CHAPTER 8: CONSUMER REGULATIONS RELATING TO ASSET PRODUCTS AND CERTAIN GOVERNMENTS POLICIES

8.0 INTRODUCTION

This chapter examines regulations aimed at either protecting the interests of consumers who seek credit from financial institutions or that result in financial institutions acting as agents for the implementation of Government policies. It will also consider the commercial activities being undertaken by the Reserve Bank of Australia (RBA).

The National believe that there are four primary reasons for Government intervention in commercial activities on behalf of consumers:

- ensuring that consumers are fully informed as to the nature of the financial service being provided, and as to their rights and their obligations;

- ensuring that consumers are protected from deceptive or misleading conduct;

- ensuring that personal information is protected; and

- ensuring that consumers have access to a low cost dispute resolution mechanism, outside of the adversarial process of the Courts.

In considering the four basic objectives outlined above, it is possible to detail the extent of regulation which directly affects the financial services industry.

It is the National's contention that consumer orientated regulations, taken as a whole, sometimes fail to meet their objectives in either an efficient or effective manner. The discussion in Chapter 7 provided evidence of this.

Inconsistent and sometimes conflicting objectives have led to overlaps and inconsistencies, both between various regulations and between regulators at both Federal and State levels.

It is our recommendation that the Financial Sector Inquiry and the Commonwealth Government recognise the excessive costs associated with the plethora of consumer regulation and seek a means of rationalising the number of regulations, the number of regulators and the intensity of regulation. In doing so, it is our strong contention that any consumer type regulation should be applied on a nationally consistent basis and supervised or monitored by a single supervisor under the auspices of the Commonwealth Government. This recommendation is consistent with that made in the previous chapter in relation to non-bank liability information disclosure regimes. While it notes that generally regulations governing information disclosure in relation to liability products are offered mainly by NBFIs, this is not the case for the provision of credit.

However, it must be emphasised that the National is **not** seeking to reduce the level of protection afforded to consumers. It is simply seeking a more efficient and effective means of achieving the basic aims outlined above. At the same time, it is necessary to alter the balance of the regulatory environment towards the establishment of standards rather than prescriptive rules. This alteration of the balance would tend to favour effective self regulation rather than the inflexible and prescriptive legislation which is a feature of the current regulatory environment. This will allow a better balance to be achieved between the legitimate concerns of consumers and the commercial needs of financial institutions.

8.1 SOURCES OF REGULATION

Currently, consumer regulation covered in this chapter is achieved by means of Commonwealth, State and Territory regulation. Further protection is afforded by way of industry based codes of conduct and alternative dispute resolution schemes.

In terms of the four objectives outlined above, regulations are imposed in the following ways, although this is not an exhaustive list:

8.1.1 Information Disclosure

a) Commonwealth Legislation

- *Trade Practices Act* (incorporating the Prices Surveillance Act), administered by the Australian Competition and Consumer Commission (ACCC).
- *Corporations Law*, administered by the Australian Securities Commission (ASC).

b) State/Territory Legislation

- Uniform Credit Code (due to be implemented on 1 November 1996), but not yet passed in Western Australia and Tasmania.
- Existing State Credit Acts, Money Lending Acts, Hire Purchase Acts etc. - some of which will be superseded by the Uniform Credit Code.
- Fair Trading Acts - which purport to reflect the Trade Practices Act.
- *Contracts Review Act (NSW*).

c) Self Regulation

- Code of Banking Practice, monitored by the Reserve Bank of Australia (RBA).
- Electronic Funds Transfer (EFT) Code of Conduct - monitored by the Australian Payments System Council (APSC).
- Code of Practice for Farmers, which does not have a formal monitoring procedure.
- Australian Stock Exchange (ASC).
- Credit Union Code of Practice - monitored by the RBA.

8.1.2. Protection from Deceptive or Misleading Conduct

- Commonwealth: *Trade Practices Act.*
- State/Territories: Fair Trading Acts (which are intended to complement the *Trade Practices Act* in respect to corporations, and to proscribe areas not covered by the *Trade Practices Act* such as sole traders and partnerships).

- *Contracts Review Act (NSW).*

8.1.3 Privacy

- *Privacy Act* in so far as it applies to credit reporting guidelines.
- Banking Code of Practice and the EFT code - these place some limited obligations on financial institutions in relation to privacy.

8.1.4 Alternative Dispute Resolution Schemes

- Australian Banking Industry Ombudsman (ABIO). This is a wholly funded and controlled voluntary scheme with the aim of providing retail customers with a no cost option for dispute resolution with member banks.
- *Superannuation (Resolution of Complaints) Act* (Superannuation Complaints Tribunal) - administered by the ISC.
- Life Insurance Complaints Service Limited.
- Financial Planners Complaints Resolution Tribunal.

These last three schemes, which focus on liability products, such as life insurance and superannuation, have also been covered in Chapter 7. They have been included here for completeness.

8.2 CURRENT ISSUES IN REGULATORY OVERSIGHT

In addition to existing regulations, there are numerous "initiatives" underway at both the State and Commonwealth level, which could well result in increased oversight of the activities of financial institutions. These include:

- Commonwealth and State examinations of the need for, and the extent to which privacy legislation should be extended to the private sector;
- Numerous examinations of the privacy and law enforcement implications of electronic commerce. The primary focus of these examinations is on smart card technology;

- For example, Austrac, the Privacy Commissioner, the Attorney-General's Department and the Department of Industry, Science and Tourism (in concert with the Asia Pacific Smart Card Forum) and the Commission for The Future are all examining ways in which electronic commerce could impact on their specific areas of interest and how such products should be regulated:
    - the major task of industry is to discern the agendas of each of these groups and to attempt to provide some form of commercial expertise to their examinations. Given the apparent overlapping fields of interest, this is proving a difficult and time consuming task;
- Bureau of Consumer Affairs sponsored review of benchmarks for alternative dispute resolution schemes (an outcome of the previous Government's Justice Statement).
- Bureau of Consumer Affairs "audit" of consumer protection laws;
- Commonwealth Parliamentary Committee on Industry, Science and Technology Inquiry into "fair trading";
- Various reviews undertaken by the Parliamentary Committee on Financial Institutions and Public Administration (including acting as a "de-facto" dispute resolution mechanism);
- A number of law enforcement agencies, for example Austrac, currently are conducting inquiries into the impact on their activities of emerging technologies;
- The Australian Taxation Office has recently set up a Taskforce to examine the basic problems of tax evasion, erosion of the revenue base and the ability of the existing tax system to deal with the new technological developments;
- Commonwealth sponsored or supported initiatives which at the very least provide a forum for reviews of various financial activities, including the rural summit and the small business forum; and
- Corporations Law Simplification project.

8.2.1 Examples of Inefficiencies

The above lists indicate the pervasive influence of the various levels and institutions of government in the activities of the financial sector. In other forums the National, and other

industry participants, have argued about excessive costs, overlaps and inconsistencies[1] which result from consumer regulation.

Although the above lists indicate that there is a plethora of consumer legislation, the impact of the Consumer Credit Code on efficiency is the most excessive. This is not to say that the original intention of the Credit Code was not laudable. Rather, the implementation of a simple, nation-wide code designed to overcome the information problems of "ordinary" borrowers was something that the industry had sought for some time. Unfortunately, the objectives have been largely diluted by the excessively prescriptive, possibly ineffective (although this is difficult to test, ineffectiveness can be gauged by moves to supplement existing regulations with new ones) and costly obligations imposed on the financial institutions and their customers.

Some examples include:

- The lack of uniformity between States and Territories, in particular the fact that neither the Western Australian nor the Tasmanian Governments have passed complimentary legislation and the draft Western Australian legislation indicates some punitive differences in the area of civil penalties;
- Over prescription of the form and content of account statements;
- The requirement that all contracts be signed in writing, which completely ignores the fact that contracts can be delivered electronically and that digital signatures are an accepted and riskless means of concluding a contract;
- Section 15 of the Code specifies the content of a credit contract. The section includes some 15 aspects in respect of non-compliance, of which more than half expose a creditor to a civil penalty, a criminal penalty, or compensation for a debtor or a guarantor;
- The oppressive civil penalties regime under the Code which not only extends the power of a court to award punitive damages, but potentially penalises a credit provider in a disproportionate way to the nature of the "offence";
- The requirement that all credit card holders be recontracted;
- The need for the existing 10 page mortgage document be expanded to 24 pages;

[1] See the Submission from the Australian Bankers Association for some examples in relation to the Consumer Credit Code.

- Instead of two copies of a mortgage document being prepared - one for the customer and one for the Bank - under the Code, 3 copies need to be given to a sole borrower, 5 copies to joint borrowers and 7 copies where a guarantor is involved. In the National's case, this will result in an additional 120 million sheets of A4 size paper being required annually;
- The National has already spent $11.5 million on preparations for the introduction of the Code (now scheduled for 1 November 1996), with on-going annual costs in excess of $14.5 million; and
- Given that there are limits to which the Bank can continue to cross subsidise between products, and between customers, including as a result of the influences of the Government, it is inevitable that this additional cost will eventually be passed to customers.

Aspects of the Credit Code, for example the advertising, canvassing and harassment provisions, also overlap with certain provisions of State Fair Trading Acts, including the Victorian *Fair Trading Act*. This latter Act also contains provisions restricting telephone marketing to existing customers, which is substantially different to provisions in other States.

Another significant overlap is the ability under the Code to invest in a court the power to review interest and charges which are considered to be unconscionable, including mortgage establishment fees or charges, early termination costs, prepayment charges and changes to interest rates. These provisions can be considered to:

- interfere with the efficient operation of the market;
- overlap with the consumer protection elements of the *Trade Practices Act* (including price surveillance);
- be contrary to the original intention of the Code in respect of information disclosure;
- provide an opportunity for special purpose groups to use the Code and the court to achieve certain political or social outcomes; and
- potentially impose further excessive costs on financial institutions.

We are also concerned about attempts, apparently being treated seriously by some State Governments on the basis of facilitating increased competition, to exempt certain providers of credit, or credit related funding, from the provisions of the Code, in particular mortgage

originators and the securitisers which provide the originators' funds. Such an exemption will have two main effects:

- it will deprive consumers of information necessary to protect them in an emerging sector of credit providers; and

- in implicitly acknowledging that there are substantial costs associated with the administration of the Code and with the application of civil penalties, any exemption will place certain competitors at a competitive advantage to other market participants.

Any exemption of this nature will only reinforce the belief that the Code is neither uniform nor fair in its application to financial institutions.

The position of financial advisers is also worthy of mention. The ASC regulates financial advisers. Subject to meeting established standards, the ASC grants advisers a licence to practice. However, the ISC regulates advice relating to superannuation, life insurance and general insurance. Sections of the *Trade Practices Act* in relation to misleading and deceptive conduct also impact on financial advisers. Additionally, prudential supervision by the RBA and AFIC can also impact on the industry[2].

Although for the purposes of this submission it is difficult to compare or describe the differences, excesses and shortcomings in information disclosure, any examination of the efficiency of consumer regulation should include a review of the way and form in which institutions disclose information. Currently, disclosure through the medium of the Credit Code, for example, is oriented towards product and service information. Elsewhere in this submission, the National argue that information about risks associated with various forms of investment and risks associated with the host institution should be increased.

8.3 PRIVACY ISSUES

2. See also Industry Commission, *Regulation and its Review 1994 - 95*, (September 1995) pp. 42 and 43

As indicated above, there are numerous efforts underway aimed at extending privacy regulation to the private sector. Interest in this is being generated by:

- an Australian Law Reform Commission Report recommending the extension of privacy laws to the private sector;
- a Privacy Commission discussion paper which found that Australians feel that they do not have control over their own information;
- an EU Directive on privacy in member states, which indicates that members should not pass information to countries which do not have "adequate protection";
- a House of Representatives Standing Committee report entitled "In Confidence" which also recommended an extension of privacy laws to the private sector;
- the NSW Privacy Committee's report "Big Brother" which examined smart card technology and advocated the need for regulation of the information collected;
- the NSW Bill on data protection;
- a Bureau of Consumer Affairs working group on direct marketing;
- proposals by the Smart Card Forum (apparently supported by the Department of Industry, Science and Tourism and the Warren Centre for Advanced Engineering at the University of Sydney) to introduce a Code of Conduct for Smart Cards which consists almost entirely of privacy protection principles;
- a proposed regulation project to be undertaken by the NSW Consumer Credit Legal Centre with funding from a Law Foundation of NSW Trust established by the State Attorney General and the Law Society of NSW; and
- an on-going review by the Attorney-General's Department on the need for and form of national privacy legislation (which is consistent with Government policy).

Currently, the Commonwealth *Privacy Act 1988* contains 11 Information Privacy Principles covering the collection, use, access to and the security of personal information. It does not apply to the private sector except for the credit reporting guidelines. Banks are bound by a common law duty of confidentiality not to reveal anything about the banker/customer relationship without the customer's consent, or unless legally bound to do so.

The uncoordinated and prescriptive introduction of privacy protection into the private sector has the potential to severely restrict innovation in electronic commerce, as well as to restrict the ability of companies operating under a holding company structure to offer customers an integrated range of products and services.

If the Government considers that, for public policy purposes, there should be additional privacy regulations covering the private sector, then the following precepts should apply:

- inclusion of clear statements as to aims and the type of information being protected;
- avoidance of over prescription;
- avoidance of penalties which are disproportionate to any alleged wrongdoing;
- facilitation of the ability of service and product providers to seek from customers consent for the use of personal information according to specified uses;
- provision of general guidelines or standards for implementation according to industry codes of conduct; and
- national applicability, with agreement from States and Territories that they will not implement legislation which further limits the use of information beyond that specified in the national Code and any industry specific codes.

Both New Zealand and Canada have privacy models which we understand are being examined by the Commonwealth Government. Elements of those models meet the above criteria.

Further, moves to introduce privacy principles into the private sector should be undertaken in full consultation with industry participants, including industry bodies and individual companies. In this respect, we note that the Attorney General and his Department are beginning a consultation process on privacy regulation.[3]

3. See also submission from the Australian Bankers' Association

8.4 FINANCIAL INSTITUTIONS AS INSTRUMENTS OF GOVERNMENT POLICY

8.4.1 Financial Transactions Taxes

State and Territory Governments impose *taxes on financial debits and credits.* Known as Financial Institutions Duty and Debits Tax, these are the only sector in which specific taxes are imposed for the single purpose of revenue raising.

Evidence available to the Financial Sector Inquiry through the Australian Bankers' Association clearly details the regressive nature of these taxes. Further, the compliance costs, including in some instances the necessity to absorb the taxes rather than pass them to the customers on whose transactions the taxes are based, are significant.

While acknowledging that State and Territory Governments are undertaking an examination aimed at reforming the taxes, there is no suggestion that they will be removed. This is despite clear evidence of their regressive and anti-competitive nature. In particular, as Australia is the only country in the world to impose such taxes, their existence has a negative effect on Australia's ability to compete in world markets as well as on our ability to attract foreign corporations to Australia.

State Governments implicitly acknowledge the effects of the taxes on competition by providing corporations willing to participate in the joint Government Regional Headquarters Policy with exemptions. Inter alia, such exemptions from imposts on Australian corporations provide new foreign competitors with unfair competitive advantages.

As well as generating significant distortions within the financial system, these two taxes also provide significant revenue to State and Territory Governments, in the order of $1.8 billion annually. Without compensatory action by the Commonwealth Government through revenue sharing arrangements, it is highly unlikely that the States and Territories could consider their removal. Consequently, it may be that some review of the Commonwealth Government's revenue sharing arrangements will be necessary.

8.4.2 Law Enforcement Issues

The *Financial Transactions Reports Act*, administered by Austrac, imposes on financial institutions an obligation to report all transactions in excess of $10,000. The purpose is to track illegal transactions (i.e. money laundering), taxation evasion and social security fraud. This Act has an impact on both the costs of opening accounts and on the maintenance of the National's data base.

In the absence of other more efficient and effective methods of achieving the Government's desired outcomes, the National consider that the Commonwealth Government should meet the costs of complying with these policies. Such recognition would also enable the Government to better evaluate the real costs and benefits of its policies. In the absence of a specific subsidy, the "know your customer" rule should replace current identification requirements, and the purpose of the Act should be restricted to money laundering only.

We note that while the 1994/95 Austrac Annual Report does not reveal the amount collected in evaded taxes, for example, as a result of Austrac's oversight, it seems likely that the amount collected is less than the costs accrued by Austrac and the industry costs in administering this aspect of the scheme. The ABA Submission indicates that industry compliance costs are in the order of $20 to $30 million annually.

Additionally, the Government has legitimate concerns that electronic commerce will progressively pose threats to law enforcement. The National, to the extent possible, have been assisting the various agencies with their inquiries. However, given the number of agencies conducting investigations there is scope for rationalising investigations into the Government's concerns.

An outcome of such rationalisation would be to provide a focus for industry input into the policy process. The industry's concern is to ensure that any extensions of legislation to cover electronic commerce will not adversely affect the ability to introduce new technologies in a cost effective manner, or to compete globally with emerging competitors who may not face similar restrictions and costs.

8.4.3 Deeming Arrangements

Arguably, deeming arrangements have a number of objectives, including:

- relieving the Government of administrative difficulties associated with adjusting pension and benefits when investment returns change;
- removing incentives to lower investment returns as a means of receiving or increasing pension and benefits; and
- protecting pensioners and beneficiaries from exploitation resulting from low investment returns.

In order to achieve these aims, the Government "deems" savings to receive a given level of return. Recent changes introduced a two tier arrangement. Savings over $30,000 are deemed to receive a return of 7%, while lesser savings are deemed to attract interest of 5%. The deeming rate applies not only to long term savings, but also to accounts maintained as part of normal transacting behaviour. The deeming rate is reviewed annually.

To maintain customer confidence and continuity, most financial institutions have established separate deeming accounts. Unlike many financial institutions, eligibility for a National retirement account which attracts the deeming rate is not restricted to social welfare beneficiaries, but is extended to all retirees over 55 years of age.

The Department of Social Security does not formally reveal the basis on which deeming rates are calculated. The National understands, however, that the 7% rate is based on published term deposit rates, while the Department has been unwilling to reveal the basis for setting the 5% rate. Neither of these standards recognise market forces where returns are based on risks and that, at least for banks, interest on longer term savings is related to the cost of funds.

Recent decreases in the official discount rate have resulted in the National paying interest at the deeming rates which are greater than the cost of funds. While accepting the legitimate concerns of Government towards pensioners and beneficiaries, the existence of a deeming rate is a further example of deposit taking financial institutions bearing the costs of public policies.

In order to overcome the deficiencies inherent in the deeming arrangements, the National consider that the Government must align the rate to market rates.

8.5 THE NEED FOR A FUNDAMENTAL REVIEW OF CONSUMER REGULATION

In this submission, the National emphasised the need for Government to facilitate the efficient functioning of the financial markets by providing a minimal regulatory environment, by better defining desired outcomes, by treating like functions equally and ensuring that regulatory oversight is flexible and less prescriptive.

We also have argued that the financial market is global and that, given rapid technological developments, any perceived barriers to entry by both domestic and international competitors are rapidly being eroded. The apparent lack of focus in existing and potential areas of Government intervention in the area of consumer protection only serves to impede the efficient operation of the market, as well as imposing excessive compliance costs on financial institutions.

Efficient and effective consumer regulation requires the following characteristics:

- it should be national in character and application;
- it should be administered by a single regulator, under the auspices of the Commonwealth Government;
- its purpose should be clearly stated;
- consistent with National Competition Policy principles, it should be subjected to regular evaluation as to both efficiency and effectiveness;
- it should avoid being prescriptive;
- it should avoid excessive costs to both consumers and service providers, and should avoid an overload of unnecessary information;
- penalties should be consistent with common law and with the alleged offence; and

- it should be flexible, avoid interfering with the efficient functioning of the market and recognise that most consumers are able to make educated judgements as to their own needs.

The National recognise the difficulties associated with achieving nationally consistent regulations, given the Constitutional prerogatives of the States and Territories in this area. Nevertheless, in the past where the Commonwealth has recognised the need to introduce efficiencies into State based legislation, it has managed to achieve national regulation administered by a single body. The Corporations Law is an example of a national body of law which was previously the province of the States.

In recognising that the current system of consumer regulation is neither efficient or effective, it would seem that the Commonwealth has two primary options:

- to take a lead role through either or both the Council of Australian Governments (COAG) and the Standing Committee of Consumer Affairs Ministers (SCOCAM) in better coordinating and simplifying consumer affairs legislation, in particular the Uniform Credit Code with the view to introducing Commonwealth legislation under Commonwealth administration; or

- in the absence of national agreement, introduce Commonwealth legislation designed to overcome the many shortcomings of existing consumer legislation, including the Uniform Credit Code.

Unlike the moves to unify and simplify corporations laws, there are no impediments to this course of action resulting from revenue shortfalls. Therefore, it would seem that the first option above would be an appropriate course of action to pursue.

8.5.1 The Commercial Activities of the Reserve Bank of Australia

The RBA undertakes a range of activities in competition with the private sector, including:

- transaction banker to the Commonwealth Government and various State Governments, including electronic data interchange facilities;
- a bulk electronics payment system (the Government Direct Entry System);
- securities clearing, registry and settlement services;
- banker to overseas organisations; and
- banker to Initial Public Offerings and Public Share Offers (privatisations and part privatisations).

The National Australia Bank has noted that the RBA seems able to provide services at significantly reduced cost to its private sector competitors. While the information on which to judge whether the RBA is cross-subsidising its commercial activities is not available, it would appear that some element of this occurs.

The principles articulated in the Hilmer Report indicate that at the very least the RBA should operate in a transparent manner. While we would not go so far as the recent National Commission of Audit - which considered that it was arguable whether Government provision of any commercial services was justified - it is the National's strong view that the RBA's private sector activities should be conducted on a fully commercial basis.

To facilitate that, it is recommended that, all the commercial activities should be separated from the main body of the RBA into a separate subsidiary which would be subject to the *Commonwealth Authorities and Companies Act 1994.*

8.6 RECOMMENDATIONS

Consistent with the above, our recommendations for this chapter are:

- Together with existing State, Territory and Commonwealth legislation affecting consumers, the Uniform Credit Code, through the auspices of COAG and SCOCAM, should be substantially simplified and revised to better emphasise its basic aims. The review of the Code should be aimed at the education of consumers about the features of credit contracts, rather than prescribing the process. Civil penalties for breaches under the Code should be removed, with dispute resolution being through the appropriate industry dispute resolution process;

- Administration of all consumer regulations, whether they be related to liability or asset products, should be under a single regulator. This is consistent with the National's recommendation that regulation over the financial sector should be based on functional precepts, rather than being purely institution based;

- Privacy concerns should be recognised by the Commonwealth Government as a national concern, with prescriptive legislation having the potential to disrupt the efficient functioning of the market and the efficient adoption of new technologies. In full consultation with the private sector, including comment on draft legislation, the Commonwealth Government should introduce over-arching privacy legislation which establishes a series of privacy principles with implementation being the responsibility of industry. Privacy legislation should be administered by a national body and funded by the Commonwealth Government;

- It is recommended that the distortions associated with FID/BAD are removed. Further, and consistent with other changes advocated by the National, it is recommended that distortions in the tax treatment of financial instruments be removed;

- It is recommended that the "know your customer" rule replace the current identification requirements of the *Financial Transaction Reports Act* and that the aims of the Act be

focussed on preventing money laundering rather than also covering taxation and social security fraud.

- It is recommended that the Government review its deeming arrangements under *the Social Security Act* and base deemed interest rates on market rates and clearly publicise the basis for its decision;

- All commercial activities undertaken by the RBA should be fully costed on a commercial basis. To help achieve that objective, commercial activities undertaken by the RBA should be undertaken by a separate commercially structured subsidiary and be subject to the *Commonwealth Authorities and Companies Act 1994*.