



2 December 2013

By email: fsi@treasury.gov.au

Head of Secretariat
Financial System Inquiry
The Treasury
Langton Crescent
PARKES ACT 2600

Dear Sir/Madam

Financial System Inquiry—Draft Terms of Reference

The Consumer Action Law Centre (**Consumer Action**) welcomes the opportunity to comment on the draft terms of reference for the Financial System Inquiry (**Inquiry**).

In summary, we recommend that:

- the overall objective for the Inquiry could be enhanced by clarifying that it will examine whether the financial system meets consumers' needs and contributes to Australia's wellbeing;
- the terms of reference should ask the Inquiry to consider how and when consumer protection and effective regulation encourages competition and efficient market outcomes;
- the Inquiry should consider ways innovation can be encouraged that contributes to fulfilling a social or economy-wide need;
- in assessing the consequences of financial regulation, the Inquiry should consider whether that regulation is meeting its stated aim efficiently, and not only the costs and negative impacts of the regulation;
- in recommending policy options, the Inquiry should consider the adequacy of consumer protections in promoting consumer confidence, as well as the behaviour of consumers in facilitating competition; and
- the Government consider including an expert in consumer policy on the Inquiry panel.

About Consumer Action

Consumer Action is an independent, not-for-profit, campaign-focused casework and policy organisation. Consumer Action offers free legal advice, pursues consumer litigation and provides financial counselling to vulnerable and disadvantaged consumers across Victoria. Consumer Action is also a nationally-recognised and influential policy and research body, pursuing a law reform agenda across a range of important consumer issues at a governmental level, in the media, and in the community directly.

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Objective—outcomes for consumers

Consumer Action endorses the objective of the Inquiry to examine how the financial system can be positioned to meet Australia's evolving needs and support Australia's economic growth.

However, we submit that the objective could be clarified to make it clear that consumer interests are a key consideration in the objectives of Australia's financial system. The draft terms of reference states that recommendations will be made that foster efficient, competitive and flexible financial system. Improved efficiency, competitiveness and flexibility in the financial system will not only contribute to economic growth, but importantly meet the needs of Australian consumers as end-users of the financial system.

Recommendation

The overall objective for the Inquiry could be enhanced by clarifying that it will examine whether the financial system meets consumers' needs and contributes to Australia's wellbeing, and how competition, flexibility and market efficiency can contribute to these ends.

Consumer protection can facilitate and encourage competition and productive innovation

The draft terms of reference state that the inquiry will refresh the philosophy, principles and objectives underpinning the development of a well-functioning financial system, including '*balancing* competition, innovation and efficiency, *with* stability and consumer protection' (at 2.1). Consumer Action submits that the inquiry needs to also consider how consumer protection and a strong regulatory framework can stimulate competition, productive innovation and a well-functioning economic system.

Australia's experience of the global financial crisis is that it has not been as damaging as the experience in many overseas advanced, developed economies. The strong prudential framework for our banks and key financial institutions has been attributed as a key factor supporting our financial system's resilience. Timely reforms to consumer credit laws also meant that irresponsible lending encouraged by short-termism in sales returns and some mortgage securitisation practices has not been the problem it has been here in the United States.

It is now generally agreed that competition and consumer protection are mutually reinforcing. The Productivity Commission has acknowledged 'the role of consumers in facilitating competition, and promoting well-functioning markets, is long recognised'. The Commission has also stated that:

As a general rule, competition works best when the bulk of consumers are reasonably well-informed and willing to act on information. To this end, a key goal of consumer protection is to overcome significant information failures that can hinder effective competition. ... It is also important to note that good consumer protection benefits goods businesses (and their shareholders) as well as consumers.¹

¹ Productivity Commission, *Review of Australia's Consumer Policy Framework, Inquiry Report No 45*, April 2008, p 28.

Consumer Action also submits that innovation will not always be productive for the economy. Indeed, innovation that is focused on generating short-term returns for industry may result in long-term negative consequences for the economy and the country.

In the UK finance sector, for example, miss-selling practices of payment protection insurance have been a widespread scandal after initially being an “innovative” service delivered by banks. These practices were largely driven by significant profits to lenders that sold the insurance, and have resulted now in billions of pounds being refunded to consumers. This has not only cost the industry involved, but has contributed to poor consumer confidence impacting overall economic growth.

We submit that the Inquiry should consider ways innovation can be encouraged that contributes to fulfilling a social or economy-wide need, rather than innovation that is only about short-term benefits for the finance industry.

Recommendations

Rather than positing competition, innovation and efficiency as objectives that must be balanced with consumer protection, the terms of reference should ask the Inquiry to consider how and when consumer protection and effective regulation encourages competition and efficient market outcomes.

The Inquiry should consider ways innovation can be encouraged that contributes to fulfilling a social or economy-wide need.

Assessing the consequences of financial regulation

The draft terms of reference state (at 2.3) that the inquiry should assess the consequences of financial regulation, including its impact on compliance costs, flexibility, innovation and financial services trade.

Consumer Action agrees that government intervention in markets is itself not cost-free and poorly designed intervention can be bad for consumers in the long term. For example, since the Wallis Inquiry, it has been acknowledged in a number of sectors (for example managed investments, financial advice and superannuation) that product disclosure is insufficient to protect consumer interests.

However, in assessing the consequences of financial regulation, we submit that the focus of the Inquiry should not entirely be on the compliance costs or impact on innovation and financial services trade. Rather, the focus should be on whether regulation is achieving a desirable social or economic purpose in the most efficient way.

Consumer Action has previously submitted that policy makers face challenges in identifying the benefits of regulation.² It is relatively easy for businesses to assess and monetise what additional paper burden or hours of labour will result from new regulation. However assessing the benefits of the change (for example, improved competition, better trader conduct) or the detriment of maintaining the status quo (poor products and services, diffuse and relatively small financial losses, time lost and frustration caused by disputes) is highly complex. The Inquiry needs to consider whether the purpose of regulation is being achieved, including identifying the benefits of regulation, rather than merely consider its costs.

Recommendation

In assessing the consequences of financial regulation, the Inquiry should consider whether that regulation is meeting its stated aim efficiently, and not only the costs and negative impacts of the regulation.

Promotion of competition and stability

The draft terms of reference (at 4.1) states that the Inquiry will recommend policy options that promote a competitive and stable financial system that contributes to Australia's productivity growth.

Consumer Action welcomes a focus on competition, which is a means to improve consumer wellbeing. Despite the recent wave of consumer banking reforms aimed at increasing competition and consumer mobility, Australians are still not switching products in significant numbers, particularly beyond the big four banks. Measures should be considered to improve competition to improve consumer outcomes.

However, it is important that competition is not considered from the perspective of the supply-side alone. As noted above, consumers play an important role in 'activating' competition. To play their role effectively, consumers need to be confident and supported by strong protections. When consumers are not confident:

- they may avoid transacting so that they do not face the possibility of a bad deal and its consequences;
- it may result in consumer inertia—they may opt to stay with an existing supplier because of the perception they will face risk or costs by switching, or that 'they're all as bad as each other' even if there is a better deal on offer;
- they may spend considerable time and effort investigating or will accept higher costs attempting to avoid a bad deal.

In other words, consumers may incur additional costs or competition may be adversely affected where they lack confidence and protection.

² See, submission to Department of Finance's Review of the Regulatory Impact Assessment Process: <http://consumeraction.org.au/wp-content/uploads/2012/04/Review-of-the-Regulatory-Impact-Assessment-process.pdf>

For these reasons, we submit that the Inquiry must also consider the adequacy of consumer protections to promote consumer confidence as well as the behaviour of consumers in facilitating competition.

Recommendation

In recommending policy options, the Inquiry should consider the adequacy of consumer protections in promoting consumer confidence, as well as the behaviour of consumers in facilitating competition.

Consumer policy expertise on Inquiry panel

The Prime Minister and Treasurer have indicated that the Inquiry panel will comprise of four eminent Australians led by Mr David Murray AO. Consumers across Australia are the largest stakeholder in this Inquiry. As such, we submit that the Inquiry panel will benefit from the expertise of an eminent person with a strong understanding of consumer policy and the financial services consumer protection framework. We would happy to make recommendations of individuals that would make a significant contribution to this important Inquiry.

Recommendation

The Government should consider including an expert in consumer policy and financial services consumer policy on the Inquiry panel.

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

Yours sincerely

CONSUMER ACTION LAW CENTRE



Gerard Brody
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