three living in regional Victoria who works part time and receives a variable income. Donna contacted the National Debt Helpline in March last year because she was struggling to manage debts accrued from utility bills, a car loan, a credit card, insurance and multiple BNPL debts. The BNPL debts were all with companies subject to the BNPL Code.

Donna told us that she had recently obtained a loan from a third-tier lender to pay off the credit card and some of her BNPL debts, because she was struggling to meet the repayments. Initially, Donna indicated that she was comfortable with her remaining BNPL debts. In the following months while we were assisting Donna negotiate some of her debts, she informed us that she was struggling for money and had been using BNPL to pay for food, and had to take out other short-term credit to pay for her daughter's living expenses (which was likely provided in breach of credit laws).

[11] National Credit Code, Sch 1 of NCCPA, section 9.

Case Study – Donna's story, cont.

Donna had high credit limits for BNPL products. At one point she owed $2000 to one major BNPL provider, nearly another $2000 to another BNPL provider, and a similar amount owing to the same provider via regulated credit as well. She likely had high BNPL credit limits because she had consistently made her repayments, which disguised her financial hardship. The reality was that she couldn't afford the repayments with her other debts, and was using these services to pay for essentials.

Donna is still paying off her BNPL debts, but has told us she cancelled one of her BNPL accounts. We have sought to assist her to negotiate the debt with the other BNPL provider, but this is difficult because so few laws apply to BNPL. Initially, the BNPL provider refused to provide us any documents regarding the BNPL debt (a likely breach of the BNPL Code). The BNPL provider described the BNPL facility as 'not regulated'.

28. While there exist some anti-avoidance provision in the NCC, these have also been interpreted narrowly. For example, section 204(1) of the NCC defines 'contract' to include 'a series or combination of contracts, or contracts and arrangements'. This provision appears designed to address business models that establish multiple or related contracts to fit within one of the abovementioned exemptions.

29. The Federal Court has considered the application of multi-contract schemes designed to fall within these exemptions, and generally found against a functional definition of credit, preferring to rely on technical statutory constructs. For example:

- In *Australian Securities and Investments Commission v Teleloans Pty Ltd* [2015] FCA 648, the Federal Court decided that a fee charged by Teleloans for loan application services to applicants for small amount credit to another company (Finance & Loans Direct Pty Ltd (FLD)) was not a fee under the credit contract with FLD and that therefore the credit contract was covered by the short term credit exemption under section 6(1) of the NCC and not regulated by the Code. Logan J specifically rejected the argument that the structuring of the contracts in this case were "arrangements" which constituted credit contracts regulated by the Code.
- In *Australian Securities & Investments Commission v BHF Solutions Pty Ltd* [2021] FCA 684, the Federal Court decided that fees charged by Cigno Pty Ltd were for providing loan services under a services agreement and was not for the provision of credit (which was provided under a separate contract by BHF Solutions Pty Ltd). As such, neither Cigno nor BHF were required to be licensed under the NCCPA. This decision arguably widened the exemption of section 6(5), noting that 'charges may be made under a credit contract that might constitute a service that is "related to the provision of credit" but not be charges *for* the provision of credit".[12] (see Ashley's story, below)

30. An alternative decision by Dowsett J in the Federal Court case of *Australian Securities and Investments Commission v Fast Access Finance Pty Ltd* [2015] FCA 1055 concluded that multiple contracts and arrangements would be a combination for the purposes of the extended definition of contract if "they are associated in a joint action, or united together for a common purpose": at [251]. The scheme the subject of Fast Access Finance was an arrangement that involved a pair of contracts pursuant to which consumers purportedly purchased and then on-sold diamonds at a loss. The loss, in effect, being the interest payable under the scheme. The Court found the scheme was a sham and that the arrangement was regulated under the NCCPA and NCC.

[12] This case is awaiting appeal at the Full Federal Court.

31. These decisions indicate that the law related to regulatory exempt lending models is unsettled.

Case Study - Ashley's story

Ashley (name changed) took out a $230 loan from BHF Solutions through Cigno in mid-2021. The agreement with BHF Solutions claimed the loan was a continuing credit contract arrangement, and charged a $15 fee on top of the loan. The Cigno services agreement imposed nearly double the loan amount in fees relating to 'financial supply' and 'account keeping'. Ashley made three payments on the loan totaling over $350. Cigno also charged Ashley an additional $79 default fee for missing one payment.

A community worker helping Ashley with the loan sought a waiver and refund of amounts paid over the original loan. Ashley's only source of income was the disability support pension, and because he has a developmental disability he would not have understood the terms of the agreement.

Despite Ashely having paying at least $60 more than would be permitted under an equivalent regulated small amount credit contract, Cigno refused the request for a refund, and still required Ashely pay over $100 more to satisfy the debt.

32. We urge the ALRC to consider the policy basis of these exemptions in the NCC, which are unclear. Rather than serving a productive purpose, the exemptions appear to be used to avoid more robust regulatory oversight associated with being licensed and specifically regulated by the NCCPA.

33. More and more so-called alternative credit providers are being established which make use of these exemptions. Some of these credit providers are establishing themselves as major market players, with hundreds of thousands if not millions of customers. For example:

- Afterpay does not charge consumers for providing credit, so the arrangement is not regarded as credit due to section 5(1) of the NCC.
- Other buy-now-pay-later providers, such as zipPay, Humm, and Brighte, offer continuing credit contracts not regulated by the NCC because they only include charges within the requirements of section 6(5) of the NCC.
- Early wage access providers, such as MyPayNow, offer credit for a term that is less than 62 days and purport to offer an unregulated product in accordance with section 6(1) of the NCC. These businesses and similar providers impose late fees that, if considered 'credit fees', may take them outside of this exemption.
- Other cash lenders such as Wallet Wizard and Nimble offer continuing credit contracts with limited repayment terms seemingly to avoid being classified as a 'small amount credit contract' as defined by section 5 of the NCC.

34. While these firms have put a significant amount of resources into marketing these products as distinct from regular credit, they would quite clearly fall within a functional definition of credit. One indicator of the absurdity in this legal distinction comes from the descriptions of the target market for these products firms provide in their target market determinations.[13] In those documents, many firms explicitly recognise that their product is designed for people seeking credit, or a credit facility.[14]

[13] Documents required to be published for all financial products under the design and distribution obligations, which came into effect on 5 October 2021.
[14] See for example, target market determinations for LatitudePay (available at https://www.latitudefinancial.com.au/target-market-determinations/), MyPayNow (available at https://mypaynow.com.au/target_market_determination/).

Case Study – Kelly's story

Kelly (name changed) is being assisted by a financial counsellor in regional Victoria, having recently escaped from an extremely abusive partner. The financial counsellor told us that over a 12-month period, Kelly had experienced shocking abuse, with the perpetrator exercising complete control over Kelly. This included taking out numerous forms of credit in her name, for his own benefit.

The financial counsellor told us the perpetrator had obtained numerous forms of credit not captured by the National Credit Code, including at least two wage advance products, and two buy now pay later products. The financial counsellor told us there was also a loan with unregulated lender Cigno, for which she was going to seek a waiver. The financial counsellor did not know exactly how much the Cigno loan was for, but reported that documents from a recent informal debt agreement indicated $1017 had allegedly been owed to Cigno (at that time).

35. As the ALRC progresses its inquiry, we urge it to consider the policy basis for these exemptions and understand how they are being exploited by a growing set of credit providers. We strongly support a functional definition of credit that is applied consistently and captures a broad range of similar credit arrangements. This should not only apply to the relevant definitions in the ASIC Act, but also the NCCPA and the NCC which provides for more industry-specific oversight. This approach would aid simplification of the regulatory regime and improve consumer protection.

36. In response to Question A1, the ALRC may wish to consider whether its inquiry and assessment of the appropriateness of these exemptions in the NCC would be assisted by data on the size and value of the credit market currently operating within these exemptions, avoiding fundamental consumer protections. If this information would be of value, we suggest seeking data from ASIC. The Reserve Bank of Australia may also hold data that gives an indication about the value of transactions going through buy now pay later platforms.

37. Related to these exemptions in the NCC, we note that that the Federal Government has proposed an additional general anti-avoidance measure to be enacted to the NCCPA through Schedule 4 of the National Consumer Credit Protection Amendment (Supporting Economic Recovery) Bill 2020. This measure, if enacted, seeks to prohibit schemes that are designed to avoid the application of the NCCPA in relation to small amount credit contracts and consumer leases.[15] The prohibition captures schemes where it would be reasonable to conclude that the purpose, or one of the purposes, was an avoidance purpose, which includes:

- To prevent a contract from being either a small amount credit contract or a consumer lease;
- To cause a contract to cease to be a small amount credit contract or a consumer lease;
- To avoid application of a provision of the NCCPA to the small amount credit contract or consumer lease.

38. An anti-avoidance provision was recommended by the Small Amount Credit Contract Review[16], noting that experience under the NCCPA and its predecessors is that there is a long history of some lenders seeking to avoid pricing and conduct obligations in credit laws through a range of avoidance practices. As per the examples mentioned above, avoidance practices can be very harmful to consumers either through resulting in arrangements where consumers pay higher amounts than legislative caps on interest and

[15] National Consumer Credit Protection Amendment (Supporting Economic Recovery) Bill 2020, schedule 4.
[16] See: https://treasury.gov.au/consultation/review-of-small-amount-credit-contracts-final-report

charging, or there is avoidance of licensing and conduct obligations such as responsible lending, risking severe indebtedness. Avoidance can also mean that a complaint cannot be made about the lender to the Australian Financial Complaints Authority (**AFCA**), reducing access to justice substantively. In addition, avoidance can have a significant adverse impact on compliant industry participants as firms that engage in avoidance activity can obtain a competitive advantage by being able to provide products more quickly, given they do not comply with responsible lending and other conduct obligations and by having reduced compliance costs.

39. While we welcome the intention behind the proposed general anti-avoidance measure, the proposal is limited in that it is confined to schemes aimed at avoiding the small amount contract and consumer lease provisions in particular. As such, it is unclear whether they would extend to schemes that are based on avoiding sections 5 and 6 of the NCC which relate to the application of the NCC generally. It would be far preferable for an anti-avoidance provision to be drafted broadly, so it is likely to capture the full range of avoidance strategies, and not just those seeking to avoid provisions relating to small amount credit contracts and consumer leases.

RECOMMENDATION 7. Adopt the functional definition of 'credit', being an arrangement involving the deferral of a debt, consistently across all financial services legislation.

RECOMMENDATION 8. Examine the policy basis for exemptions in the National Credit Code from the definition of 'credit' that have been exploited by egregious lending models, and remove them.

RECOMMENDATION 9. Remove the exemptions in the National Credit Code that allow for buy-now-pay-later, wage advance providers, and similar business models to avoid consistent regulatory standards and regulatory oversight.

RECOMMENDATION 10. Adopt a broadly conceived general anti-avoidance law to supplement clear regulatory boundaries for consumer credit.

Consolidating licensing regimes

40. ALRC Report 137 includes commentary considering the incorporation of 'credit' within a single definition of 'financial product', thereby consolidating the currently separate Australian Financial Services Licence and Australian Credit Licence regimes.

41. At this stage, we can see some merit in this idea, but it would depend on the nature of the licensing scheme in practice. We are not aware of credit and financial products being consolidated under one regime internationally; we'd welcome ARLC's investigation of this. As set out later in this submission, we do consider that there is benefit in aligning the regulation of 'debt advice' with 'financial advice' in some core respects.

Disclosure

Over-reliance of disclosure as consumer protection

42. Consumer advocates strongly support the recognition in ALRC Report 137 that there has been an over-reliance on disclosure to protect consumer interests. ASIC has published a report about the real-world context in which disclosure operates, showing why disclosure and warning can be ineffective in influencing consumer behaviour and choices.[17] Reasons identified by ASIC include:

[17] https://asic.gov.au/regulatory-resources/find-a-document/reports/rep-632-disclosure-why-it-shouldn-t-be-the-default/

- Disclosure doesn't solve complexity in financial services – for example, research indicates that once we have to take into account more than two or three different factors, our ability to identify good and bad deals becomes strikingly inaccurate.[18]
- Disclosure must compete for consumer attention – consumers are constantly saturated with competing attempts to capture our attention and influence our decisions, particularly through advertising and marketing. Regulated disclosure can't compete with, let alone reverse, the messages of the marketing industry.
- The effects of disclosure are different from person to person and situation to situation – as people, we all differ in how we make financial decisions, using different decision-making styles and processes and different ways of engaging with information. It is impossible to design a "one-size fits all" disclosure regime.

43. Research also highlights the perverse outcomes of certain types of disclosure. For example, research on disclosure of behavioural price discrimination online (for example, actually telling consumers that the price presented is based on previous purchasing behaviour) has 'has an upward effect on intention to purchase', contrary to a regulatory purpose of encouraging consumers to be more circumspect.[19] The authors suggest 'the possibility that framing as a result of regulatory intervention may inadvertently appeal to consumers' wishes, desires, and in the process of doing so, increase the likelihood of (over)spending'. As further outlined below, the researchers recommend 'road-testing' of disclosure to address perverse outcomes.

44. Any reform to disclosure regulation must recognise that it is not a complete response to the risk of consumer harm resulting from information asymmetries. Below, we suggest a perhaps more important focus is to consider appropriate regulation of advertising and marketing.

The failure of existing outcomes standards in disclosure regulation

45. ARLC Report 137 notes that disclosure obligations across financial services seek to regulate the comprehensibility of disclosure documents through particular standards, such as:

- 'information that a person would reasonably require' to make a decision; and
- 'clear, concise and effective'.[20]

46. We consider that these sorts of standards should provide for flexibility for a business to design disclosure in a way that meets customer needs. Put another way, these standards are a form of 'outcomes-based' regulation, as the disclosure required must meet the outcome of including 'information that a person would reasonably require' or being 'clear, concise and effective'.

47. However, as stated by the ALRC, 'there appears to be general consensus that the existing disclosure requirements have limitations, do not facilitate consumer understanding, and are a source of significant compliance costs'. Unfortunately, we concur; our experience is that financial services disclosure can be long, unengaging, and ineffective at providing information a person would reasonably need to know.

48. While some of the cause of this may relate to additional prescription in certain disclosure requirements, it seems that a key cause is the failure of firms to be able to comply with these standards without over-whelming consumers with complex and impenetrable information. A particular driver behind this appears

[18] P Lunn, M Bohacek, J Somerville, AN Choisdealbha & F McGowan, PRICE Lab: An investigation of consumers' capabilities with complex products, report, Economic & Social Research Institute, May 2016.
[19] W van Boom, JP. van der Rest, K van den Bos & M Dechesne Consumers Beware: Online Personalized Pricing in Action!
How the Framing of a Mandated Discriminatory Pricing Disclosure Influences Intention to Purchase, Social Justice Research (2020) 33:331–351, https://doi.org/10.1007/s11211-020-00348-7
[20] Such as the requirement the applies to product disclosure statements, under *Corporations Act 2001* (Cth), s 1013C(3).

to be conservative and risk-adverse compliance postures, where firms seek to disclose everything in dense, written documents, without considering how it would be interpreted or received by customers.

49. We note the above to make the point that any change disclosure to promote more 'outcomes-based' approaches needs to respond to the cause of existing ineffective disclosure. We consider that risk-averse compliance postures within firms play a role, though there may be other causes. It seems to us that the cause is not simply the existing standards.

What good disclosure looks like

50. Given this, instead of regulation just stating the outcome sought (which has not worked), we must consider the use of incentives for firms to meet those outcomes. We also must consider how consumers use and interpret information, and what is useful when.

51. In our view, good disclosure:

- *is comprehensible and simple*: information on disclosure documents needs to be expressed in a way that is, as much as possible, able to be understood by all customers. Disclosure should be designed to appeal and should be written in plain English without overly legalistic terminology or expression. Disclosure should be designed to ensure that it is simple and easy to understand for all customers, including those with low levels of literacy
- *presents the most important information prominently*: things like the total price of a product, key features, important limitations, are what people need to know most. These should be prominent (for example, on the front page of a disclosure document, in large type) and easy to understand. Fine details and generic statements ('seek advice', 'consider your needs and objectives', 'read the PDS') may be important but they don't usually impact decision-making. They can be further back in a document and less prominent. Where a document is just designed to give an overview of the most important features of a product, fine details and generic statements are best left out completely. Including them can just bury more important information. Greater detail could more appropriately be provided separately.
- *includes product warnings*: any features which carry notable risk for a customer should be made prominent and very clear. Warnings should be specifically brought to the attention of the customer at the relevant point when a decision is to be made, and should not be included in the detail of documents that are provided after a decision to purchase.
- *is comparable*: one of the main purposes of disclosure is to allow consumers to shop around and find the product that is best for them. In turn, it means that providers get accurate signals about what consumers want and what they are prepared to pay. Consistent terminology (for example, where the same product, feature, or fee is called different things by different businesses) and the way figures are expressed (for example, total cost over life of product, cost per week, month or year) should as much as practicable be consistent between products and providers.
- *is based on an understanding of how ordinary people use disclosure documents and make decisions*: people do not always act perfectly rationally, and the design of a disclosure document can influence whether the disclosures are read, or which disclosures are read (for example, those highlighted upfront). Good disclosure is written with this in mind and, ideally, is consumer tested to ensure it is comprehensible and effective.

The problem with a "reasonable consumer" standard

52. Proposal A8 in ALRC Report 137 states that financial product disclosure should be reframed to incorporate an outcomes-based standard of disclosure. As mentioned, we caution against this merely stating the outcome sought and expecting firms to achieve it without something more.

53. We also raise concerns about the ALRC's framing of an outcome-based disclosure requirement, as involving "reframing the obligation as a requirement to take reasonable steps designed to ensure that a reasonable consumer would understand the key risks, costs and benefits of the product". Our particular concern is the concept of a "reasonable consumer".

54. As noted above, the effects of disclosure vary from person to person, and we consider that there is no "reasonable" consumer. Rather, consumers are heterogenous and experience and engage with information in varying ways. As humans, we experience 'bounded rationality', and there are biases which we are all subject to.[21] In addition, the competitive marketplace can mean that 'even without intent to deceive, firms not only will but must leverage consumer confusion to compete with other firms'.[22]

55. We are particularly concerned about consumers experiencing vulnerability (for example, people for whom English is not their first language; people living with a disability; older people; people with poor literacy or low levels of education etc). Our consumer policy framework has a specific objective 'to meet the needs of those consumers who are most vulnerable or are at greatest disadvantage'.[23] It is important that any disclosure requirements meet the needs of those experiencing vulnerability.

56. Importantly, reasonableness implies importing an objective standard to evaluate compliance. In practice, this evaluation will be undertaken without reference to actual consumers. As stated by Lauren Willis, 'a judge reviewing a document after the fact and knowing what she is looking for may decide whether a consumer ought to have noticed the disclosure and ought to have understood it, rather than deciding whether real consumers did notice and understand it'. Courts in Australia commonly rely on expert evidence to make judgments about information documents, rather than consumer testing or surveys. The recent decision of *Australian Securities & Investments Commission v Commonwealth Bank of Australia (No 2)* [2021] FCA 966 provides a good example.

Consumer testing disclosure

57. We consider consumer testing of disclosure should be part of any reform initiatives. Consumer testing is required to understand what kind of information will be useful for consumers, and when and how to present it for maximum effect.

58. Lauren Willis has proposed 'performance-based consumer law' as a solution. She states that:

> *Firms should be required to demonstrate through periodic independent third-party expert testing of representative samples of the firm's actual customers that a good proportion of its customers know, at the time the customers can make use of this knowledge, the key pertinent costs, benefits, and risks of the products and services the firm has sold them.*
>
> *Firms that fail these "confusion audits" would face motivating repercussions, such as fines or prohibitions on enforcing terms that their customers do not understand. Confusion audits and caps would thus incentivize firms to implement marketing campaigns that educate rather than*

[21] See, e.g., Cass Sunstein & Richard Thaler, Nudge, Yale University Press, 2008.
[22] George Akelof & Robert Schiller, Phishing for Phools: The Economics of Manipulation & Deception, Princeton University Press, 2015.
[23] Intergovernmental agreement f4: https://consumer.gov.au/sites/consumer/files/2015/06/acl_iga.pdf

obfuscate and to develop simple and intuitive product terms that align with rather than defy consumer expectations.[24]

59. Willis draws on pollution emissions standards from environmental protection, with the goal that consumers are either not confused about key aspects of the transactions in which they engage or nonetheless do not suffer ill consequences from the transaction.[25] Requiring firms to comply with periodic audits provides an incentive for them to meet consumer information needs. This approach also recognises that firms are better suited than regulators or courts to inform and provide information. After all, we know from marketing that when firms do want to communicate with customers, they can do so effectively. Firms are by their nature more able to experiment, segment and personalise and respond quickly to changes.

60. We note that the ARLC Report 137 does acknowledge the possibility of adopting such an approach in delegated legislation. As the ARLC continues its work on outcomes-based disclosure, we urge it to require consumer testing, mandate ongoing assessments, and incorporate incentives for firms as core to any regulatory reform.

Product use disclosure

61. Another alternative in regulating disclosure which may better meet varied consumer needs is to shift to 'product use' disclosure. Most disclosure is 'product attribute' disclosure, whereby information is communicated about the attributes or features of the product. Product use information is based on historic use-pattern information collected on individual consumers, or consumers as a whole.

62. As argued by Oren Bar-Gill in his book, *Seduction by Contract: Law, Economics and Psychology in Consumer Markets*, a mixture of product attribute and use information is necessary for disclosure to be meaningful:

Optimal disclosure design should consider the advantages of combining product-use information with product-attribute information. For example, providing information on the number of late payments made during the past year is helpful. Providing information on the total amount of money paid in late fees during the past year is even more helpful. This disclosure combines product-use information (the number of late payments) with product-attribute information (the magnitude of the fee).[26]

63. With consumer transaction data being much more accessible through the Consumer Data Right, there is a significant opportunity to utilise this data to aid consumer understanding of their use of existing and potential financial products. We encourage the ALRC to consider how regulation of "product use" might be incorporated to aid any shift to an improved outcomes-based disclosure framework.

Regulating advertising

64. As noted above, advertising and marketing has a greater impact on consumer decision-making that regulated disclosure standards. We urge the ALRC to consider this reality in the context of change to the regulatory approach to disclosure.

65. Advertisers commonly seek to refer customers to "terms and conditions" in fine print in advertising, or the ubiquitous "terms and conditions apply" in TV and radio advertising. Personalised advertising online is another development that needs consideration. In particular, it may be that advertising in this way amounts to an 'offer' that triggers disclosure requirements.

[24] See: https://www.fca.org.uk/insight/can-performance-based-regulation-succeed-where-mandated-disclosure-has-failed
[25] Lauren E Willis, Performance Based Consumer Law, 82 *University of Chicago Law* Review 1309 (2015)
[26] Oren Bar-Gill, 2012, Seduction by Contract: Law, Economics and Psychology in Consumer Markets, Oxford University Press.

66. Consumer advocates consider that there is further opportunity to design appropriate standards and guidance on disclosure in the context of advertising, in the context of any reform to disclosure standards in financial services law.

RECOMMENDATION 11. Recognise that any regulatory shift to improved outcome-based disclosure must address the causes of why it hasn't worked previously, including risk-adverse compliance approaches by firms.

RECOMMENDATION 12. Do not frame outcomes-based disclosure standards with reference to a "reasonable consumer" and instead incentivise firms to meet the information needs of all consumers.

RECOMMENDATION 13. Incorporate consumer testing, ongoing audits of consumer understanding, product use disclosure, and incentive regulation to improve firm approach to disclosure.

RECOMMENDATION 14. Further explore appropriate standards and guidance on disclosure in the context of advertising and marketing.

Approach to exemptions & exclusions

Rule-making powers

67. Proposals A9 and A10 of the ARLC Report 137 recommend reforming the various ways exemptions and exclusions to financial services laws can be made, replacing them with a consolidated regulatory instrument or rule-book. Consumer advocates supports the transparency that a rulebook could create.

68. ALRC Report 137 then asks whether ASIC should have the power to make rules. We consider that there are benefits from the specialist regulator having greater rule making power. Key among these is that regulatory decision-making by an independent and transparent regulator can aid effective administration of law, and remove opportunities for politicisation. Treasury has noted that industry lobbying for prescription, detail and tailoring has bene a significant contributor to the current state of the law.[27]

69. In Consumer Action's submission to the Financial Services Royal Commission [28], we noted that internationally parliaments have devolved greater rule making power to regulators. We also consider such an approach may allow for swifter effective reform, given delays in dealing with consumer harm through Parliament.

70. The Product Intervention Powers (**PIPs**) are a step in this direction, allowing the regulator to adopt rules with the purpose of advancing objectives set by parliament. One limitation with this framework, however, is that PIPs expire after a period of 18-months, and can only be extended after receiving approval from the Minister. We note that one PIP made by ASIC, which addressed a very unfair and problematic short-term lending business model, lapsed in March 2021, and ASIC did not extend the order because of ambiguity in the PIP legislative provisions.[29] By comparison, the Financial Conduct Authority in the UK has the power to make permanent interventions.

71. Another limitation of the PIP appears to be a lack of power for ASIC to compel its regulated entities to provide recurrent data. After many years of surveillance work and consultation by ASIC on the sale of add-on insurance and extended warranties in caryards (often referred to as 'junk insurance'), it proposed a

[27] Treasury, Submission to Interim Report of FSRC, 5 [23] – [25].
[28] Consumer Action, Submission to Royal Commission into Misconduct in the Banking, Superannuation and Finance Industry, February 2018; https://consumeraction.org.au/royal-commission-into-misconduct-in-the-banking-superannuation-and-finance-sector-consumer-action-submission-part-2/
[29] ASIC, Media Release, 2021: Full Federal Court upholds First Product Intervention Power, https://asic.gov.au/about-asic/news-centre/find-a-media-release/2021-releases/21-151mr-full-federal-court-upholds-first-asic-product-intervention-order/

tailored and highly effective product intervention in caryards that went well beyond the economy-wide deferred sales model for add-on insurance, which does not apply to extended warranties. For example, ASIC's proposed intervention order in the caryard add-ons market would have:

- Required a consumer-centric online portal where consumers could meaningfully receive information about the product's features and its claims ratio;
- Banned the sale of junk products, for example by banning:
    - warranties during their period of overlap with the manufacturer's warranty;
    - warranties with low claim limits (which led to consumers at most only ever getting back what they paid for the warranty); and
    - onerous servicing requirements used by warranty provider to deny claims.

72. Consumer groups were very disappointed when ASIC abandoned this product intervention, apparently in part because it did not hold up-to-date data showing harm due to the impacts of Covid (i.e. 2020 was a bad 'base' year for the reform).[30] This squandered years of good work by the regulator – and consumer groups – to evidence the clear harm, and refine solutions that would stopped the ongoing harm we see in the caryards.

73. We consider that it is entirely appropriate that ASIC, as the specialist regulator, have a broad rule-making power to make rules that promote the principles, outcomes or norms outlined in legislation. We consider that this is consistent with recommendation 7.4 of the Financial Services Royal Commission which stated, "as far as possible, legislation governing financial services entities should identify expressly what fundamental norms of behaviour are being pursued when particular detailed rules are made about a particular subject matter".

The problem of exemption by regulation

74. We would oppose a new regulatory architecture that promotes the wide use of exemption by regulation. Given that more and more regulations are being made that provide for exemptions,[31] we do not consider that moving exemptions solely to regulation rather than ASIC instrument will achieve this aim. We consider that the plethora of exemption by regulation is largely as a result of lobbying by vested interests, a point acknowledged by Treasury.[32] This does not auger well for the goal of eliminating exemptions and qualifications.

75. A recent example of this problem involves the exemptions process for the deferred sales model for add-on insurance (FSRC Recommendation 4.3), from which the Federal Treasurer may grant class exemptions by regulations and ASIC may grant individual exemptions. We have been closely involved in the class exemptions process, and hold serious concerns about the integrity of the process and the outcome, which saw numerous products receive unwarranted exemptions—most notably add-on travel insurance.[33]

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[30] See e.g. Senate Economics Legislation Committee, Hansard, Senate Estimates, 2 June 2021, ASIC, at p 54: https://parlinfo.aph.gov.au/parlInfo/download/committees/estimate/392ffa59-25f2-4dd9-809e-2221cc3b93a9/toc_pdf/Economics%20Legislation%20Committee_2021_06_02_8815.pdf;fileType=application%2Fpdf#search=%22committees/estimate/392ffa59-25f2-4dd9-809e-2221cc3b93a9/0000%22. ASIC Deputy Chair stated: 'But it's the data that's killing us, Senator, and it's in areas where we do not have recurrent data. It's an issue we've raised with the government, we've raised with Treasury and the Treasurer and we're waiting for an answer on. If we were to have recurrent data in some of these areas, we could implement product intervention orders in a much more decisive and quicker way so we can realise the aspirations that we all had for the product intervention order power.'

[31] EG https://treasury.gov.au/consultation/c2021-190728; https://www.legislation.gov.au/Details/F2020L01277

[32] See submission to FSRC Interim Report, page 5 para 23-25.

[33] See https://ministers.treasury.gov.au/ministers/josh-frydenberg-2018/media-releases/outcome-consultation-deferred-sales-model-add; and https://treasury.gov.au/consultation/c2021-190728.

76. Firstly, both Commissioner Hayne[34] and the Productivity Commission[35] recommended that the federal government establish a 'Treasury-led working group to develop an industry wide deferred sales model for add-on insurance'. This was not done.

77. Second, there should have been no exemptions beyond comprehensive motor insurance. Commissioner Hayne's express recommendation was that the 'industry-wide' deferred sales model apply to 'any add-on insurance products (except policies of comprehensive motor insurance)'. The lack of uniform approach and regulatory arbitrage was at the very heart of Commissioner Hayne's recommendation. The Final Report noted that industry attempts to implement a deferred sales model failed to cover the field, and cited the Productivity Commission's observation that:[36]

> *At present, the regulatory paradigm [for add-on insurance] appears to involve ASIC in a game of whack-a-mole with insurers and their retailing partners. Legislators cannot expect the regulator to be effective in this game.*

78. Third, there is no meaningful class of add-on insurances to exempt because it is a reform to a sales tactic and distribution channel, not to an underlying product that is consistent or capable of a meaningful definition. Almost every consumer insurance product is different—even home insurance—because we lack a much-needed modernised 'standard cover' regime in insurance.[37] This required painful work by Treasury to artificially define classes of add-on insurance products, even though coverage varies wildly between individual policies within the so-called class.

79. Fourth, even when the reason for car insurance's exemption—being historically good value for money at a claims ratio of around 89 cents in the dollar—is extended to other products by analogy, few if any add-on insurances meet this high threshold. The Treasury acknowledged any exemption must reach this high threshold, stating in its class exemptions consultation:

> *The Treasurer has noted there may be a limited number of add-on insurance product classes that represent a very high level of value for consumers and where it would not be appropriate that they are captured by the deferred sales model. Treasury is seeking information from stakeholders to identify if any possible add-on classes could meet this high standard to inform Government decisions regarding possible exemptions.*[38]

80. Treasury requested a detailed list of evidence to justify an exemption. Despite this request for evidence, none has been presented transparently or publicly to give comfort that robust evidence was in fact provided, beyond a mere media release.[39] Part way through the consultation process for these exemptions, Consumer Action was asked by Treasury if it could provide evidence that specific classes of add-on insurance products were poor value or causing harm. It appeared that Treasury's approach to exemptions had shifted, from asking industry to demonstrate the value of a product or the harm that the application of the model would cause consumers, to assuming a product should be exempt unless evidence was available to demonstrate otherwise.

81. We are very concerned that some insurers simply don't have or failed to provide the required evidence—we understand that insurers reported they were unable to provide claims ratios for their insurance

[34] Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry (**FSRC**), *Final Report: Volume 1*, Recommendation 4.3.
[35] Productivity Commission, *Competition in the Australian Financial System: Inquiry Report,* 28 June 2018, Recommendation 15.1, page 432: https://www.pc.gov.au/inquiries/completed/financial-system/report.
[36] Final Report, above n 7, p 290.
[37] Reforms to standard insurance that commenced in 2019 have since stalled. For more information, see https://treasury.gov.au/consultation/c2019-t354736.
[38] See: https://treasury.gov.au/consultation/c2021-142813.
[39] Treasurer, Media Release, 8 July 2021, Outcome of Deferred Sales Model Consultation, https://ministers.treasury.gov.au/ministers/josh-frydenberg-2018/media-releases/outcome-consultation-deferred-sales-model-add.

products. This position seems unlikely and highly convenient, considering it is a basic metric that effectively measures the profit margin for a product. Despite this, a significant portion of the insurance industry is exempt from the deferred sales model (including home building, home and contents, landlord insurance and travel).[40] It appears these products have been granted a 5-year exemption, making a mockery of the entire class exemptions process.

82. In our view, ASIC took a much better and more transparent approach to individual exemptions, describing the specific kind of evidence necessary to successfully obtain an exemption and signalled, appropriately, that it was unlikely that any would be given. The reality is that the responsible Minister (supported by Treasury) does not work with insurers enough in a market supervision sense to know whether an exemption should be granted, or to properly test the 'evidence'. Generally, ASIC is in a much better position to do so.

83. Fourth, exemptions powers decided by the responsible Minister are inherently and increasingly political. The Federal Treasurer signalled an intention to exempt travel insurance while tabling the legislation to enact this reform. This exemption would appear to be more about keeping Covid-19-impacted businesses afloat through huge commissions from add-on insurance than any evidence consumers get appropriate insurance cover from travel agents or airlines. The exemption for travel insurance was particularly galling as it came before the Treasury and ASIC exemptions processes, and during all-time high AFCA complaints about travel insurance due to Covid-19 and pandemic exclusions. Travel insurance for the sake of travel insurance is not worth having—it is only worthwhile if the policy purchased covers the risks that are relevant for the consumer and provides value, which thousands of Australians found out the hard way through claims declined on the basis of pandemic and other exclusions. Deciding this in a commission-fuelled add-on sales process is not likely to lead to appropriate cover.

84. This was supposed to be an industry-wide reform to a sales practice—stopping the pressure-sale of complex and often low-value financial products at the point of sale for an entirely different products—that has morphed into an exemption lobbying process.

85. So, despite a lengthy consultation process, we ended up with an outcome not based on evidence or sound public policy but on self-interested lobbying efforts by segments of the insurance industry and their retailing partners. Indeed, the main reason retailers like travel agents and car dealers want to continue distributing complex financial products like insurance is to keep receiving huge commissions. This is linked to yet another problematic loophole resulting from lobbying rather than good public policy: the exemption for insurance from the ban on conflicted remuneration.

Transparency and consultation in rule-making

86. Generally, we would observe that there is often beneficial transparency and explanation where ASIC makes regulatory decisions. This includes publishing feedback papers on any submissions made, to explain how stakeholders' views were or were not taken into account. In the above example, ASIC published REP 695 in response to its consultation on the process and factors ASIC will consider in deciding individual applications for exemptions from the deferred sales model.[41]

87. If the decision to make exemptions is to be via regulation, then we consider that there would be benefit in adopting a transparent charter of consultation around these decisions which would include commitments relating to openness and transparency, decision timelines, and clear feedback and explanations of decisions. We are concerned about a recent practice of ASIC to undertake non-public targeted

[40] A*ustralian Securities and Investments Commission Amendment (Deferred Sales Model) Regulations 2021*, Schedule 1.
[41] ASIC, Media Release, 28 July 2021, ASIC releases guidance and customer information requirements to implement the new add-on insurance deferred sales model, https://asic.gov.au/about-asic/news-centre/find-a-media-release/2021-releases/21-189mr-asic-releases-guidance-and-customer-information-requirements-to-implement-the-new-add-on-insurance-deferred-sales-model/.

consultation following industry requests for exemptions. While consumer advocate views have been sought, this is commonly on the basis of very short timeframes and there is no public transparency around this.

88. We are also concerned that ASIC no longer publishes regular reports about relief applications, including its exercise (or refusal to exercise) exemption or modification powers.[42] The last report on relief applications was published in June 2020, and we understand that no further reports are planned. We think this is a step backwards. Whether decisions regarding regulatory relief or exemption are made at the Minister or regulator level, there needs to be transparency about these decisions, including a clear articulation about how any decision supports the legislative principle, outcome or norm.

Rule-making and industry codes

89. Recent changes to the voluntary code of conduct framework in the *Corporations Act* enable ASIC to designate 'enforceable code provisions' in approved codes of conduct.[43] This is a different form of rule-making, which while based on industry self-regulation, involves the regulator in both approving codes (thus ensuring that they meet certain standards) and designating some provisions of codes to be enforceable.

90. Consumer advocates note that many people achieve justice most directly through reliance on industry code obligations via AFCA. Furthermore, most people do not and cannot go to court and, therefore, most common law development in financial services comes from regulator action rather than consumer-driven action. This means that precedent can build slowly. In this context, industry codes and improvement thereof through consultation with customers can be beneficial.

91. That said, the new 'enforceable industry code' regime suffers from significant flaws that will limit its effectiveness. This is because the incentives in the system do not encourage optimal outcomes:

- Industry sectors will become more circumspect about what provisions they are willing to put in their codes. Establishing that a breach of an "enforceable code provision" will be a breach of the law backed by civil penalties will lead to industry inevitably seeking to water down and weaken their commitments so as to more easily avoid any such penalties.
- There is little incentive for an industry sector to seek approval for their code. While the ASIC approval process applies a degree of rigour to the code development process, there is no compulsion to seek approval. Indeed, the Australian Banking Association is the only industry sector to have done so. Despite other industry associations announcing plans to follow suit, the spectre of enforceable code provisions is likely to dissuade them from doing so with no real adverse consequence.
- In the event that reputational motivation is somehow sufficient to drive sectors to seek approval of their code, ASIC has limited ability to influence what codes actually contain. ASIC only has one tool: approval or not. There is no reason the industry sector won't decide to simply walk away from the process if it is too difficult.
- The only incentive in the proposed system is that the Government can ultimately step in and impose a mandatory code. Certainly the Government may move to impose a code on a very recalcitrant industry, but it seems unlikely this step will be taken lightly, or quickly. Unfortunately, the likelihood of this happening to improve a mediocre code seems rather remote.

92. A much more effective regime would enable ASIC rule-making powers with the respect to the introduction of mandatory codes or code provisions where an industry either fails to submit a code for approval within

[42] See: https://asic.gov.au/regulatory-resources/find-a-document/reports/reports-on-relief-applications/
[43] Financial Sector Reform (Hayne Royal Commission Response) Act 2020

the timeframe provided, or falls short of meeting the standards for approval. This approach would maintain industry agency of the code development process while incentivising industry to strengthen their commitments to consumers.

Accessibility and navigability of rule-books

93. If a rulebook or rulebooks are established, we urge that these are truly a 'one stop shop'. That is, they should include the legislation, any rules, and any exemptions in one transparent place. We would strongly oppose that this level of transparency only be available through commercial legal publishers. While commercial publication can add additional value, there is a public value in having a clear articulation of the law and rules that in one easily accessible place that is free of charge. Individuals, and even community legal centres, will struggle to afford the eye-watering cost of subscriptions to each commercial legal publishers.

94. To give a practical example, we frequently referred the United Kingdom Financial Conduct Authority's freely available Consumer Credit Sourcebook in our advocacy on the need for UK-style reforms to debt management firms in Australia—something we could not have easily done if we had needed a paid subscription to a UK commercial legal publisher. Putting this critically important information behind a paywall would significantly impede access to justice. Instead, ASIC should be required to maintain a user-friendly and freely available rulebook, incorporating best practice principles on accessibility and inclusive design.

95. We consider that the National Electricity Rules, published online by the Australian Energy Market Commission, offers a good example of an easily navigable rulebook.[44] Even this rulebook could be improved by also incorporating the legislation that empowers the rules in the same place.

RECOMMENDATION 15. Adopt a comprehensive rule-book for any exemptions and exceptions from generally-applicable financial services laws.

RECOMMENDATION 16. Provide ASIC with the power to make rules, drawing on its specialist knowledge and expertise as the marketplace regulator.

RECOMMENDATION 17. ASIC's rule-making power should be extended to make specific and generally applicable rules where it considers there is a substantial risk of consumer detriment.

RECOMMENDATION 18. Ensure there is a charter of consultation that provides for public, clear and transparent consultation processes ahead of any regulator decision to issue rules that provide for exemptions and exceptions.

RECOMMENDATION 19. Any rule-book should be publicly accessible and easily navigable.

Financial product advice and debt advice

96. ALRC Report 137 makes various proposals relating to the scope and naming of 'personal' and 'general advice'.

97. In contemplating the definition of 'general advice', the ALRC refers to the finding that the definition of 'general advice' has little to no impact on consumer understanding. ASIC research found that consumers were more likely to be influenced by factors other than the term used. Instead, ASIC noted that 'the circumstances in which general advice is received could significantly increase the risk of consumer misunderstanding of the nature of the advice given'.[45] Despite this, the ALRC recommends that the

[44] https://energy-rules.aemc.gov.au/ner/172

[45] Australian Securities and Investments Commission, 'Findings from Consumer Research on "General Advice" Label' (News Item, 4 May 2021)

definition should be replaced, even if consumer understanding is not enhanced. Given this recommendation fails to deal with the problem consumers face in understanding the nature of the advice given we question the value of making such a change.

98. The recent problems with 'general advice' have had to do with the circumstances in which the advice was provided, rather than the legal definition of advice. In the recent case against Westpac, this boiled down to the fact that consumers reasonably believed the advice they were provided had considered their financial situation.[46] As Gordon J concluded, "Section 766B(3)(b) is concerned with the circumstances of the retail client. Here, those circumstances included the form, content and context of the financial product advice given to the members that they should roll over their external superannuation accounts into their BT account. As O'Bryan J observed, where a provider of advice urges the recipient to follow a particular course of action, there is a greater likelihood that a reasonable person might expect the adviser to have considered the recipient's personal circumstances." On the evidence amending the definition of general advice will lead to no improvement for consumers in navigating advice.

99. A change of definition that does not improve consumer understanding also brings unwanted risk. One of these is that changing the term to something such as 'general information' sends a message that recent problems with 'general advice' are now solved, wasting limited legislative resources and delaying proper resolution to this issue.

100. The provisions relating to advice should be part of a greater policy debate about the circumstances in which general advice is received. We recommend that the ALRC consider any outcomes of the Quality of Advice Review before making recommendations concerning these provisions. This review is meant to be a more holistic review of the problems facing consumers in navigating the advice sector and has the potential to be a better starting point for law reform.

101. That said, we urge the ALRC to consider the benefits of more consistent treatment of financial product advice and debt management advice. In many respects, these two activities share significant attributes in that a consumer is relying on a professional to offer advice to improve their financial situation.

102. From 1 July 2021, persons providing debt advice are required to obtain an Australian Credit Licence (referred to as 'debt management assistance' in regulation 4B of the NCCP Regulations). Debt management assistance is defined as the following activities in relation to consumer credit contracts where a fee is charged by or on behalf of the consumer:

- Suggesting and/or helping a consumer to:
    - apply for a change to a credit contract for which the consumer is a debtor
    - apply for a postponement of enforcement proceedings
    - make a complaint or claim to a credit provider, AFCA, ASIC or the Information Commissioner
- Suggesting and/or helping a consumer to apply for a change to information collected by a credit reporting body about a credit contract for which the consumer is a debtor.

103. This definition covers the following common activities:

- 'Credit repair' services: Offering to 'repair', 'clean' or 'fix' entries in a consumer's credit report that relate to a consumer credit contract
- 'Debt negotiation' services: Offering to help a consumer negotiate repayment arrangements or changes to a debt under a consumer credit contract with the credit provider

[46] Westpac Securities Administration Ltd v Australian Securities and Investments Commission[2021] HCA

- Dispute lodgement assistance: Helping a consumer lodge a dispute with a credit provider or AFCA in relation to the consumer's credit contract
- Hardship notice assistance: Helping a consumer give a hardship notice to a credit provider where they are having difficulties meeting their repayment obligations under their credit contract.

104. The Australian Credit Licence requirement means that relevant service providers must: be 'fit and proper persons'; provide services efficiently, honestly and fairly; have organisational competence; be members of AFCA, among other requirements.[47]

105. This reform is very welcome and for the first time means that this growing area of advice is regulated.

106. Despite this, we remain concerned about the inconsistencies between the regulatory framework that applies to financial advice and that which applies to debt management assistance. For example, the latter does not requirements such as a 'best interests' duty. Such a duty would meet community expectations and ensure that people seeking debt advice are treated consistently with those seeking advice about investments.

107. People struggling with money and debt problems have a number of options that may be available depending on their individual circumstances. These can include hardship and repayment arrangements, debt waivers, 'do not contact' letters and judgment proof options, and insolvency options such as bankruptcy and debt agreements, or legal claims relating to the underlying debt where the lender has breached the credit laws. Financial counsellors and community lawyers can provide impartial, competent advice on these options, and assist and empower people to choose the best option.

108. It is essential that people in financial difficulty can trust their advisors. People are often at their most desperate when they seek advice from a debt management firm. They may be facing home repossession proceedings, bankruptcy, or other enforcement action by creditors, or have been refused credit due to listings on their credit report. The UK Financial Conduct Authority found that people are unlikely to shop around for debt management services and once the firm offers the prospect of help, people are susceptible to influence or make choices that are not in their best interest.[48]

109. Unfortunately, we see conflicted or poor-quality advice from debt management firms (**DMFs**) in Australia:

- recommending the options that the firm itself delivers in-house but ignoring or downplaying options that the firm doesn't deliver in-house;
- recommending the option from which the DMF will earn larger fees—such as recommending a Part IX debt agreement instead of negotiating hardship arrangements;
- failing to inform customers of all the relevant options, particularly options like requesting no more contact, 'judgment-proof' options (for people with no assets and low income), and debt waivers; or
- failing to consider the pros and cons of each option and whether it meets the consumer's needs and individual circumstances.

110. These issues can be seen in our casework, ASIC Report 465, and in AFCA Determination 661320 against a firm that holds an Australian Credit Licence and a Debt Agreement Registration.[49]

[47] See info sheet 254

[48] Financial Conduct Authority, *Quality of Debt Management Advice*, June 2015, available at: https://www.fca.org.uk/publication/thematic-reviews/tr15-08.pdf.

[49] AFCA Determination, Case Number 661320, 9 June 2020, p11-12: https://service02.afca.org.au/CaseFiles/FOSSIC/661320.pdf.

111. Ultimately, it is our view that debt management assistance needs a specific and more appropriate regulatory regime that is aligned with financial advice. This should include specific conduct obligations that respond to the risks of consumer harm associated with debt management assistance, including:

- A ban on advance fees – the use of high upfront or advance fees before services are provided is common;
- Obligations to place client monies into trust;
- Restrictions on unsolicited selling and aggressive marketing;
- Requirements to meaningfully signpost the availability of free services.

112. In addition, the definition of debt management assistance should not be limited to assistance that relates to consumer credit contracts. These advisers commonly purport to provide assistance on a wide array of consumer debts, including energy debts, telco debts and others. The current ACL requirements have created an exemption and opportunity to exploit loopholes. For example, a credit repair company could incorporate a separate business tailored to "telco credit repair" or "energy credit repair" and not be required to obtain a licence.

RECOMMENDATION 20. The ARLC should consider the outcomes of the Quality of Advice Review before making recommendations regarding the labels 'personal' and 'general' advice.

RECOMMENDATION 21. The ALRC should examine opportunities to make the regulation of debt management assistance more consistent with financial advice , and the need for a targeted fit-for-purpose regulatory regime for debt management assistance.

Retail and wholesale client definitions

113. The ALRC Report 137 asks whether the definitions of 'retail client', 'wholesale client' and related concepts should be reframed.

114. The current requirements to be classified by the Corporations Regulations 2001 as not being a "retail client" (and therefore being a "wholesale client") are:

- An Individual investment of at least $500,000
- Or $250,000 annual income in each of the previous two years
- Or $2.5 million of net assets
- Or the person being a "professional investor".

115. The financial threshold test is based on the assumption that people with assets above a prescribed value can afford to acquire financial products or services and do not require protection as a retail client. These people are presumed to have either adequate knowledge of the product or service, or the means to acquire appropriate advice.

116. Evidence given in a recent Federal Court case found that people meeting this threshold often didn't have a sophisticated understanding of finance and investment.[50] Mayfair 101 offered products that were described as low risk 'Fixed Income Notes' and 'Australian Property Bonds' and were exclusively available to wholesale investors. These products were in fact highly speculative and carried very substantial risk. This had a high potential to do very significant financial damage to people who were not sophisticated in

[50] Australian Securities and Investments Commission v M101 Nominees Pty Ltd (No 3)

matters relating to finance and investment. One 70-year-old noteholder, lost $900,000 of superannuation invested with Mayfair 101.[51]

117. The wholesale/retail threshold is a crude implement for the policy problem it is attempting to solve. The ALRC should be looking to learn from the current situation and develop different solutions to solve this problem.

118. We are also attracted to the proposal for greater alignment in these terms with the definitions of 'consumer' under the ASIC Act and the scope of coverage of the NCCPA, that is, where 'services are of a kind ordinarily acquired for personal, domestic or household use or consumption'. This would simplify the regulatory regime and provide for more effective consumer protection.

RECOMMENDATION 22. Align definitions of 'retail client' with the definition of 'consumer' in the ASIC Act to where 'services are of a kind ordinarily acquired for personal, domestic or household consumption'.

Conduct obligations

Norms of conduct

119. ALRC Report 137 asks whether certain norms should be added to financial services legislation as an objects clause. Consumer advocates consider objects clauses should focus on the core objects of the legislation, for example, to protect consumers. Fundamental norms are more effective if they are actually enforceable by the consumer and the regulator, not merely as objects clauses.

120. The FSRC Final Report articulated six fundamental norms of conduct which are already 'reflected in existing law'. The norms are:

- Obey the law;[52]
- Do not mislead or deceive;
- Act fairly;
- Provide services that are fit for purpose;
- Deliver services with reasonable care and skill; and
- When acting for another, act in the best interests of that other.

121. While we agree that these norms are 'reflected' in existing law, there remain gaps – for example, we refer to comments above around debt management assistance (there is no best interests duty); and inadequacies in the requirements that products are fit for purpose and services are rendered with due care and skill (the regulator does not have power to enforce implied warranties in the ASIC Act). It would be helpful if the ALRC could more clearly ensure that these norms provided fundamental enforceable obligations across all areas of financial products and services.

122. At question A19, the ALRC asks what norms should be included in an objects clause. If objects clauses are to go beyond high-level objects (i.e. advance interests and welfare of consumers; build confidence in markets) and into norms, then we would generally support those set out in Table 13.1 of the ALRC Report 137, being 'Principles for Business' in the UK. In particular, norms such as 'act with integrity'; 'pay due

[51] See: https://www.moneymag.com.au/loophole-preventing-investors-complaining-about-ponzi-scheme

[52] We agree with the ALRC that this is redundant because the requirement to obey is fundamental to all law, and is not a norm specifically attributable to this statutory regime.

regard to information needs of clients' are helpful. Other norms might focus on 'building and retaining trust' or 'sustaining an ethical business culture'.

'Efficiently, honestly and fairly' obligation

123. Proposal A20 in ALRC 137 is to separate the legislative paragraph that requires licensees to provide services 'efficiently, honestly and fairly' into three separate paragraphs and to replace 'efficiently' with 'professionally'.

124. We support this proposal so as to aid clarity that there are three separate obligations. Furthermore, replacing 'efficiently' with 'professional' will align the obligation with judicial interpretation which has found efficient to mean 'competent, capable and having and using the requisite knowledge, skill and industry'.

125. That said, we need to point of that the normative notions embedded in the term 'professional' can refer to: "relating to a profession" (like the banking or legal profession), or "paid occupation rather than amateur. We consider that much of the financial services sector would not necessarily see themselves as part of a 'profession'. As such, 'professional' may be at risk of being interpreted more narrowly than 'competent, capable and having and using the requisite knowledge, skill and industry'. It may be better to define 'professional' to address this risk.

126. The ALRC then asks whether the obligation to provide services fairly should be particularised or clarified, and raises concerns about uncertainty of meaning in the term 'fair'.

127. We consider that there is benefit in keeping the legislative obligation relating to fairness broad and simple, without particularisation. A broad obligation should, as stated by Justice Maxwell, "promote and encourage moral awareness and moral agency in the marketplace". Justice Maxwell notes a particular problem with the existing prohibition on unconscionable conduct is that it is not well understood and, indeed, there have been conflicting interpretations across the judiciary. He argues that it would promote better understanding by all concerned—and, it might be hoped, higher standards of conduct—if we had a general consumer law prohibition on conduct which was "in all the circumstances, unfair".

128. Consumer advocates strongly support this, and have argued for an economy-wide probation on unfair conduct for many years. In 2017, the Australian Consumer Law Review recommended exploring how an unfair trading prohibition could be adopted within the Australian context to better address unfair business practice. [53] The Federal Government Response to the ACCC Digital Platform Inquiry, which also recommended a prohibition on unfair trade practices, also supported development of this reform.[54] To aid simplicity, the financial services conduct obligation should reflect any economy wide provision.

129. Consumer advocates do not consider that there is uncertainty of meaning in the term 'unfair'. We broadly support the contention of the ARLC that it includes:

- conduct that exploits another person's vulnerability;
- conduct that substantially and adversely affects the interests of another, undertaken in the pursuit of self-interest; and
- conduct that indicates a lack of reciprocity, including a lack of fair or agreed value.

130. However, we consider it is important not to equate unfair conduct with existing prohibitions on unconscionable conduct and misleading conduct.

[53] CAANZ, Final Report of the Review of the Australian Consumer Law, page 48
[54] See: https://treasury.gov.au/publication/p2019-41708

Gaps in the prohibition on misleading & deceptive conduct

131. The prohibition against misleading and deceptive conduct (in the ASIC Act and the ACL) is a powerful provision, but it has some weaknesses. First, it can be very difficult to prove 'deceptive' conduct against large, modern companies. As argued by Elise Bant, deception requires there to be deliberate dishonesty and knowledge on those who are the 'directing mind and will' of the company:[55]

> *'In large corporations, where roles and responsibilities are dispersed between a huge array of managers, employers and agents, attributing knowledge and dishonesty to defined and "leading" individuals is incredibly challenging and expensive for regulators and victims.*

132. Faced with the almost impossible difficulty of proving fraud in corporate contexts, private litigants and regulators instead focus on conduct that is "misleading… or likely to mislead" rather than "deceptive".'

133. The prohibition on conduct that is misleading or is likely to mislead also has gaps. Judicial interpretation confirms that this prohibition does not require a business to be upfront in its communication. There have been divergent approaches for determining whether omissions (that is, a failure to disclose information) may be misleading. One approach is to analyse the conduct viewed as a whole and to determine whether it conveys a representation that is misleading.[56] Another approach is to analyse whether the circumstances give rise to a 'reasonable expectation' that if some relevant fact existed, it would be disclosed to the person who claimed to be misled.[57] In any event, examples abound where customers are lawfully not informed of material information such that they incur detriment.

134. An example can be found in the decision *Australian Competition & Consumer Commission v AGL South Australia Pty Ltd.*[58] In this case, the energy provider AGL had signed certain residential customers up to energy plans in 2012. In mid-2013, the rates for these customers were increased, but the customers were informed that there was no change in the discount they would continue to receive under their energy plan. This representation was found to be not misleading, and there was no obligation on AGL to inform its customers that the underlying rates had increased. This practice made it more likely that the customers did not shop around and were thus paying a higher price than was reasonable.

135. Another example is the decision of *Australian Competition & Consumer Commission v LG Electronics Australia Pty Ltd.*[59] In this case, LG Electronics made statements outlining what it was prepared to offer a customer as a remedy for a defective appliance, where a manufacturer' warranty had expired. These statements were found not to be misleading. This is despite the consumer guarantee provisions of the ACL providing the customer with remedies greater than what was being offered by LG Electronics. The court held that these were mere 'offers', as part of a 'negotiation', and were not considered to be representations of the consumers' statutory rights. The findings in this case put the onus on the customer to know their consumer guarantee rights and, if they don't, they are likely to suffer detriment by agreeing to a remedy less than those rights.

136. These cases might be contrasted with the European Union and United Kingdom laws relating to unfair commercial practices, which covers misleading omissions. This provision prohibits conduct that 'hides or provides [material information] in an unclear, unintelligible, ambiguous or untimely manner'.[60]

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[55] https://pursuit.unimelb.edu.au/articles/misleading-conduct-so-what. See also section 139B(1) of the CCA.
[56] *Miller & Associated Insurance Broking Pty Ltd v BMW Australia Finance Ltd* [2010] HCA 31 at [23].
[57] *Demagogue v Ramensky* [1992] FCA 557.
[58] [2014] FCA 1369.
[59] [2018] FCAFC 96.
[60] European Commission, Directive 2005/29/EC on Unfair Commercial Practices, [2005] OJ L 149/22, available at: http://ec.europa.eu/consumers/consumer_rights/unfairtrade/unfair-practices/index_en.htm. Implemented in the UK through the Consumer Protection from Unfair Trading Regulations 2008.

Problems with the prohibition on unconscionable conduct

137. The statutory prohibition on unconscionable conduct is designed to addressed egregious behaviour but unfortunately fails to address conduct that has a harsh or unfair impact on consumers.

138. The case of *Australian Competition & Consumer Commission v Medibank Private Ltd*[61] (*Medibank* decision) is an example. In this case, the private health insurer Medibank failed to notify its members about a decision to limit benefits for certain services, despite previously representing across a number of its communication and marketing materials that it would provide such benefits. The Federal Court held Medibank acted harshly and unfairly but found this did not pass the threshold of statutory unconscionability.

139. The High Court decision in *Australian Securities & Investments Commission v Kobelt*[62] *(Kobelt* decision) provides a further example. This case involved the provision of credit known as 'book up' which targeted Indigenous consumers in the Anangu Pitjantjatjara Yankunytjatjara Lands (APY Lands) in remote South Australia. The scheme involved the operator of a general store withdrawing significant amounts of money from his customer's accounts for current and future purchases, depriving them of the independent means of obtaining the necessities of life and creating a dependence upon the store. The majority of the High Court found that unconscionable conduct requires the wrongdoer taking unconscientious advantage of another, determining that the operator of the general store had not engaged in undue influence, pressure or trickery.

140. This approach aligns the statutory prohibition on unconscionable conduct with equitable notions of unconscionability, requiring a high degree of moral wrongdoing on behalf of the trader. It fails to adequately consider the harm conditioned on the consumer nor the fairness of the outcome of the transaction. The judgments of Justices Gaeglar and Keane, which each formed part of the majority in the *Kobelt* decision, demonstrate this focus. Justice Keane asserted that for conduct to be unconscionable it had to exhibit a high level of moral obloquy consistent with predatory conduct.[63] Justice Gageler, while admitting that the concept of moral obloquy was not helpful, nevertheless maintained that for conduct to be condemned as unconscionable it should be conduct that falls well outside societal norms of accepted commercial behaviour.[64]

141. This focus on the conduct of the wrongdoer can be also seen in the judgment of Justice Perram in the *Medibank* decision, where his honour said:[65]

> *'[T]he fact that conduct may be said to have had harsh consequences on a class of members does not in and of itself establish that it was unconscionable. To repeat, neither unfair conduct nor harsh conduct nor both are sufficient to establish unconscionable conduct.'*

142. This focus on the wrongdoer rather than the impact or outcome of conduct is a key reason why the prohibition on unconscionable conduct has not delivered on the community expectation associated with fair dealing.

143. Parliament intended to encourage a more liberal interpretation of the prohibition on statutory unconscionable conduct, but the courts have read down the provision by focusing on conduct rather than impact. This was described by Justice Edelman in a minority opinion in the *Kobelt* decision, when he emphasised the fact that there are two provisions relating to unconscionable conduct—section 20 of the

[61] [2018] FCAFC 235.
[62] [2019] HCA 18
[63] [2019] HCA 18 at [119-120].
[64] [2019] HCA 18 at [91].
[65] [2018] FCAFC 235 at [349].

ACL which prohibits unconscionable conduct within the meaning of the underwritten law (thus drawing on equitable notions of unconscionable dealing) and section 21 which prohibits conduct which, in all the circumstances, unconscionable. The latter was intended to be broader, with the second reading speech stated that the intent was 'to extend the common law doctrine of unconscionable conduct'.[66]

144. In 2010, after concerns that the law was not being interpreted broadly enough, further changes were made to the provision in recognition that the 'current interpretation sets the bar too high'.[67] Two years later, further amendments were adopted to clarify that the prohibition was not to be limited to equitable or common-law doctrines of unconscionable conduct.[68] Interpretive principles were also inserted to make clear that the proscription can apply to a system of conduct or a pattern of behaviour and a specific person with a special disadvantage need not be identified,[69] and that unconscionable conduct 'can extend beyond the formation of the contract to both its terms and the way in which it is carried out'.[70]

145. But as stated by Justice Edelman:[71]

> *'This legislative history clearly demonstrates that although Parliament's proscriptions against unconscionable conduct initially built upon the equitable foundations of that concept, over the last two decades Parliament has repeatedly amended the statutory proscription against unconscionable conduct in continued efforts to require courts to take a less restrictive approach shorn from either of the equitable preconditions imposed in the twentieth century, by which equity had raised the required bar of moral disapprobation. In particular, statutory unconscionability permits consideration of, but no longer requires, (i) special disadvantage, or (ii) any taking advantage of that special disadvantage. Like other open-textured criteria, such as "unfair" or "unjust", there is no clear baseline moral standard for what constitutes "unconscionable" conduct within [the provision]. Nevertheless, the history of development of that statutory proscription demonstrates a clear legislative intention that the bar over which conduct will be unconscionable must be lower than that developed in equity even if the bar might not have been lowered to the "unreasonableness" and "unfairness" assessments in the various categories in nineteenth century equity'*

146. Ultimately, Justice Edelman suggests that if there is to be a lowering of the bar, it 'may only be possible if "unconscionable" is replaced with "unjust" or "unfair"'.[72]

Conceiving fairness

147. As stated by the ALRC, there are existing provisions relating to fairness in the general consumer law, in the guise of the prohibition on unfair contract terms. This prohibition, however, relates specifically to the terms of a regulated contract,[73] and the prohibition doesn't deal with other harmful practices beyond the contract terms like marketing or after-sales conduct.

148. The Full Federal Court in *ASIC v Westpac Securities Administration Limited* [2019] FCAFC 187 examined the duty to provide financial services efficiently, honestly and fairly, in the context of a Westpac outbound telephone sales campaign, and identified a similar principle. In describing the offending conduct, Chief

[66] Australia, House of Representatives, Parliamentary Debates (Hansard), 30 September 1997 at 8800.
[67] Australia, Senate, Standing Committee on Economics, The need, scope and content of a definition of unconscionable conduct for the purposes of Part IVA of the Trade Practices Act 1974 (2008) at 32 [5.6]
[68] Section 21(4)(a), ACL.
[69] Section 21(4)(b), ACL.
[70] Section 21(4)(c), ACL.
[71] [2019] HCA 18 at [49]
[72] [2019] HCA 18 at [311].
[73] It is worth noting that unfair contract terms do not apply comprehensively to consumer contracts, for example, group insurance contracts in superannuation. This is a further example of an exemption in financial services law.

Justice Allsop said: "The perceived importance of the 'closing' being over the phone might be seen as not wanting to let the customer out of the showroom or shop."[74] Westpac's telephone sales impeded the consumer's free choice and was thus considered unfair. We consider this is a helpful conception because it goes to the impact on the consumer, rather than the moral position of the wrongdoer.

149. In this way, a prohibition on unfair conduct can help focus on outcomes, rather than process or actions that a firm might take to comply with the law. Rather than prescribe rules, a principle that promotes fair outcomes for consumers may be more likely to deliver on the community norms relating to fair dealing.

150. Consumer advocates thus consider that a prohibition on unfair conduct is normative and that it can serve to ensure that not only the practices of firms are fair in terms of the processes followed but in terms of the outcomes delivered. This would include, for example, the prices consumers pay. This supports a move towards outcomes-based regulation and a focus on good culture within firms. Such an approach can also mitigate harms associated with unequal outcomes among different classes of consumers in market, particularly consumers experiencing vulnerability.

151. We agree that it is helpful to conceive the scope of such a provision to understand its import and impact, but do not necessarily think this needs to be included in the legislation itself – this detail could be provided in regulatory guidance or approach documents published by an ombudsman. The more particularisation and examples that are provided, the more industry will seek to adhere to the strict words or scenarios outlined and identify loopholes in them.

152. In conceiving the scope of the prohibition on unfair conduct, it may also be helpful to consider the life course of a consumer transaction or service: covering sales and marketing; product design & pricing; as well as service elements, including post-sale customer service. It is also useful to draw upon the analytical framework that already exists for unfair contract terms, that is, whether there is a legitimate business purpose associated with the particular practice and whether it results in an imbalanced outcome for the consumer.

Marketing: addressing manipulation

153. Marketing that impacts or restricts the freedom of choice of a consumer (without good reason) might be considered manipulation and a form of unfair conduct. Manipulation also involves consumer harm that is not reasonably avoidable by a consumer.

154. The widespread digitisation of commerce has given firms an enhanced ability, not only to compile detailed customer profiles, but also exploit consumers' cognitive biases and individual vulnerabilities. The collection of a greater amount of intimate and personalised data creates the opportunity to target marketing more specifically, and even subvert or manipulate reasonable decision-making by consumers.

155. A provision that enables consideration about the impact on the consumer (i.e. was, or is it likely, that harm is incurred) will improve the operation of consumer law; compared to unconscionable conduct which focuses on the conduct of the firm and whether it is against some sort of social norm.

156. The way in which digital platforms exploit personal data has been a particular driver behind the ACCC's prosecution of the need for an economy-wide prohibition on unfair trade practices.[75]

[74] At [175]
[75] ACCC, Digital Platforms Inquiry, July 2019, see https://www.accc.gov.au/focus-areas/inquiries-finalised/digital-platforms-inquiry-0/final-report-executive-summary.

Core product purpose: design and pricing

157. Clearly identifying a core product purpose is an important aspect of fairness, as it provides a yardstick for assessing consumer outcomes. A consumer product or service needs to have a reason for existing (other than a customer paying for and using it, and the firm supplying it).

158. A related aspect of fairness involves ensuring that the commercial returns to the firm associated with the product arise predominantly from consumer outcomes that are consistent with the product's purpose. This analysis would then help identify unfair practices—such as, offering discounts to new customers that aren't replicated for loyal/ongoing customers (a problem in insurance, mortgages, energy) or paying intermediaries (brokers, advertisers, comparison websites) rebates or commissions, creating risks associated with misaligned incentives.

159. This analysis builds on existing rules around fitness for purpose but has a greater focus on fair outcomes, that is, is the product or service likely to meet a consumer need. A key limitation of the existing provisions relating to fitness for purpose is that they generally only apply if the consumer discloses their purpose for purchasing a particular product or service.[76] In most instances, consumers do not disclose a specific purpose.

Addressing vulnerability: universal design

160. Fairness is also about ensuring consumers experiencing vulnerability do not experience worse outcomes than more capable consumers. Where consumers have limited ability to maximise their wellbeing, or have difficulty in obtaining or assimilating information, due for example to age, disability or background, they are less able to buy, choose, or access suitable products.

161. A requirement around fairness can require a better balance between business and customer responsibilities—it can help address the incessant problems caused by long and impenetrable terms and conditions by ensuring that businesses are more upfront with their customers. It can also require businesses to identify potential consumer harm caused by their products and service systems, adopting a 'prevention is better than cure' approach. Importantly, it can also address problems in the area of customer service and complaints processes, which can commonly be designed for those have capability rather than those who experience vulnerability. An unfair trade practice may be one that incorporates unnecessary barriers to service assistance.

162. Fairness can also help establish a universal approach to addressing vulnerability, moving away from a policy approach that focused solely on specific areas of disadvantage.[77] In this way, a regulatory focus on fairness would improve the position of all consumers, including those who need more support due to their vulnerable characteristics or circumstances.

Examples of effective applications of fairness in financial services

163. One example of a fairness standard that operates clearly and simply comes from how AFCA approaches complaints relating to listings on a person's credit report. AFCA has developed an approach to disputes of this nature that largely reflects ensuring that the credit provider has complied with all legal obligations necessary to give it a right or obligation to make such a listing.[78] To assess what is fair in these circumstances, AFCA has determined as a general rule that a listing that is made in accordance with the legal requirements will generally have been fairly made. Indeed, most published AFCA decisions where a

[76] Sections 55 and 61, ACL.
[77] Consumer Action, Submission to ABA Guideline on Customer Vulnerability, June 2019, available at: https://consumeraction.org.au/20190613-vulnerable-customers/.
[78] Reflected in the diagram on page 6 of AFCA decision: https://service02.afca.org.au/CaseFiles/FOSSIC/617615.pdf

credit listing is in dispute find in favour of the credit provider on the basis that proper process has been followed, and there are no other substantial factors impacting the default.[79]

164. However, where other legitimate factors have unfairly impacted the complainant and can reasonably be said to have caused the listing to have occurred, AFCA can consider if fairness would dictate an alternative answer. This power is used sparingly, but has been of immeasurable value in some cases that clearly demonstrate the value of providing for fairness. One example of this is in AFCA determination 617615, where AFCA ordered that a validly made listing be removed, because it occurred as a result of family violence being experienced by the complainant.[80] This reflects what AFCA considers to be good industry practice in such situations,[81] and applies fairness where the negative outcome was outside the control of the consumer thus respecting consumer sovereignty and wellbeing.

165. Another example of where a similar direction had been made based on fairness was in AFCA determination 661320.[82] In that case, a debt management firm quite clearly misled their client about the implications of a listing of a Part IX debt agreement, as well as the alternatives options available to her, and the fees that they were charging for arranging the agreement. This was despite the provision of written disclosure documents that provided relevant consumer information. As the client would not have entered the Part IX but for the misleading advice from the firm (which was not cured by the disclosure), AFCA directed that the firm do all things necessary to remove the client's name from the National Personal Insolvency Index. The case also provides a very clear example of how compensation can be fairly awarded for loss caused by unfair conduct. AFCA awarded compensation for all loss incurred by the complainant that reasonably flowed from the entering of the debt agreement – as it was found that this would not have happened but for the misleading conduct.

Best interests duty

166. The ALRC should proceed with caution in considering changes that may narrow the application of the best interests duty. The Banking Royal Commission was not convinced that it was necessary or appropriate to remove the safe harbour provision.[83]

167. Recasting the safe harbour steps as indicative behaviours of compliance is unlikely to have any material effect on the provision of advice because advisers are currently not actually required to follow the safe harbour requirements in 961(B)2. They are meant as an option to aid the industry's understanding of the law. The root cause of the 'box ticking' problem outlined by the ALRC has been slavish adherence to the guidance by industry participants. The result has been overly complex consumer disclosures which industry claim are costly to produce and we agree have limited impact in alerting consumers to potential harm. As such the law itself is not necessarily at fault, rather the industry has placed all of its emphasis on compliance and ignored the policy intention. The solutions are cultural change within the industry, so that it takes a more consumer centric focus. This includes the industry acknowledging that conflicts of interest are not appropriate and ensuring its disclosures are written in a way that consumers can read and understand them with minimal effort.

RECOMMENDATION 23. Norms of conduct should be enforceable by a regulator and the consumer, not just 'objects' provisions in legislation.

[79] See for example, https://service02.afca.org.au/CaseFiles/FOSSIC/773697.pdf; https://service02.afca.org.au/CaseFiles/FOSSIC/741944.pdf.
[80] https://service02.afca.org.au/CaseFiles/FOSSIC/617615.pdf
[81] The AFCA Approach to joint facilities and family violence, AFCA, page 13.
[82] See https://service02.afca.org.au/CaseFiles/FOSSIC/661320.pdf
[83] Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry, p177

RECOMMENDATION 24. The obligation to provide services 'efficiently, honestly and fairly' should be disaggregated into three clear obligations, and 'efficiently' should be replaced with 'professionally'.

RECOMMENDATION 25. The obligation to provide services fairly should not be particularised in legislation, and should align with an economy wide prohibition on unfair conduct in the general consumer law.

RECOMMENDATION 26. The scope of the fairness provision should not be limited, but regulatory guidance can be provided to help businesses understand what is meant by unfair conduct or practices, including in the areas of:

- Marketing and sales, particularly addressing harm associated with consumer manipulation;
- Product or service design and pricing, drawing on the concepts of a legitimate business purpose and fitness for purpose; and
- Customer service and complaints processes, ensuring service is responsive to customer vulnerability.

RECOMMENDATION 27. The ALRC should proceed with caution in considering changes that may narrow the application of the best interests duty

Please contact **Consumer Action Law Centre** on [redacted] if you have any questions about this submission.

APPENDIX A – SUMMARY OF RECCOMENDATIONS

RECOMMENDATION 1. Retain the broadest definition of 'financial product' and 'financial service' for the purposes of general consumer protection provisions.

RECOMMENDATION 2. Address the complexity of the nexus between the Australian Consumer Law and the ASIC Act, to remove gaps in consumer protection.

RECOMMENDATION 3. Extend consumer guarantee provisions in the Australian Consumer Law to the financial products and services under the ASIC Act.

RECOMMENDATION 4. Abolish the incidental product exclusion in section 763E of the Corporations Act.

RECOMMENDATION 5. The regulatory arrangements should adopt a mechanism such as the UK FCA 'Perimeter Report' to identify any activity that falls outside of regulated definitions.

RECOMMENDATION 6. Regulate consumer leases that are 'finance leases' in the same way as consumer credit contracts, and do not apply a different level of regulation.

RECOMMENDATION 7. Adopt the functional definition of 'credit', being an arrangement involving the deferral of a debt, consistently across all financial services legislation.

RECOMMENDATION 8. Examine the policy basis for exemptions in the National Credit Code from the definition of 'credit' that have been exploited by egregious lending models, and remove them.

RECOMMENDATION 9. Remove the exemptions in the National Credit Code that allow for buy-now-pay-later, wage advance providers, and similar business models to avoid consistent regulatory standards and regulatory oversight.

RECOMMENDATION 10. Adopt a broadly conceived general anti-avoidance law to supplement clear regulatory boundaries for consumer credit.

RECOMMENDATION 11. Recognise that any regulatory shift to improved outcome-based disclosure must address the causes of why it hasn't worked previously, including risk-adverse compliance approaches by firms.

RECOMMENDATION 12. Do not frame outcomes-based disclosure standards with reference to a "reasonable consumer" and instead incentivise firms to meet the information needs of all consumers.

RECOMMENDATION 13. Incorporate consumer testing, ongoing audits of consumer understanding, product use disclosure, and incentive regulation to improve firm approach to disclosure.

RECOMMENDATION 14. Further explore appropriate standards and guidance on disclosure in the context of advertising and marketing.

RECOMMENDATION 15. Adopt a comprehensive rule-book for any exemptions and exceptions from generally-applicable financial services laws.

RECOMMENDATION 16. Provide ASIC with the power to make rules, drawing on its specialist knowledge and expertise as the marketplace regulator.

RECOMMENDATION 17. ASIC's rule-making power should be extended to make specific and generally applicable rules where it considers there is a substantial risk of consumer detriment.

RECOMMENDATION 18. Ensure there is a charter of consultation that provides for public, clear and transparent consultation processes ahead of any regulator decision to issue rules that provide for exemptions and exceptions.

RECOMMENDATION 19. Any rule-book should be publicly accessible and easily navigable.

RECOMMENDATION 20. The ARLC should consider the outcomes of the Quality of Advice Review before making recommendations regarding the labels 'personal' and 'general' advice.

RECOMMENDATION 21. The ALRC should examine opportunities to make the regulation of debt management assistance more consistent with financial advice , and the need for a targeted fit-for-purpose regulatory regime for debt management assistance.

RECOMMENDATION 22. Align definitions of 'retail client' with the definition of 'consumer' in the ASIC Act to where 'services are of a kind ordinarily acquired for personal, domestic or household consumption'.

- Marketing and sales, particularly addressing harm associated with consumer manipulation;
- Product or service design and pricing, drawing on the concepts of a legitimate business purpose and fitness for purpose; and
- Customer service and complaints processes, ensuring service is responsive to customer vulnerability.

RECOMMENDATION 27. The ALRC should proceed with caution in considering changes that may narrow the application of the best interests duty

APPENDIX B – ABOUT THE CONTRIBUTORS TO THIS SUBMISSION

About Consumer Action

Consumer Action is an independent, not-for profit consumer organisation with deep expertise in consumer and consumer credit laws, policy and direct knowledge of people's experience of modern markets. We work for a just marketplace, where people have power and business plays fair. We make life easier for people experiencing vulnerability and disadvantage in Australia, through financial counselling, legal advice, legal representation, policy work and campaigns. Based in Melbourne, our direct services assist Victorians and our advocacy supports a just marketplace for all Australians.

About CHOICE

Set up by consumers for consumers, CHOICE is the consumer advocate that provides Australians with information and advice, free from commercial bias. By mobilising Australia's largest and loudest consumer movement, CHOICE fights to hold industry and government accountable and achieve real change on the issues that matter most. To find out more about CHOICE's campaign work visit www.choice.com.au/campaigns and to support our campaigns, sign up at www.choice.com.au/campaignsupporter.

About Financial Rights Legal Centre

The Financial Rights Legal Centre is a community legal centre specialising in financial services, particularly in the areas of consumer credit, banking, debt recovery and insurance. It is the only such Centre in NSW, and one of the only centres in Australia that fully integrates telephone assistance and financial counselling with legal advice and representation. The Financial Rights Legal Centre also operates the Insurance Law Service, a national specialist consumer insurance advice service, Mob Strong Debt Help, and the Credit & Debt Legal Advice Line.

About Super Consumers Australia

Super Consumers Australia is the people's advocate in the superannuation sector. Originally called the Superannuation Consumers' Centre, Super Consumers advances and protects the interests of low and middle income people in Australia's superannuation system. It was founded in 2013 and received funding for the first time in 2018.