



Productivity Commission Review of Australia's Consumer Policy Framework

CHOICE pre-hearing submission, April 2007

Australia's consumer policy framework has delivered many benefits to the community over the last few decades. However the market and policy environment has changed significantly over that period. The consumer policy framework needs to be **modernized** and given a stronger **consumer focus** so that it can serve consumers in today's market.

The purpose of this paper is to briefly identify some of the themes and issues that CHOICE will be exploring in its submission and to point to some areas that we would like to discuss at our appearance before the Commission on 16 April 2007.

Key changes required

In summary, these are the changes that CHOICE sees as necessary to the consumer policy framework:

A policy focus on consumers

The policy framework needs to be built on a stronger understanding of actual consumer behaviour, market trends and risk analysis. This requires a well resourced policy agency with a focus on building consumer confidence in markets. The policy framework also needs to ensure that vulnerable consumers are better protected and able to take advantage of the choices increasingly available to them.

Institutional arrangements – a national framework

Consumer policy should be a national responsibility and primarily developed and implemented at a national level. This requires a "home" in a properly resourced policy agency at the federal level, supported by effective regulators. There should also be much better coordination of agencies with consumer protection responsibilities, including more consistent accountability for their performance.

Revamped consumer policy toolkit

A significant expansion of the consumer policy toolkit is urgently required so that today's market issues can be addressed in more effective ways. A package of reforms to key consumer legislation is needed to give regulatory agencies greater flexibility and more cost-effective powers. Outdated regulations that prevent or inhibit competition need to be removed where possible.

Streamlined policy development processes

A national framework would facilitate this outcome, but it also requires better quality impact assessment and research on policy issues.

Improve enforcement outcomes

Consumer protection ultimately depends on the quality of enforcement and the *performance* of regulators. At present there are inconsistent approaches to enforcement across industries and jurisdictions. Accountability for enforcement is inadequate. Enforcement needs to be better targeted to major areas of risk and harm to consumers.

Greater consumer representation and independent research

There is a clear need to ensure wider consumer input into policy development, including through better resourced consumer organizations that carry out advisory and legal "case-work" activities. There is also a clear need for independent research on consumer policy issues so that policy development can be better targeted and policies can be more effectively designed.

Fix priority areas

There is a range of industry areas where reform is urgently needed. Credit, property investment, telecommunications, health (obesity), superannuation are examples.

The comments below follow the PC's Issues Paper structure.

Rationale for consumer policy

Good consumer policy underpins efficient markets. Well designed consumer policy:

- Establishes, shapes and creates markets (eg telecommunications deregulation, compulsory third party vehicle insurance)
- Facilitates competition through strengthening the demand side of markets
- Builds trust in consumer markets, thereby reducing transaction costs and facilitating innovation
- Rectifies market failures primarily arising from information problems
- Consistent with behavioural economics, provides devices to improve the balance between short term and long term consumer objectives and default mechanisms to improve market outcomes (eg, compulsory superannuation, cooling off periods for timeshare scheme purchases)
- Provides additional protections to vulnerable consumers

Market Trends and Developments

The market environment has changed dramatically since the basic elements of Australia's consumer policy framework were put in place in the 1970s. However, too much consumer policy is based on assumptions about markets that do not seem to have factored in these changes. For example, the heavy emphasis on more information disclosure as the answer to a wide raft of market problems is arguably less relevant in an era characterized by overwhelming amounts of information and a vast array of choices in most markets.

An updated consumer policy framework will need to take account the pervasive nature of *technological change*, including the growth in e-commerce, and its impact on business models, contract formation and access to redress. It must also take into account *the impact of globalization*

The review must recognise the increased *importance of services* for consumers, and the related rise in the *importance of intermediaries* such as financial planners, mortgage brokers and telecommunications sales people, in industries which by and large did not exist 30 years ago.

Many new and not-so-new practices diminish the ability of consumers to play their vital role in making markets work. The review must systematically address these *barriers to competition on the demand side*. Examples include *bundling of goods and services*, "*lock-in*" contracts and "*fine print*" clauses in contracts which can disable the ability of consumers to determine the real cost of their choices. *Switching costs* (both real and artificial) make it difficult for consumers to easily change brands or service providers.¹

- Some of these barriers to switching are also intertwined with policy requirements. Switching superannuation funds is an example – CHOICE's conservative estimate is that the barriers to consolidating super accounts are costing consumers between \$1bn and \$2bn each year at present.

There is an urgent need to understand developments in *risk* in modern consumer markets. Much of the discussion about risk during the recent "red tape" review was disappointingly simplistic and empirically weak. CHOICE believes that this is an area requiring further study along the lines of the IMF study on the impact of global financial developments on the risks households bear.

How well is the current framework performing?

Problems

The current framework has significant drawbacks in several areas:

- The objectives of the policy framework are not clear.
- Coordination between state and federal agencies is inadequate. There are also inconsistent approaches and poor coordination across regulatory agencies with consumer protection responsibilities in different sectors.

¹ See Paul Klemperer, *Competition when Consumers have Switching Costs: An overview with Applications to Industrial Organization, and International Trade*, Review of Economic Studies (1995) 62 p 516 : 'where products are artificially differentiated by switching costs, firm's incentives to differentiate their products in any real, functional way, are reduced'.

- Both policy development and enforcement do not have sufficient focus on major consumer risks, including systemic issues.
- The framework is very poor at responding in a timely manner to emerging issues, especially when jurisdictional responsibilities are not completely clear.
- There is a very limited approach to the policy tool kit.
- Policy development is not supported by effective, ongoing research
- The framework fails to ensure wider consumer input into policy making
- There is a tendency to build on existing regulatory structures, often creating red tape, rather than consider new approaches.

Market problems and regulatory gaps are often identified but not addressed. Current policy thinking has not been able to deal with key features of the market that are at the root of some consumer problems including conflicts of interest and deliberate strategies to undermine competition. A major example is the regulation of property investment, which is the subject of a dispute between federal and state agencies.

Under the current policy approach it is also apparent that shifting costs to consumers or small businesses is too often seen as reducing the cost of regulation because it reduces costs for governments (eg aspects of superannuation regulation).

Successes

Having pointed to these flaws, it is also vital to learn from the successes in the current policy framework. Two major examples are instructive:

- The development of consumer protection agencies with a focus on enforcement has had a critical longer term impact on markets, notably the ACCC (which also has a critical role in competition policy) and ASIC in financial services. Building effective regulatory capacity has been a major achievement in consumer protection over the last 10-15 years.
- The development of Ombudsman schemes within a co-regulatory framework, particularly in the financial services sector, has been a major benefit for consumers and industry participants.

There are also many successes at a smaller scale:

- An example that has significant positive impacts for vulnerable consumers (eg remote indigenous communities) is the ban on door-to-door sales of financial products under the Financial Services Reform changes. CHOICE believes this should be extended to credit as soon as practicable.
- Another example is the improved consultation arrangements established by some agencies, such as the establishment of ASIC's Consumer Advisory Panel, a model which has been successfully adopted by other regulators.

Policy tools

This is a key area for reform. At present there is a lack of innovative thinking on policy tools and mechanisms to address problems in consumer markets. As noted above, when problems emerge policy makers too often add to existing regulation without considering whether existing regulation is part of the problem (eg disclosure in financial services).

Some problems with the current approach include:

- Undue reliance on regulating market *processes* vs regulating *substantive* matters, with the exception of Victoria's approach to unfair contracts law. This is typically undertaken in

the mistaken belief that this will always involve regulation that is lighter touch and more “market friendly”.

- Key example is the overemphasis on disclosure in financial services.
- Insufficient powers to address systemic issues.
- An over-reliance on tools based on theoretical rather than empirical models of consumer behaviour.
- An unwillingness to consider a wider range of tools to address hard issues such as conflicts of interest and confusopoly.

CHOICE believes it is also appropriate to look to innovations from other jurisdictions

- Substantive regulation – unfair contracts, prohibition of particular behaviours
- Behavioural economics – cooling off periods, default options
- Tools for systemic problems
- Tools for protecting vulnerable consumers – default options are again important
- Supercomplaint procedures
- Evidence-based and targeted literacy and education programs, rather than broad brush education projects.

Generic vs industry specific

The discussion about generic vs industry specific legislation needs to start from the proposition that both are required in most industries – it is not a question of one or the other. The issue then becomes one of appropriate balance and effective integration.

Generic regulation is vital, but typically will be strongest as an “after the event” mechanism when inappropriate or misleading conduct has already taken place. Industry specific legislation will typically be better at setting out the “rules for participation” such as minimum educational standards or requirements to belong to an industry ombudsman.

Enforcement and redress

Poorly enforced policies and regulations create a range of problems for policymakers. They tend to impose costs on compliance participants but allow non-compliant firms to undercut or free ride. They also lead to red tape as pressure grows for new rules when better enforcement of existing rules may be a superior approach.

Enforcement by appropriately resourced regulators is critical. There are too many consumer rights that are not able to be directly enforced by consumers in the real world, primarily due to the imperfect nature of the legal system. Examples include matters that concern relatively small value claims (from a legal perspective), matters pitching involving major corporations, matters involving firms with little reputational capital (eg David Tweed share offers) and matters involving repeat players in industry opposed to individual claimants.

Industry based complaint resolution schemes have proved to be a successful way to improve consumer redress, although in most industries they have proved to be truly effective only when established within an adequate co-regulatory framework.

An adequate system of redress also requires some improvements to the legal system and the powers of regulators including improved class action procedures and effective disgorgement powers following a successful civil or criminal action by a regulator.

Self and non-regulatory approaches

There is strong evidence that good faith industry engagement in developing consumer protection rules and participation in the design and management of dispute resolution scheme can produce superior outcomes to alternative approaches. However, CHOICE has seen very few examples of self regulatory arrangements that can *by themselves* deliver better market outcomes. This is because of inherent problems such as weaknesses in industry-based disciplinary or policing procedures and free rider issues.

Jurisdictional responsibilities

There is a clear need to operate Australia's consumer policy framework at a national level. This would improve the policy development process and the responsiveness and flexibility of consumer market regulation. The failure to develop a clear framework for regulating investment in property is a good example of why this needs to occur. A national approach would also be beneficial in areas such as consumer product safety and credit.

Gate keeping

Government policy development benefits from processes that effectively ensure that government decisions are based on an accurate economic assessment of the benefits and costs. The key challenges in developing such effective gate-keeping processes are:

1. to develop ways to ensure that benefits or costs which are less able to be directly measured are adequately taken into account (and to develop ways, including improved research capacity, to assist with such measurement),
2. to avoid incorrectly discounting the cost of not acting,
3. to increase the influence of evidence, analysis and long term benefits over the influence of prejudice or lobbying by influential stakeholders in the political decision making process

Some measures that could be used to improve current processes include requiring government policy development agencies to release options papers at an early stage in the policy development process, and requiring RISs in the case of significant decisions not to act.

The proposed super complaint power might be crafted in such a way that a decision not to proceed on the complaint, or a decision to not take any action once a complaint was investigated, might be required to be supported by an approved RIS.

Regulatory and oversight bodies

A very important issue in this review is how the policy framework can deliver good regulatory performance, rather than focus just on regulatory structure.

Even leaving aside the state/Commonwealth split, the range of agencies with some consumer policy or consumer protection responsibilities is wide. As well as agencies such as ACCC and ASIC there are bodies such as ACMA, FSANZ, TGA, RBA (a non-exhaustive list) that have some consumer policy/protection roles. These agencies have different legislative underpinnings, and a problem that arises in CHOICE's experience is that they take quite different approaches to policy development, enforcement, interaction with industry, interaction with consumers,

interaction with other consumer agencies etc. This picture is complicated by the sometimes hazy distinction between policy agencies and regulatory agencies, and also by the range of industry-based bodies that purport to have a role in these areas.

CHOICE will be looking at the possibility of whether some of the responsibilities that fall across different agencies could be rationalized, but realistically there will continue to be multiple bodies in any future policy framework. Therefore Australia's consumer policy framework would also benefit from much better coordination and accountability across agencies, and this should be a key role of a central policy department.

In its submission due May 11 CHOICE will propose an initial draft of a good practice framework for enforcement agencies.