15 August 2018

By email: productregulation@treasury.gov.au

Manager
Consumer and Corporations Policy Division
The Treasury
Langton Crescent
PARKES ACT 2600

Dear Sir/Madam

Design and Distribution Obligations and Product Intervention Powers

Thank you for the opportunity to comment on the revised exposure draft of the *Treasury Laws Amendment (Design and Distribution Obligations and Product Intervention Powers) Bill 2018* (**the revised Bill**) and explanatory materials.

The following organisations have contributed to and endorsed this submission:

- Australian Shareholders Association
- CHOICE
- Consumer Action Law Centre
- Consumer Credit Law Centre SA
- Consumer Credit Legal Service (WA)
- Consumers' Federation of Australia
- COTA Australia

- Financial Counselling Australia
- Financial Rights Legal Centre

Details about each contributing organisation are contained in **Appendix 1.**

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EXECUTIVE SUMMARY

We continue to strongly support the introduction of the Design and Distribution Obligations (**DADOs**) and Product Intervention Powers (**PIP**) for the reasons outlined in our previous submissions.[1] The recent examples of misconduct revealed by the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Sector (**the Royal Commission**) have provided even further evidence of the need to improve product design and distribution, and enhance the enforcement powers of regulators.

We reiterate recommendations outlined in our previous submissions on the proposed DADOs and PIP to the extent that they have not been addressed in the revised Bill. In particular, we maintain our position that the DADOs and PIP should apply to 'financial products' as defined in the *Australian Securities and Investments Commission Act 2001 (***ASIC Act**). This would reduce regulatory gaps and incentives for firms to engage in regulatory arbitrage, a major problem that has also been highlighted at the Royal Commission, and which had been flagged in submissions to the Financial System Inquiry (**FSI**). Importantly, it would ensure that regulated and unregulated consumer credit are captured by these reforms.

We note that the revised Bill has weakened the regime in several key respects, which risks undermining the policy intent behind the regime. In preparing our submission, we returned to the original objectives of the PIP and DADO recommendations in the FSI Final Report. These objectives are more pertinent than ever in an environment of declining consumer confidence in financial services providers and should inform consideration of any exemptions or weakening of obligations. These objectives included:

- Reduce the number of consumers buying products that do not match their needs, and reduce consequent significant consumer detriment;
- Promote fair treatment of consumers by firms that design and distribute financial products;
- Build consumer confidence and trust in the financial system; and
- Limit or avoid the future need for more prescriptive regulation.[2]

[1] Joint consumer submission, *Design and Distribution Obligations and Product Intervention Power – Proposals Paper,* 15 March 2017, available at: https://policy.consumeraction.org.au/2017/03/21/design-and-distribution-obligations-and-product-intervention-power-proposals-paper/; Joint consumer submission, *Supplementary submission: Design and Distribution Obligations and Product Intervention Power – Proposals Paper,* 24 March 2017, available at: https://policy.consumeraction.org.au/2017/03/28/supplementary-submission-design-distribution-obligations-and-product-intervention-power-proposals-paper/; Joint consumer submission, *Treasury Laws Amendment (Design and Distribution Obligations and Product Intervention Powers) Bill 2018,* 8 February 2018, available at: https://policy.consumeraction.org.au/2018/02/13/submission-design-and-distribution-obligations-and-product-intervention-powers/.

[2] Financial System Inquiry, *Final Report,* December 2014, pp. 199 and 207, available at: http://fsi.gov.au/files/2014/12/FSI_Final_Report_Consolidated20141210.pdf.

We have reviewed the revised Bill having considered these original objectives, and we have made additional recommendations relating to amendments in the revised Bill as a result. In relation to DADOs, our organisations:

- Support the requirement to provide target market determinations to the public free of charge, increased penalties and the extended civil liability regime;
- Support some but not all aspects of the ordinary shares exemption;
- Have concerns with some of the other proposed exemptions, in particular margin lending and products listed under section 708;
- Oppose the weakened requirements for suitability of target market determinations, record keeping, ASIC notification and timeframes for stopping harmful product distribution;
- Oppose the proposed exemption for personal financial advice and dealing associated with implementing personal financial advice; and
- Oppose the extension of the transition period to two years.

In relation to ASIC's PIP, our organisations:

- Strongly support extending the regime to funeral insurance, extended warranties and short-term credit;
- Oppose intervention orders only applying to products acquired after the date of the order; and
- Reiterate previous recommendations to strengthen ASIC's PIP, including extending the maximum period for interventions and allowing ASIC to intervene in relation to a broader range of conduct, including remuneration and training.

We have provided further comments and recommendations below.

DESIGN AND DISTRIBUTION OBLIGATIONS

Products subject to the obligations

We maintain our position that linking the application of the new obligations to disclosure requirements in the *Corporations Act 2001* (**Corporations Act**) unnecessarily narrows the scope of the DADOs. We reiterate our previous recommendation that the obligations apply to financial products as defined in the ASIC Act, which would include regulated and unregulated credit. This would ensure that harmful credit products and financial products that are designed to exploit regulatory loopholes would be captured.

We note the Minister's ability to add new products by regulation.[3] If our recommendation above is not accepted, in the alternative we recommend that the Minister use the regulation-making power to apply the DADO regime to funeral expenses insurance, certain extended warranties and short-term credit, which would correspond with the proposed PIP regulations.[4] Further, we recommend the Minister extend coverage by regulation to credit products that pose a considerable risk of harm to vulnerable Australians, such as payday loans, consumer leases, credit cards and 'buy now pay later' products.

Recommendation 1: Apply DADOs to 'financial products' as defined in the ASIC Act. In the alternative, extend the scope of the regime by regulation to funeral expenses insurance, certain extended warranties and short-term credit, plus other types of harmful consumer credit.

Exemptions

We understand the rationale for the exemption of fully paid ordinary shares. However, as we stated in our two earlier submissions, we consider that the exemption is too broad. We repeat our recommendation that the exemption, if any, for ordinary shares be limited to fully paid ordinary shares in listed Australian companies traded on the ASX. Secondary listings (for example, for NZSE50 stocks) could be considered for exemption by ASIC on a case-by-case basis. This would ensure that low-cap shares traded on alternative exchanges are not covered by the exemption. The new, additional exemption for shares of foreign-incorporated companies should be likewise limited to those shares that are listed on the ASX. The anti-avoidance mechanisms are acceptable.

We remain concerned about the exemption of margin loans from the DADO regime, particularly given that the protections under Division 4A of Part 7.8 of the Corporations Act do not protect 'sophisticated investors'.[5] Since clients can qualify as sophisticated investors by virtue of their assets or income, rather

[3] Schedule 1, section 994B(1)(e).
[4] Explanatory Memorandum, paragraph 2.24.
[5] *Corporations Act 2001* (Cth) s 761GA.

than investment expertise, it is undesirable that investment products that may be specifically targeted to them would be exempted.[6]

Further, paragraph 1.24 of the Explanatory Memorandum states that "As [section 708 products] are excluded from disclosure under Part 6D.2, they are not subject to the new design and distribution regime". We acknowledge this rationale; however, this list does not refer to section 708(10), which outlines the conditions under which an offer can be made without disclosure. For example, the licensee must be satisfied that the person to whom the offer is made has previous experience in investing in securities that allows them to assess the merits of the offer and other matters. Without reference to the conditions under section 708(10), it appears that there would be a wide loophole for the DADO regime to be circumvented.

Recommendation 2: Limit the exemption for ordinary shares to fully paid ordinary shares in listed Australian companies traded on the ASX. The new, additional exemption for shares of foreign-incorporated companies should be likewise limited to those shares that are listed on the ASX.

Recommendation 3: Remove the exemption for margin lending and clarify that the exemption for products listed in section 708 of the Corporations Act is subject to the conditions in section 708(10).

Making target market determinations

We support the new obligation to make target market determinations available to the public free of charge.[7] We agree that this would mitigate evidential difficulties with substantiating non-compliance with target market determinations. It also enables consumers, policymakers and advocates to access a target market determination should they wish to do so. However, the obligation to make target market determinations available only applies to issuers, rather than distributors of the product. This is problematic given the extensive white-labelling of financial products in the Australian market. As noted by the Productivity Commission in its draft report considering competition in the financial system:

> *…much of what passes for competition is more accurately described as persistent marketing and brand activity designed to promote a blizzard of barely differentiated products and 'white labels'.*[8]

[6] See: Joint consumer submission, *Treasury Laws Amendment (Design and Distribution Obligations and Product Intervention Powers) Bill 2018,* 8 February 2018, pp. 9-10, available at: https://policy.consumeraction.org.au/2018/02/13/submission-design-and-distribution-obligations-and-product-intervention-powers/.

[7] Schedule 1, section 994B(9).

[8] Productivity Commission, *Competition in the Australian Financial System – Draft Report,* 7 February 2018, p. 2, available at: https://www.pc.gov.au/inquiries/completed/financial-system/draft.

Following this observation, the Productivity Commission noted that we need 'less of a blizzard of new but barely-distinguishable products with labels that obfuscate'.[9] These comments highlight the difficulty many people face when trying to identify the real issuer of a product. We are concerned that some consumers might find it difficult to identify issuers and access target market determination from them given the prevalence of white-label arrangements. This would be a confusing and unsatisfactory situation and would undermine the intent of the reform. We therefore recommend that any person engaging in retail product distribution conduct be required to make relevant target market determinations available free of charge. We would not expect the content of target market determinations to be referenced in every advertisement, but details about where this information is available should be included. Target market determinations should be easy to find on issuer and distributor websites and should also be sent directly to the consumer if requested. We would not expect target market determinations would include commercially sensitive information, meaning they should be available to the public.

We were already disappointed that the regime has not included requirements to determine and publicise "non-target" markets, as that approach would help greatly in narrowing the risk of inappropriate marketing. Now, the revised Bill has significantly weakened requirements for making suitable target market distributions. The proposed standard has dropped from the product needing to 'generally meet' the likely objectives, financial situation and needs of the target market, to now only being required to 'likely be consistent with' those objectives and needs. We recommend that 'likely be consistent with' in Schedule 1 paragraph 994B(8)(b) be replaced with 'suitable for'.[10] This would ensure robustness in the DADO regime, rather that it merely providing only a veneer of accountability of product issuers and distributors. It would also accord with the policy intention of the FSI Final Report, which sought to 'reduce the number of consumers buying products that do not match their needs'.

We are also concerned that the 'risk management' approach to reasonable steps under section 994E has weakened the obligation to ensure distribution conduct is consistent with a target market determination.[11] Regulated persons are now simply required to take reasonable steps that will, or are reasonably likely to, result in distribution being consistent with a determination. In doing so, they must only take steps they are 'reasonably able' to take.

Recommendation 4: Require any person engaging in retail product distribution conduct to make relevant target market determinations available free of charge to the public.

[9] Ibid, p. 6; The Commission also discussed the 'blizzard of barely differentiated products' and white-labelled loans in its Final Report – see https://www.pc.gov.au/inquiries/completed/financial-system/report, pp. 12, 316-317.
[10] Joint consumer submission, *Treasury Laws Amendment (Design and Distribution Obligations and Product Intervention Powers) Bill 2018,* 8 February 2018, pp. 11-12, available at: https://policy.consumeraction.org.au/2018/02/13/submission-design-and-distribution-obligations-and-product-intervention-powers/.
[11] Section 994E sets out the obligation to take reasonable steps to ensure consistency with target market determinations.

Recommendation 5: Replace 'likely be consistent with' in Schedule 1 paragraph 994B(8)(b) with 'suitable for', and strengthen the risk management approach to compliance with section 994E.

Taking reasonable steps to ensure consistency with target market determinations

We support the DADOs applying to new issuances of financial products, which would include insurance renewals and some product rollovers.

With regards to automatic renewals of insurance, we consider that 'reasonable steps' to ensure retail product distribution is consistent with target market determinations should require active engagement with consumers to assess whether they still fall within the target market prior to renewal. For example, this might mean the written notice insurers are required to send consumers 14 days before a contract of insurance is set to expire[12] would include questions designed to ensure the policy holder still falls within the target market determination.

We consider that DADOs must apply to product renewals and rollovers to ensure that the legislation reflects the policy intent of this reform. The FSI Final Report noted that one of the key objectives of the DADO regime is to 'reduce the number of consumers buying products that do not match their needs, and reduce the consequent significant consumer detriment.'[13] The FSI Final Report also made it clear that the DADOs should be designed to apply after the sale of a product, which would include periodically reviewing whether the product still meets the needs of the target market.[14] Simply assuming a person remains within a target market would transfer risk back to the consumer, and undermine the intention of the reform as it would continue to allow issuers to take advantage of consumers using 'set and forget' systems.

In our view, the best way for this goal to be achieved would be for insurers to engage more closely with consumers to assist them with taking active steps to confirm they remain a part of the product's target market. Insurers used to take similar steps before the days of automatic renewals and business models that encourage a set and forget approach to insurance engagement and disclosure. Consumers would benefit from more suitable products and insurers would have many of their information asymmetry issues solved by being better informed about policyholders' personal circumstances.

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[12] *Insurance Contract Act 1984* (Cth) s 58.
[13] Financial System Inquiry, *Final Report*, December 2014, p. 199, available at: http://fsi.gov.au/files/2014/12/FSI_Final_Report_Consolidated20141210.pdf. http://fsi.gov.au/files/2014/12/FSI_Final_Report_Consolidated20141210.pdf. http://fsi.gov.au/files/2014/12/FSI_Final_Report_Consolidated20141210.pdf. http://fsi.gov.au/files/2014/12/FSI_Final_Report_Consolidated20141210.pdf.
[14] Ibid, p. 198.

More broadly, insurers are on notice that they must improve their customers' engagement with products. Last year's Senate Economics References Committee inquiry into general insurance found a lack of transparency prevents people from understanding insurance products, and more needs to be done to protect and support insurance consumers.[15] Consumers do not prefer convenience and speed over product suitability and affordability. This is particularly clear where their insurance claim is rejected later because the product did not meet their needs. Solicitors at the Insurance Law Service see the poor consumer outcomes that result. Insurance is an important product, and for many aspects of modern life, essential. Ensuring consumers engage better with their insurance is a key issue plaguing the sector and one that will be enhanced by a requirement to take reasonable steps to ensure consumers continue to fall within target market determinations at renewal time.

We regularly hear complaints from general insurance consumers whose claims have been declined. It is common for a person's circumstances to change over a 12-month period. Perhaps they have had an accident, a criminal conviction, had children, or become unemployed. These changes in circumstances already need to be disclosed to insurers under ongoing disclosure requirements. They are however rarely if ever disclosed or discussed with an insurer under current set and forget approaches encouraged by insurers whose bottom lines benefit from this lack of engagement. A failure to engage with a passive notification about ongoing disclosure obligations results in people having "illusory insurance" – insurance coverage a person thinks they have but do not. This is because the insurance will be cancelled or claims rejected on the basis of failure to disclose relevant information when the consumer makes a claim. It is imperative that the DADO regime also applies at renewal time to ensure that consumers do not remain in unsuitable products and insurers do not profit unfairly from automatic renewals.

Recommendation 6: ASIC regulatory guidance should clarify that the DADO regime applies to all new issuances of products, including insurance renewals. Insurers should take reasonable steps to actively engage with their policyholders at renewal time to ensure distributions remain consistent with target market determinations.

Scope of regulated distribution activity

Under the original exposure draft, the distribution activities caught were dealing in, and providing financial product advice about, a relevant product. Under the revised Bill, the regulated activity must fall within the defined term 'retail product distribution conduct'.[16]

[15] Senate Economics References Committee, *Australia's general insurance industry: sapping consumers of the will to compare*, August 2017, paras 3.73-3.80.
[16] Schedule 1, section 994A.

Personal financial advice is now largely excluded from the DADOs, as is dealing in financial products to implement personal advice.[17] We do not support this exclusion, given that some of our biggest financial scandals have resulted from poor personal advice exacerbated by weaknesses in product distribution and design. The FSI Final Report made it clear that the DADO regime was intended to complement the Future of Financial Advice (**FOFA**) regime for personal financial advice. The FSI Final Report stated:

> *Although FOFA has made significant changes to reduce incentives for inappropriate distribution where personal advice I provided, more can be done during the product design phase to complement these measures… A number of recent high-profile ASIC enforceable undertakings (EUs) demonstrate some firms had serious compliance issues in providing personal advice and internal controls. Although these examples raise potential breaches of the personal advice regime and occurred before the significant FOFA changes, they also demonstrate weaknesses in processes for, and controls on, product distribution to consumers that are not limited to the provision of personal advice.*[18]

The proposed exemption also effectively removes ASIC's power to issue stop orders and removes requirements to report certain conduct to ASIC in relation to products distributed through a personal financial advice model. We strongly oppose this exemption, given that financial advisers are critical distribution channels for product issuers. This exemption would open a significant regulatory loophole and hamper ASIC's ability to enforce the DADO regime. We have serious concerns that products could be systematically distributed to consumers outside the determined market through this loophole. It is not clear that the revised record keeping requirements for distributors would provide adequate information to ASIC and issuers in these circumstances. We therefore recommend removing the exemption for personal financial advice.

To the extent there is any overlap with the best interests duty, we recommend clarifying that in the event of a conflict, when an adviser has determined that a certain product is in the best interests of his or her client but the client falls outside of the target market, the best interests duty takes priority. Given that 'factors that are important to providing good personal advice are also important to good product design',[19] we consider that these instances would be limited. However, any instances of conflict should be recorded and provided to the issuer.

We oppose amendments that weaken protections against products being distributed without a target market determination.[20] Under the amended provisions, a distributor would avoid a penalty for engaging in retail product distribution conduct without a target market determination if they believe 'on reasonable grounds' that a determination is not required. In coming to this belief, the distributor merely needs to make 'all inquiries (if any) that were reasonable in the circumstances'—presumably meaning that in some

[17] Schedule 1 sections 994A, 994D(d), 994E(1) and (3), 994G(b) and 994J(2).
[18] Above n. 10, pp. 199-200.
[19] Explanatory Memorandum, p. 18.
[20] Schedule 1, section 994D.

circumstances a distributor could make no inquiries and still avoid penalty. It is difficult to imagine a situation where it would be appropriate for a distributor to not make any inquiries, but still reasonably conclude that a determination was not required. This is a significant weakening of protections for consumers, and appears unnecessary as distributors would already have the defence of mistake or ignorance of fact available.[21]

In the event that a distributor reasonably (but mistakenly) believes that a target market determination is not required, distributors would then be free to distribute products to anyone—regardless of whether the product is suitable or not. Further, if a distributor reasonably (but mistakenly) believes that a target market determination has been made, there would be no obligation that the distribution should be consistent with the presumed determination. This situation gives free rein to distributors once they form a 'reasonable belief', which is unsatisfactory and increases the risk of consumer harm.

Recommendation 7: Remove the exemption from the DADO regime for personal financial advice, and clarify that the best interests duty would take precedence in the event of a conflict with the DADO regime.

Recommendation 8: Amend Schedule 1 section 994D to remove additional defences for distributors that engage in retail product distribution conduct without a target market determination.

Record-keeping requirements

Under the revised Bill, the minimum record keeping requirements for distributors have been substantially weakened. The only mandated information that distributors would now be required to collect is the number of complaints, steps taken to comply with target market determinations, and the dates they reported information to the issuer. Issuers determine all other types of information to be recorded by distributors.[22] This provides significant leeway to issuers and might result in important records not being kept by distributors that would have assisted to determine whether distributions have been consistent with target market determinations. This would make it more difficult for ASIC to take enforcement action, and to monitor compliance with the new DADO regime.

We anticipate that some distributors would also find the revised record keeping requirements difficult to comply with. Distributors that work with multiple issuers might be required to maintain different records for each, which could make system development difficult. Further, many distributors would not know what

[21] Attorney-General's Department, *The Commonwealth Criminal Code – A Guide for Practitioners,* March 2002, available at: https://www.ag.gov.au/Publications/Documents/GuideforPractitioners.pdf.
[22] Schedule 1, section 994F(1).

information needs to be recorded for each product or each issuer until the issuer makes a determination, making it more difficult to design and implement systems.

We note that while distributors are required to report information specified in a target market determination to the issuer, there appears to be no obligation for distributors to make reasonable efforts to actually acquire this information.[23] If the distributor does not acquire the information, they are simply required to tell the issuer that fact.[24] We recommend introducing a requirement for the distributor to make reasonable efforts to acquire information specified in a target market determination.

We support the requirement for distributors to provide records to issuers, including complaints. We note that it is critical that complaints must be accurately identified as complaints in accordance with ASIC Regulatory Guide 165, and that internal and external dispute resolution processes are properly followed.[25]

Recommendation 9: Specify additional minimum record keeping requirements for distributors, in consultation with ASIC.

Recommendation 10: Introduce a requirement for the distributor to make reasonable efforts to acquire information specified in a target market determination.

Reviews

We are concerned that the revised Bill has extended the time to stop distribution after a review is triggered, particularly where there might be a significant risk of consumer harm. Under Schedule 1 section 994C(3) and (4), issuers would only be required to stop distribution 'as soon as practicable' or within 10 business days. This is a significant period for distribution of products to potentially unsuitable target markets to continue. We recommend reducing the maximum period within which distribution can continue after a review is triggered, preferably five business days or less.

Recommendation 11: Reduce the maximum period within which product distribution can continue after a review is triggered.

[23] Schedule 1, section 994F(2)(f).
[24] Schedule 1, section 994F(4)(f).
[25] Australian Securities and Investments Commission, *RG 165 Licensing: Internal and external dispute resolution,* May 2018, available at: https://asic.gov.au/regulatory-resources/find-a-document/regulatory-guides/rg-165-licensing-internal-and-external-dispute-resolution/.

Notification to ASIC

We are concerned that the drafting of Schedule 1 section 994G, which requires issuers to report 'significant dealings' that are not consistent with a determination to ASIC, might give rise to uncertainty about timing. Issuers might interpret these provisions as only requiring them to report the event 10 business days after they have formed the view that it was a 'significant dealing', rather than 10 business days after the event itself.

Similar concerns were raised by the ASIC Enforcement Taskforce in relation to financial services licensee breach reporting. Under the current breach reporting regime, the report to ASIC must be made within 10 business days of the licensee 'becoming aware of' the contravention or likely contravention. The ASIC Enforcement Taskforce Review raised concerns about the potential for uncertainty arising from the fact:

> *…that the commencement of the time period for reporting is dependent on subjective factors, including when the licensee becomes aware of a breach and its significance as well as the robustness of internal reporting mechanisms. There also exists uncertainty whether the current 10 day reporting timeline commences from the licensee becoming aware of the breach or from the date on which the licensee forms the view that it is significant. The latter usually, though not always, may involve an internal investigation and in addition may give rise to a need to obtain legal advice as to significance and whether the reporting obligation is triggered or not.*[26]

We recommend clarifying the ASIC notification obligations to ensure that the 10 day reporting period begins from the date of the event, rather than the date that the issuer forms the view that a 'significant dealing' has occurred. ASIC should also provide guidance about the meaning of 'significant dealing'.

We are also concerned that exempting distributors from the obligations to notify ASIC would make it more difficult for the regulator to enforce the regime. A distributor must report significant dealings in a product that are not consistent with a determination to the issuer, but not to ASIC. While failing to report a significant dealing to the issuer is an offence, presumably the issuer would not be aware of the dealing and would therefore not be required to notify ASIC. The Bill would require both the issuer and the distributor to conclude that 'significant dealings' had occurred before a report about the conduct would be made to ASIC. We recommend that the requirement to notify ASIC in Schedule 1 section 994G be extended to both distributors and issuers to avoid notification delays and under-reporting of issues to ASIC.

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[26] The Treasury, *ASIC Enforcement Review Taskforce Report,* April 2018, p. 8, available at: https://treasury.gov.au/review/asic-enforcement-review/r2018-282438/.

Recommendation 12: Clarify the ASIC notification obligations to ensure that the 10-day reporting period begins from the date of the 'significant dealing', rather than the date that the issuer forms the view that the dealing was significant.

Recommendation 13: Extend the ASIC notification obligations to both distributors and issuers.

Consequences and penalties

We support expanding the civil liability regime to enable consumers to seek compensation for loss and damages resulting from contraventions of subsections 994C, 994D or 994E. We reiterate our previous submissions that action should be available for contravention of all provisions, particularly sections 994B and 994J.

We also support increased criminal and civil penalties but note that any penalties should be consistent with the recommendations of the ASIC Enforcement Taskforce Review, which have been accepted by Government.[27]

Recommendation 14: Extend the civil liability regime to enable consumers to seek compensation for loss or damages resulting from contraventions.

Recommendation 15: Ensure criminal and civil penalties are consistent with the recommendations of the ASIC Enforcement Taskforce Review.

Transition period

We strongly oppose the proposed two-year transition period for new and existing financial products. These reforms were recommended by the FSI in December 2014 and were accepted by Government in October 2015. This means that reforms proposed in 2014 would not come into effect until at least 2020, perhaps even later. This transition period is far too generous and fails to meet community standards and expectations particularly in light of the misconduct being revealed by the Royal Commission. Many of these issues have been widely known about for months or years in the relevant sectors. The industry has already had ample time to prepare for the new regime.

[27] The Treasury, *Australian Government response to the ASIC Enforcement Review Taskforce Report*, April 2018, available at: https://treasury.gov.au/publication/p2018-282438/.

Recommendation 16: Apply DADOs to new financial products from the date of Royal Assent, and to existing products 12 months after the date of Royal Assent.

PRODUCT INTERVENTION POWER

Products subject to the intervention power

We maintain our position that the PIP should apply to 'financial products' as defined in the ASIC Act. However, in the alternative, we support extending ASIC's PIP by regulation to funeral insurance, short-term credit and extended warranties. As noted above, we recommend introducing corresponding regulations in relation to the DADO regime. The PIP and DADO regulations should come into effect at the same time as the relevant provisions in the revised Bill.[28] We have provided further details about problematic features of these products below.

The problems relating to funeral expenses insurance were laid bare during recent hearings at the Royal Commission.[29] Funeral expenses insurance is a low-value product which is often sold to people for whom it is unsuitable. Major concerns include cancellation rates of 80 percent, increasing premiums, negative value policies and sales to young people (particularly Aboriginal people). Marketing of funeral expenses insurance is a particular concern, as it can be highly emotive and invoke a sense of fear about the need to provide for the costs of funerals. Funeral expenses policies are currently exempt from regulation under the Corporations Act.[30] The regulation to include funeral expenses policies in the PIP should be drafted so it is not inconsistent with Regulation 7.1.07D, which explicitly states that a funeral expenses policy is not a financial product for the purposes of the Corporations Act.

Tracey's story

Consumer Action client Tracey Walsh, an Aboriginal and Torres Strait Islander woman from Victoria, gave evidence to the Royal Commission into Misconduct in the Banking, Superannuation & Financial Services Industry in relation to the Aboriginal Community Benefit Fund (**ACBF**), a provider of funeral insurance products.

In 2005, Ms Walsh signed up to the ACBF funeral insurance policy at her place of work, the Rumbalara Aboriginal Co-Operative, and the fact that the word 'Aboriginal' and the images on the

[28] As proposed in paragraph 2.24 of the Explanatory Memorandum.
[29] Consumer Action Law Centre, *Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry – Submission on Round 4 Hearings,* 16 July 2018, available at: https://policy.consumeraction.org.au/wp-content/uploads/sites/13/2018/07/180716-ConsumerAction-Submissions-Policy-Round4.pdf.
[30] *Corporations Act 2001* (Cth) section 765A(1), Corporations Regulations 2001 (Cth) Reg 7.1.07D.

product materials, including the rainbow serpent and the image of the family contributed to her understanding that ACBF was run by Aboriginal people. She explained that she understood that the salesperson was also Aboriginal.

She also gave evidence that it was important to her to sign up to this product with what she thought was an Aboriginal organisation because she liked to support other Aboriginal people and that she feels more comfortable dealing with other Aboriginal people. Her evidence also revealed she had paid over $10,000, for a plan with a maximum benefit of $8,000, and that she thought it was a savings plan rather than insurance.

Consumer Action submissions to the Royal Commission about Tracey's evidence are available here: https://policy.consumeraction.org.au/2018/07/16/case-study-tracey-walsh-and-aboriginal-community-benefit-fund-submission-to-royal-commission/.

The short-term credit exemption is also problematic as it is used as an avoidance mechanism, as demonstrated in *ASIC v Teleloans Pty Ltd* [2015] FCA 628. We note that Regulation 50A[31] was introduced after *ASIC v Teleloans* to address this type of business model avoidance, but we continue to see clients affected by their successors, Cigno and Gold-Silver Standard Finance Pty Ltd. These clients are generally extremely vulnerable with low incomes. The fees charged are excessive, and often leave people in severe financial hardship. Extending the PIP to short-term credit would assist to close this harmful loophole. We also consider that some buy-now-pay-later schemes are using the short-term credit exemption to avoid regulation.

Richie's story

Richie has had three Cigno loans in the past six months. He has been unemployed at the time of each loan, with living expenses in excess of his small Centrelink income. He struggles with addiction and bi-polar disorder. At the time of taking out at least two of the three loans, Richie was in a drug rehabilitation facility. Cigno sent Richie repeated marketing emails, offering him "pre-approved" loans, despite having never (as best we can tell) done any assessment of his capacity to repay.

Further, Richie managed to pay back the first loan (he could not explain to Financial Rights how). Richie's mum paid the second loan to stop Cigno taking the money out of Richie's account (which would have meant he defaulted on his payments to the rehab facility and got kicked out), and the third loan remains unpaid. Richie borrowed $200 on 3 June and as at 12 July was being pursued for $711.55, with the amount increasing all the time. Cigno's avoidance of the National Credit Code means they do

[31] *National Consumer Credit Protection Regulations 2010* (Cth).

not comply with the restrictions on fees and charges that apply to small amount credit contracts. Not only does Cigno charge more than the permitted 20% establishment fee and 4% monthly fee (calculated by reference to the loan amount) for small amount credit contracts,[32] Cigno does not limit the amount they seek to recover from defaulting customers to twice the amount lent.[33] This is why Richie's $200 debt more than tripled in a little over a month and continued to grow.

Case study provided by Financial Rights Legal Centre

Dealer-issued extended warranties sold by car dealers are purported to be 'issued' by the dealership and 'administered' by a warranty company. Because they are said to be issued by the retailer, they may fall within the incidental product exemption under the Corporations Act, and not be regulated as financial products.[34] Complaints made through Consumer Action's DemandARefund.com website indicate that these warranties are widespread in car dealerships throughout Australia. In substance, these are financial products issued by the warranty company, but avoid the consumer protections that apply to other financial products.

Bree's story

Bree bought a car for $23,000 cash. She felt pressured by the car dealer into also buying a dealer-issued warranty for $1,700. Bree eventually gave in, paid the deposit and made monthly repayments on the warranty. She says she never received the warranty documents and was confused about who the warranty provider was.

Bree contacted the car dealer to cancel the warranty soon after she purchased it. Bree says the dealer refused because it did not have anything to do with them. She contacted the warranty provider six months later and again tried to cancel the warranty. The representative said she could cancel it, but that she would not receive a refund.

Bree eventually made a complaint and received the documents from the warranty provider. The documents suggest:

- neither the warranty provider nor the dealer is liable for claims once the warranty provider has finalised the review of a claim;
- cover is for limited components only and specified components have financial limits;
- strict car servicing requirements; and
- no refund is available if the customer cancels the warranty

[32] See National Credit Code, section 31A.
[33] Ibid, section 39B.
[34] Under section 763E of the *Corporations Act 2001* (Cth).

The documents also showed the wholesale price of the warranty was only $590.

Bree ultimately received a refund from the finance provider.

Case study provided by Consumer Action Law Centre

We reiterate our previous submissions that we consider there is merit in the revised Bill explicitly stating that consumer detriment should not just be determined by reference to individual loss, but also where large numbers of consumers might suffer relatively small (individual) losses. This is particularly the case where the class of consumers impacted is vulnerable or disadvantaged.

We note that Schedule 2 section 764A(3) appears to require further amendments to clarify that the regulations can also declare that the financial product is deemed to be available for acquisition by issue or regulated sale, to ensure that it falls within ASIC's powers to make orders under section 1023D.[35] Further amendments also appear necessary to the definition of financial product in section 1023B to clarify that 'financial product' includes financial products declared by regulation but not those excluded by regulation

Recommendation 17: The revised Bill specify that consumer detriment should not just be determined by reference to individual loss, but also where large numbers of consumers might suffer relatively small (individual) losses.

Recommendation 18: Amend Schedule 2 sections 764A(3) and 1023B to clarify the regulation-making power.

Prospective interventions

Under the revised Bill, the intervention power would only apply prospectively, meaning an intervention cannot apply in relation to a product once it has been acquired.[36] This is highly problematic and would significantly reduce ASIC's ability to intervene to protect consumers from harmful products. Many products are acquired by consumers before evidence of harm, or likely harm, arises. This is particularly true for longer term products such as life insurance or home loans. We strongly recommend that ASIC be empowered to intervene in relation to products already acquired where there is a risk of significant harm to consumers.

[35] See Schedule 2, section 1023D(1)(a).
[36] Schedule 2, section 1023C.

We also reiterate our previous recommendations to strengthen PIP. In particular, we recommend that intervention orders continue until ASIC, or the Minister, decides that the risk of consumer harm has been rectified and the intervention order is safe to remove.[37] Further, we recommend that ASIC be permitted to make interventions in relation to training and remuneration,[38] given these has been identified as key drivers of misconduct in the finance sector.

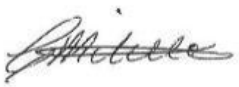
Recommendation 19: Empower ASIC to intervene in relation to products already acquired where there is a risk of significant harm to consumers.

Please contact Katherine Temple on 03 9670 5088 or at katherine@consumeraction.org.au if you have any questions about this submission.

Yours sincerely,

Gerard Brody
Chief Executive Officer
Consumer Action Law Centre

Fiona Guthrie
Chief Executive Officer
Financial Counselling Australia



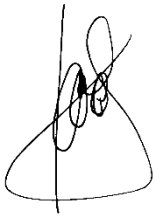
Gemma Mitchell
Managing Solicitor
Consumer Credit Legal Service (WA) Inc

Alexandra Kelly
Principal Solicitor
Financial Rights Legal Centre

[37] In March 2018, the Parliamentary Joint Committee on Corporations and Financial Services also recommended increasing the 18-month timeframe for which prodcut intervention orders apply – see https://www.aph.gov.au/Parliamentary_Business/Committees/Joint/Corporations_and_Financial_Services/LifeInsurance/Report.

[38] The Committee also recommended that ASIC be given the ability to make interventions in relation to remuneration – see https://www.aph.gov.au/Parliamentary_Business/Committees/Joint/Corporations_and_Financial_Services/LifeInsurance/Report.

Judith Fox
Chief Executive Officer
Australian Shareholders' Association



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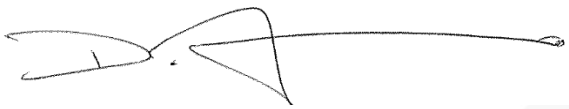

David Ferrero
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Consumer Credit Law Centre SA

APPENDIX 1 – ABOUT THE CONTRIBUTORS

Australian Shareholders' Association

The Australian Shareholders Association (ASA) is an independent, not-for-profit, member-funded organisation that has grown to be the major autonomous body representing Australian retail investors. Our advocacy promotes the interests of retail shareholders. ASA also helps its members improve their investment knowledge through its educational offerings.

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.

Consumer Action Law Centre

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 market place for all Australians.

Consumer Credit Law Centre SA

The Consumer Credit Law Centre South Australia (**CCLCSA**) was established in 2014 to provide free legal advice and financial counselling to consumers in South Australia in the areas of credit, banking and finance. The Centre also provides legal education and advocacy in the areas of credit, banking and financial services. The **CCLCSA** is managed by Uniting Communities who also provide an extensive range of financial counselling and community legal services as well as a large number of services to low income and disadvantaged people including mental health, drug and alcohol and disability services.

Consumer Credit Legal Service (WA) Inc

Consumer Credit Legal Service (WA) Inc. (CCLSWA) is a not-for-profit charitable organisation which provides legal advice and representation to consumers in WA in the areas of credit, banking and finance, and consumer law. CCLSWA also takes an active role in community legal education, law reform and policy issues affecting consumers. In the 2017 / 2018 financial year, CCLSWA provided comprehensive legal advice to 914 clients.

Consumers' Federation of Australia

The Consumers' Federation of Australia (CFA) is the peak body for consumer organisations in Australia. CFA represents a diverse range of consumer organisations, including most major national consumer

organisations. Our organisational members and their members represent or provide services to millions of Australian consumers.

CFA advocates in the interests of Australian consumers. CFA promotes and supports members' campaigns and events, nominates and supports consumer representatives to industry and government processes, develops policy on important consumer issues and facilitates consumer participation in the development of Australian and international standards for goods and services. CFA is a full member of Consumers International, the international peak body for the world's consumer organisations.

COTA Australia

COTA Australia is the national consumer peak body for older Australians. Its members are the State and Territory COTAs (Councils on the Ageing) in each of the eight States and Territories of Australia. The State and Territory COTAs have around 30,000 individual members and more than 1,000 seniors' organisation members, which jointly represent over 500,000 older Australians.

COTA Australia's focus is on national policy issues from the perspective of older people as citizens and consumers and we seek to promote, improve and protect the circumstances and wellbeing of older people in Australia. Information about, and the views of, our constituents and members are gathered through a wide variety of consultative and engagement mechanisms and processes.

Financial Counselling Australia

Financial Counselling Australia (FCA) is the peak body for financial counsellors in Australia. Financial counsellors assist people in financial difficulty by providing information, support and advocacy. They work in non-profit, community organisations and their services are free, independent and confidential.

Financial Rights Legal Centre

Financial Rights Legal Centre is a community-based consumer advice, advocacy and education service specialising in personal credit, debt, banking and insurance law and practice. Financial Rights operates the National Debt Helpline, which is the first port of call for NSW consumers experiencing financial difficulties. We also operate the Insurance Law Service which provides advice nationally to consumers about insurance claims and debts to insurance companies. We provide legal advice and representation, financial counselling, information and strategies, referral to face-to-face financial counselling services, and limited direct financial counselling.

Financial Rights took over 25,000 calls for advice or assistance during the 2016/2017 financial year.