IMPROVING CONSUMER DISCLOSURE

Submission to the Financial System Inquiry

September 2014

Executive Summary

The Financial System Inquiry Interim Report notes that the current disclosure regime for retail financial products and services is not always effective in meeting its objective. It produces complex and lengthy documents that often do not improve customer understanding and impose costs on financial service providers.[1]

ANZ Bank and the Consumer Action Law Centre have jointly prepared this paper to provide additional information and to help advance thinking on options for improving the current consumer disclosure regime.

It is recommended that the Inquiry accord priority to electronic delivery of existing product disclosure information, with appropriate safeguards for those that lack access to electronic communication.

Improved disclosure requires greater use of plain English drafting and key fact sheets or short form disclosure for basic retail banking products and credit products.

Good disclosure is comprehensible and simple, presents the most important information prominently, includes product warnings, is comparable, and is based on an understanding of how ordinary people use disclosure documents and make decisions.

Sharing information with customers about how they have used financial products in the past can help address people's overconfidence in their ability to make good and accurate decisions.

A layered approach to consumer disclosure is also favoured to address different customer needs and levels of understanding. This will be slower to implement and should be fully tested with consumers before being introduced across the financial system.

Behavioural Economics offers insights into improving disclosure for consumers. Some of these insights are already informing how organisations, including ANZ, present information to improve customers' understanding of financial products.

It is also recognised that disclosure is not always the best approach to addressing consumer concerns.

An option is to move from sole reliance on disclosure of information towards a system, such as the UK's Money Advice Service, where free consumer guidance is provided and tools are made available to assist with financial decision making.

[1] Financial System Inquiry, 3-56.

Introduction

Australia and New Zealand Banking Group (ANZ) and the Consumer Action Law Centre (Consumer Action) have jointly prepared this paper on improving consumer disclosure of retail financial products. We share the objective of improving communication between financial services providers and customers to ensure better consumer outcomes.

This submission provides additional information to help advance thinking on options for improving the current disclosure regime for retail financial products. It explains how Behavioural Economics can offer insights into improving disclosure for consumers and how organisations, including ANZ, are already using these insights to modify how they present information to improve customers' understanding of financial products.

Disclosure, as a regulatory tool, reflects the contractual nature of buying and selling services. It is necessary for consumers to make effective decisions and for companies to be accountable for what they offer. It can be expected that disclosure will remain a major part of the policy framework. This means effort should be put into improving disclosure. Better disclosure can, in turn, improve communication between businesses and their customers, reducing the likelihood of future disputes.

Disclosure has moved over time to reflect community expectations. Today, the community expects disclosure to be accurate, tailored in some circumstances to the individual seeking to act and, as a concept, disclosure contains elements of fairness.

Objectives and Principles

Good disclosure makes for efficient and transparent markets. Disclosure helps consumers choose the products that best meet their needs, and in turn helps consumers give accurate signals to business about what they want and how much they are willing to pay.

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:** following from the point above, any features which carry notable risk for a customer should be made prominent and very clear. An example is the warning required on payday lending websites and store fronts.

- **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.

Recognising limits to disclosure

In its FSI submission, the Federal Treasury noted that current approaches to disclosure "have reached the limits of their effectiveness" and "businesses are incurring compliance costs from a regulatory regime that has minimal impact on consumer empowerment, and often pass these costs on to consumers."[2]

ANZ's submission[3] suggested the operation of the disclosure regime is an area which should be improved as it does not appear to meet its objective of informing customers before they agree to proceed.

Consumer Action noted in its submission[4] the limitations of a regulatory framework focused on disclosure and based on the assumption that consumers will act rationally. This has been recognised in statements by the Head of the FSI, David Murray and by ASIC Chair, Greg Medcraft.

Consumer Action identified a shift in recent years away from using disclosure as a default option for responding to a consumer protection issue. Disclosure has long been regarded as a cost effective and politically expedient response to consumer protection problems because it doesn't require significant changes to business practices and so is less costly to introduce.

Elsewhere it has been observed that financial literacy across the community as a whole is lower than was expected when the principle of disclosure was taken up across the financial system.

Even if disclosure is improved, there will be some problems that disclosure cannot fix, like conflict of interest and unlawful conduct. Where this kind of problem exists in an industry, it is better to address it directly.

There is an increasing focus on unfair practices rather than disclosure to achieve improved consumer protection. Consumer Action argues that this is not to dismiss altogether the role of disclosure: it "should remain in the toolkit" but should be used only when appropriate.

[2] http://fsi.gov.au/files/2014/04/Treasury.pdf
[3] http://fsi.gov.au/files/2014/04/ANZ.pdf , p. 42
[4] http://fsi.gov.au/files/2014/04/Consumer_Action_Law_Centre.pdf

Incorporating Behavioural Economics

Behavioural Economics provides a critique of the assumption in classical economic theory that consumers act rationally and are well informed decision makers. It applies insights into human behaviour from Psychology to help explain how people make decisions and to demonstrate that people are not driven by rational thought in the way that traditional economics suggests. Rather, humans have systematic, inbuilt biases that affect their decision-making and can lead to decisions that are not in their best interests. Emotions, social norms, time pressures and limited processing ability may outweigh rational consideration of costs and benefits based on available information.

A good example of the issues which arise are the number of people who continue to choose the 'aggressive' investment option for their superannuation savings despite being close to retirement age.

The fact that these biases are deeply ingrained in human behaviour places limits on disclosure as a tool for ensuring consumers make informed decisions. More disclosure may not promote better outcomes. The form of disclosure, the way it is presented and the language used are key determinants of response. Using disclosure effectively means designing disclosure for consumers.

What are some of the biases?

There is no single accepted framework or agreed terminology for biases identified in Behavioural Economics. Some examples of common influences that affect financial decision-making include: framing, anchoring, procrastination/ preference for the immediate, choice overload and overconfidence.

Framing

The way an offer is presented impacts decision-making. Individuals tend to make inconsistent decisions depending on the way an offer is framed.

Anchoring

Numerical estimates are influenced by a previously considered (and potentially exogenously provided) standard of comparison. This effect has been demonstrated in many experiments and this bias can be easily exploited in product pricing and sales information.

Procrastination/preference for the immediate

People have a natural tendency to put off actions that require self-discipline or trading off enjoyment today in favour of benefits that will not be realised until well into the future. The most obvious application in financial services is to saving for retirement.

Choice Overload

People have a tendency not to enter a market where there are too many products available and if they do enter a market with a large array of choice, they tend to display a preference for simpler rather than less risky options. Examples often used to demonstrate choice overload are insurance policies and retirement income products. Research from the US shows that increasing the number of funds available to workers decreases the number of participants taking up plans and that the way people choose to allocate assets is affected by the number of options before them, rather than the risk attaching to asset types.[5]

People have limited 'processing power' and time and use rules of thumb to make decisions. More information, even accurate information, can be distracting and lead to poor decisions as well as discouragement of taking up products. For example, a rewrite of mortgage disclosure information to disclose broker commissions actually increased trust in the broker when it should have led customers to be more critical about the advice.[6]

Overconfidence

People tend to overestimate their ability to make good decisions and place too much faith in the accuracy of their own judgements. Judgements themselves are affected by a range of biases such as confirmation bias (evaluation of evidence with a bias towards one's existing beliefs) and optimism (probability of the desired outcome is higher than is warranted on objective assessment).

There are many experiments demonstrating overconfidence. It is usual that people overestimate their abilities. An example of this is provided in the ANZ Survey of Adult Financial Literacy 2011 when people were asked how they felt their financial ability and knowledge compared to other Australians when making money decisions. Some 29 per cent responded 'above average', 62 per cent 'about average' and only 8 per cent felt their financial ability and knowledge was 'below average'.

How Behavioural Economics can affect regulation

The most influential thinking on the issue of how public and private organisations can assist people to make better choices is advanced by US academics Richard Thaler and Cass Sunstein in their book, 'Nudge: Improving Decisions about Health, Wealth and Happiness'. Thaler and Sunstein call their approach 'libertarian paternalism'. They propose people can be steered towards better decisions by presenting choices in different ways – ways that 'nudge' people towards decisions in their interests. The approach is to take account of inbuilt biases in policy design.

For example, in financial services, better default plans for employees saving for retirement would reduce the disadvantage experienced by employees who do not actively choose a retirement plan to contribute to. The MySuper reforms adopted this principle. Also, people may wish to save more but do not due to procrastination bias. To address this, people could be invited to commit in advance to automatic increased saving contributions that coincide with pay increases, so that the effects of saving more do not impact strongly on the income available to be spent.[7] The importance of 'default settings' is one of the key insights offered by Behavioural Economics. Financial services providers must weigh up these factors against costs associated with a regulatory regime which mandates default products.

Research in the United States and the United Kingdom explores how regulators can improve outcomes by framing policy to take account of behavioural biases (see attachment for further details).

[5] Sheena Iyengar and Kamenica Emir, 2007, Choice Overload and Simplicity Seeking.
[6] James Lacko and Janis Pappalardo, 2004, The effect of mortgage broker compensation disclosures on consumers and competition: A controlled experiment, *Federal Trade Commission Bureau of Economics Staff Report* referenced in Financial Services Authority, 2008, Financial Capability: A Behavioural Economics Perspective.
[7] Richard H. Thaler and Shlomo Benartzi, 2003, Save More Tomorrow: Using Behavioural Economics to Increase Employee Saving

Improving the disclosure regime

Consumer Action and ANZ support Treasury's work to date on modernising disclosure and have participated in stakeholder consultations undertaken by the Department. Companies, including ANZ, are also independently introducing changes in how they disclose information to meet their statutory obligations and assist customers make informed decisions.

Plain English drafting

ANZ is working to improve disclosure of product information for financial products within the existing Product Disclosure Statement (PDS) regime. 'User experience' staff work with business units to ensure information for customers on web pages, in the PDS, and in Terms and Conditions (T&Cs) is presented clearly and simply.[8]

Legal requirements continue to govern the content of disclosure, however financial services organisations recognise that many customers do not read the PDS and T&Cs. This can be addressed to an extent by building relevant parts of the PDS into product feature descriptions, comparison tables, and through plain English writing.

Some companies are introducing innovative approaches to simplifying lawyer-approved T&Cs. For example, US start-up Bagcheck included 'plain English highlights' alongside more detailed legally drafted terms and conditions (see Table 1).[9]

Table 1: Example of Plain English drafting

Terms of Use	**Plain English highlights**
These Terms of Use ("Agreement") contain the legally binding terms for your use of the Service. By visiting, accessing or using the Service, you are accepting this Agreement and you represent and warrant that you have the right, authority, and capacity to enter into this Agreement. If you do not agree with all of the provisions of this Agreement, please do not access and/or use the Service.	By using this service, you are agreeing to this Agreement

Source: Excerpt from Bagcheck Terms webpage

Simplifying consumer credit disclosure

Research by Paul O'Shea from the University of Queensland on simplification of consumer credit disclosure has led to the development of Key Facts Sheets for home loans and insurance products.[10] This is an attempt to design disclosure in a way that reduces the volume of disclosure but improves consumer comprehension. For example, ANZ has an online tool that produces Key Fact Sheets to comply with NCCP requirements. At present ANZ produces these for home loans and credit cards (Table 2). Further work across the industry is required to ensure Key Fact Sheets reduce the overall volume of disclosure. At present it is additional rather than complementary disclosure.

[8] See for example, www.wealth.anz.com/superannuation/smart-choice-super
[9] Bagcheck has since been acquired by Twitter but see http://web.archive.org/web/20130515093815/https://bagcheck.com/terms
[10] Paul O'Shea, 2010, Simplification of Disclosure Regulation for the Consumer Credit Code: Empirical Research and Redesign – Final Report, UniQuest Pty Ltd.

Table 2: ANZ loan Key Fact Sheet example

What you have told us	
Loan Amount	$300,000.00
Term of the home loan	30 years
Interest type	Variable
Lender and product name	ANZ - Simplicity PLUS

HOW DOES THIS HOME LOAN COMPARE?

Description of this home loan	
Repayment method	Principal and interest
Repayment frequency	Monthly (other repayment options are available)
Interest rate	5.18% per annum
Personalised comparison rate (interest rate including fees)	5.20% per annum

Estimated cost of this home loan	
Total amount to be paid back (including the loan amount and fees)	**$592,306.12**
This means you will pay back	**$1.97 for every $1 borrowed**
Establishment fees	**$600.00**
Ongoing fees	**$0.00**
Repayment per month (including ongoing fees)	**$1,643.63**
Repayment per year (including ongoing fees)	**$19,723.54**

Source: ANZ.com[11]

Minimum payment warnings

In 2010, National Consumer Credit Protection reforms introduced minimum payment warnings on credit card payment bills. Consumer Action reports that feedback from its clients is that these warnings have improved consumer understanding of only paying the minimum repayment. UK research has found that credit card bills with a minimum monthly payment have an anchoring effect on customers and that removing a minimum payment could increase average repayments, halving the interest paid by cardholders.[12]

Improving online training

ANZ bank also invests in 'usability' standards incorporating behavioural principles in the design of online education courses. MoneyMinded is ANZ's flagship adult financial education program delivered in 17 countries. Previous evaluations of MoneyMinded have confirmed its success in helping people across a range of ages, backgrounds and circumstances to build their financial skills, knowledge and confidence.

The new MoneyMinded website – launched in late July - allocated 15 per cent of its total project budget on ensuring customer 'usability', including a significant investment in design and user testing. All aspects of user experience were considered when designing the website. This included using clear and simple messaging, incorporating animation and voiceovers for users with low levels of literacy, designing a friendly and

[11] See http://www.anz.com/personal/home-loans/calculators-tools/request-fact-sheet/
[12] Neil Stewart, The Cost of Anchoring on Credit-Card Minimum Payments, University of Warwick.

reassuring registration process and creating activities of no more than 15 minutes in length for time-poor users.

Future opportunities

Further work at an industry level is required to modernise approaches to disclosure for financial products to better meet customer needs. Consumer Action and ANZ endorse the drivers for modernisation identified through Treasury's work to date, including how technology is used to provide customers with information, and options for supplementing existing disclosure practices identified in the FSI Interim Report.

The following considerations are also relevant to improving disclosure.

Greater use of electronic disclosure

The default mechanism for providing disclosure is not through electronic channels. Customer permission is required before this information is provided electronically. An opt-out approach would be more efficient.

At the same time, shifting more disclosure online needs to be accompanied by approaches that reduce the risk of exclusion for customers without internet access, who are also likely to be amongst the most disadvantaged and excluded consumers (lowest incomes, lowest literacy, new migrants).

Layering

Layering the provision of information involves high impact, short form disclosure at the outset, which covers only the most important points and allows customers to easily compare different products. Then, more detailed disclosure is made available on request (click through). This may include information of particular relevance after purchase (eg relating to the Financial Ombudsman Service).

Product issuers and advisers are currently providing similar generic information through disclosure that is largely 'pushed' to consumers rather than 'pulled' from central online databases and websites. Addressing how information is communicated to customers could help development of digital services.

An example of where layering is already used is in the disclosure of privacy policies. Organisations which handle personal information are required to have an accessible privacy policy, but the full policy doesn't have to be provided upfront. It is accepted that it is more useful for everyone if organisations have a summary version covering key points, and the full version available online.[13]

Product use disclosure

More effective disclosure includes disclosing to a customer the way they use a financial product, rather than attributes of the product. Product use disclosure, though already used – for example, credit card minimum payment warnings – could be increasingly integrated into disclosure practices.[14]

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[13] See for example Our Communities with its privacy policy summarised under the heading "the stuff you really care about": http://www.ourcommunity.com.au/general/privacy_ethics.jsp. See also the new disclosure regime for Retirement Villages in Victoria. Retirement village operators are required to produce a short form disclosure document for consumers at the shopping around stage to help them compare villages. Later, when a consumer is considering a particular unit, there is also a more detailed pre-contract disclosure document which is still relatively short but has more detail on that unit. The contract then sets out all details for a consumer who decides to buy into the village.

[14] Oren Bar-Gill has written extensively about product use disclosure. For example see Oren Bar-Gill, 2012, Seduction by Contract: Law, Economics and Psychology in Consumer Markets, Oxford University Press.

Product use information makes disclosure more salient. For example, rather than only disclosing the interest rates payable on a credit card, providers could access previous transaction data to put a dollar figure on how much the customer is likely to spend in interest each year.

Guidance

Another option is to move from sole reliance on disclosure of information towards a system where guidance is also provided and tools are available to assist with financial decision making. ASIC's MoneySmart online tools is an example. In the UK, a Financial Capability Strategy was released by the Financial Services Authority in 2006 and a 'money guidance' strategy was adopted following the 2008 Thorensen Review. This is the current Money Advice Service website.[15]

The UK Money Advice Service offers free and impartial information and advice to help people make the most of their money. It offers money advice to everyone across the UK – online, on webchat, over the phone, in printed guides and face to face. The website includes articles and information to help with budgeting for major life events and offers tools – calculators, planners and comparison tables – to assist with budgeting and decision making. The UK Money Advice Service is currently working to revise its financial capability strategy. ANZ's MoneyMinded program, referred to above, has a similar objective; it aims to increase adult financial literacy in countries where ANZ operates.

Recommendations

Improving the form, content and volume of financial information provided to retail customers should be a priority. Experience in adapting complex financial services to online provision, for example in relation to e-conveyancing or the payments system innovation, indicates that a long-term approach is needed. A multidisciplinary approach is needed for improving disclosure, including considering consumer behaviour, legal and policy issues, and financial service provider operational impacts. These need to be weighed up to develop the best approach to disclosure in a digital environment.

It is recommended that the Inquiry accord priority to electronic delivery of existing product disclosure information, with appropriate safeguards for those that lack access to electronic communication.

Changes to disclosure, such as the introduction of layered disclosure, will be slower to implement. It is recommended that pilot programs test any proposed changes to disclosure to understand how customers respond before the change is rolled out across the financial system. Behavioural economics suggests that the consumer response is not always predictable.

[15] https://www.moneyadviceservice.org.uk/en

Attachment: Government responses to behavioural economics

In the United Kingdom, a Behavioural Insights Team (known as the Nudge Unit) was established by the Cameron Government in the Cabinet Office in July 2010 to influence public policy-making to help achieve the Government's goal of finding 'intelligent ways to encourage, support and enable people to make better choices for themselves'. Richard Thaler acts as adviser to The Behavioural Insights Team, headed by Dr David Halpern. The Team's work advocates testing public policy interventions and adapting them so they are much more effective at achieving their objectives. For example, the Team has demonstrated that by keeping tax letters as simple as possible and informing debtors that most others in their areas have already paid their tax repayment rates were boosted by around 15 percentage points.[16]

In Australia, the consumer movement has advocated consideration be given to behavioural economics in consumer protection policy. In practice, application has been very limited to date.[17] ASIC is aware of the implications of behavioural economics and has begun to consider them in its work on financial literacy: "improving people's knowledge will not automatically improve the quality of their financial decisions. Nor will the provision of information, or even the benefit of experience, necessarily improve knowledge".[18]

The Productivity Commission, as part of its 2007 Inquiry into Australia's consumer policy framework, convened a roundtable on behavioural economics with a keynote address by Professor Eldar Shafir from Princeton University.[19] In 2013, the New South Wales Government brought Dr Halpern, formerly of the UK Behavioural Insights Team, to speak in Australia. Since then, the NSW Government has established its own Behavioural Insights Team as part of its Department of Premier and Cabinet.[20]

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[16] Cabinet Office Behavioural Insight Team, 2012, Fraud, Error and Debt, *Policy Paper, Gov.uk*
[17] ASIC, 2011, Financial literacy and behaviour change.
[18] Ibid.
[19] Productivity Commission, 2007, Behavioural Economics and Public Policy, Roundtable Proceedings
[20] http://bi.dpc.nsw.gov.au/

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