

13 February 2018

The Manager
Financial Services Unit
Financial Systems Division
The Treasury
Langton Crescent
PARKES ACT 2600

Dear Financial Services Unit Manager

Draft legislation for Design and Distribution Obligations and Product Intervention Power

Thank you for the opportunity to comment on the exposure draft Treasury Laws Amendment (Design and Distribution Obligations and Product Intervention Powers) Bill 2017 (**the draft Bill**).

Legal Aid NSW welcomes the Government's decision to accept the Financial System Inquiry's (**FSI**) recommendations to introduce design and distribution obligations (**the obligations**) and a product intervention power. We broadly support the draft Bill and consider that the package of reforms proposed will improve market integrity and enhance consumer protections, particularly in respect of vulnerable consumers who are often the target of inappropriate products ill-suited to their needs.

This letter comments on specific areas of the draft Bill that could be amended to better align with the FSI's recommendations.

Design and distribution obligations

1. The obligations should apply to credit, including unregulated credit, and financial products not regulated by the Corporations Act

We refer to the proposed amendment to the *Corporations Act 2001* (Cth) (**Corporations Act**) in schedule 1, subsections 993DB(1)(a)-(c) of the draft Bill.

The obligations set out in the draft Bill do not extend to regulated and unregulated credit products and financial products not regulated by the Corporations Act. Legal Aid NSW recommends that all financial products, including regulated and unregulated credit products and unregulated financial products, be subject to the obligations.

We are concerned that the exclusion of regulated and unregulated credit products and unregulated financial products from the design and distribution obligations regime would create a regulatory gap, with the effect of lessening protections for consumers, especially in respect of vulnerable consumers.

The explanatory memorandum notes that the impetus to develop the obligations is the FSI's recognition of shortcomings in the existing disclosure regime regarding financial products. Legal Aid NSW is unaware of any compelling reason why the obligations regime should be limited to products which require disclosure under the Corporations Act. Consumer credit products (that is, regulated credit products) are also subject to a disclosure regime under Chapter 3 of the *National Consumer Credit Protection Act 2009* (Cth) (**Credit Act**), and some financial products are more harmful to consumers because they are exempt from the Corporations Act disclosure regime. We consider that excluding products not regulated by the Corporations Act is contrary to the intent of Recommendation 21 of the FSI, which aims to strengthen confidence in the financial system and promote positive consumer outcomes.

Credit products

In respect of credit products, the Treasury's *Design and Distribution Obligations and Product Intervention Power Proposals Paper* released in March 2017 (**the Proposals Paper**) reasoned that credit could be excluded from the obligations regime on the basis that there may be an overlap with the responsible lending obligations. However, the responsible lending obligations only provide a specific and limited protection to individual consumers when entering into a contract with a credit license holder. The proposed design and distribution obligations are much broader than this, requiring issuers and distributors to consider the question of suitability during product design, product distribution and after the product has been sold. Unregulated credit products, such as pawn-broking and very short-term credit, are not protected by responsible lending at all, leaving a significant gap in consumer protection. As consumer credit products are the very products that ordinary consumers, including vulnerable consumers, access the most, it is crucial that the products available in the market are safe, fair and suitable for consumers.

Financial products not regulated by the Corporations Act

Under the current terms of the draft Bill, products that are not regulated by the Corporations Act will not be subject to the obligations regime. For example, expenses-only funeral insurance products are exempt from the Corporations Act, and other laws offering consumer protections such as the *Insurance Contracts Act 1984* (Cth). These types of financial products already avoid regulation which makes it difficult for consumers to obtain a remedy when they are treated unfairly. Further, these products are often deliberately designed to take advantage of particular classes of vulnerable people, with significant negative impacts on the consumer.

It is critical that the obligations apply more widely to assist in preventing consumers from purchasing harmful, unfair and unsuitable financial products. We suggest that the draft Bill be amended to include all financial products, including regulated and unregulated credit and financial products not regulated by the Corporations Act. This could be achieved if the draft Bill adopted the broader and more inclusive definition of financial product at section 12BAA of the *ASIC Act 2001* (Cth) (**the ASIC Act**), rather than limiting the definition of a financial product for the purpose of the obligations to products which require disclosure under the Corporations Act.

In support of our position, we provided casework examples of credit products and financial products not regulated by the Corporations Act being targeted at unsuitable groups of consumers in our response of March 2017 to the Treasury's Proposals Paper. These include short-term and indefinite consumer leases, rent to buy contracts, pawn-broking contracts and expenses-only funeral insurance.

2. The target market determination should be reviewed within a period prescribed by the draft Bill

We refer to the proposed amendment to the Corporations Act in schedule 1, subsections 993DB(12) and 993DB(13) of the draft Bill.

The draft Bill proposes that a person who makes a target market determination must determine the maximum period between reviews of the target market determination, which must be reasonable in the circumstances.

We support this proposal, but we recommend that the draft Bill set out a maximum review period, such as 12 months from the date the target market determination was made. A prescribed maximum review period will contribute to the effectiveness of the obligations and produce consistency in industry practice.

3. A shorter transition period should apply in respect of the obligations

We refer to section 2 of the draft Bill.

The draft Bill proposes a transition period of 12 months for the obligations to apply to new products and 24 months for the obligations to apply to existing products. Legal Aid NSW does not support these transition periods.

Legal Aid NSW recommends that the obligations apply to:

- products not previously made available to consumers, six months after the Bill receives Royal Assent, and
- existing products, 12 months after the Bill receives Royal Assent.

The above transition periods allow adequate time for providers of new products to understand their product, target market and distribution channels. Further, providers of existing products should already have a deep knowledge of their products such that a transition period of 12 months is ample.

4. A product falling within the target market should be suitable for the likely objectives, financial situations and needs of the persons in the target market

The draft Bill proposes that “a target market determination for a financial product must be such that it would be reasonable to conclude that, if the product were issued or sold to persons in the target market in accordance with the distribution conditions, the product would generally meet the likely objectives, financial situations and needs of the persons in the target market.” We recommend that “generally meet” be amended to “be suitable for”. In our view, this amendment would better support the intention of the obligations to ensure that financial service providers promote suitable financial products to consumers, as noted in the draft Explanatory Memorandum.

5. Consumers should have access to redress where a product is sold as a result of an inappropriate target market determination and consumers should be able to rescind the contract where the proposed laws are contravened

The draft Bill proposes that consumers would only be able to recover loss or damage if the relevant contraventions related to: (a) distributing a product without a target market determination; or (b) failing to take reasonable steps to comply with a target market determination. We recommend that these causes of action be extended so that a consumer can recover on the ground that the target market determination was inappropriate.

We also recommend that the draft Bill be amended to allow a consumer to rescind the financial services contract where a contravention is established. This remedy would allow the consumer to exit the unsuitable product in a timely manner and limit the extent of any harm incurred.

Product intervention power

6. The product intervention power should apply to all financial products

We refer to the proposed amendment to the Corporations Act in schedule 2, subsection 1022CC(1)(a) of the draft Bill and the proposed amendment to the Credit Act in subsection 301C(1)(a) of the draft Bill.

Legal Aid NSW welcomes the introduction of the product intervention power. However, we are concerned that the draft Bill does not extend the application of the power to financial products not regulated by the Corporations Act or the Credit Act.

These financial products, such as pawn broking contracts, after pay contracts and funeral fund contracts, can cause considerable detriment to consumers, especially vulnerable consumers. We have provided case studies of the significant negative impact that unregulated products can have on our clients in our response to the Treasury's Proposals Paper.¹ In summary, financial products subject to limited regulation are often deliberately designed to avoid consumer protection laws and requirements for membership of external dispute resolution schemes. Providers of these products often target sales practices towards disadvantaged consumers, such as people living in remote communities, people experiencing severe financial hardship and Aboriginal people. Given the regulatory gap in respect of these products, it can be very difficult for consumers to obtain a remedy against the provider.

Further, in respect of certain financial products, such as the Aboriginal Community Benefit Funds (**ACBF**), ASIC have taken action only to have the company change their approach slightly, and continue operating. ASIC have been unable to get to the core of the issue, which is a poor value product targeted at vulnerable consumers. In the case of ACBF, for example, ASIC needs to be equipped with powers to address a product that is solely marketed to Aboriginal consumers and does not have a cap on costs or age, with the result that funeral cover is sold to children from birth.

To achieve the FSI's goals of:

- reducing significant detriment arising from consumers buying products they do not understand
- limiting the future need for more prescriptive regulation, and
- building consumer confidence in the financial system,

the product intervention power must be available for ASIC and the Government to intervene in respect of a broad range of financial products.

We suggest that the draft Bill be amended so that the product intervention power applies in respect of all financial products. As we suggested in respect of the obligations regime, one way this could be achieved is for the draft Bill to adopt the broader ASIC Act definition of financial product in section 12BAA.

¹ Legal Aid NSW *Design and Distribution Obligations and Product Intervention Power – submission to the Treasury March 2017* https://www.legalaid.nsw.gov.au/__data/assets/pdf_file/0006/26961/Legal-Aid-NSW-submission-on-DDO-and-PIP-March-2017.pdf

7. Intervention orders should continue until the consumer harm has been addressed

We refer to the proposed amendment to the Corporations Act in schedule 2, sections 1022CF and 1022CG of the draft Bill, and the proposed amendment to the Credit Act in sections 301F and 301G of the draft Bill.

The draft Bill proposes that an intervention order made by ASIC may continue for a period of up to 18 months, unless the Minister extends the period. We note that the draft Explanatory Memorandum states that the Minister may delegate his or her power to extend an intervention order to ASIC.

Legal Aid NSW submits that the intervention order should remain in place until the risk to consumers has been remedied, and it is safe for the order to be removed.

Legal Aid NSW's preferred approach is for ASIC to have the power to make initial interventions and permanent rules for individual and market-wide matters. This approach mirrors the UK model where the Financial Conduct Authority (**FCA**) has the power to make permanent rules, following consultation, about a wide range of matters, such as banning products and services.

In the alternative, should intervention orders be limited to an 18-month period, there must be a clearly defined process for the Government to consider and address the intervention order in a timely manner. It would be a poor outcome if the intervention order expired after an 18-month period without any systemic action to resolve the consumer detriment.

8. The consultation process requirement should not prevent ASIC from responding to consumer harm in a timely manner

We refer to the proposed amendment to the Corporations Act in schedule 2, subsection 1022CE(1) of the draft Bill, and the proposed amendment to the Credit Act in subsection 301E(1) of the draft Bill.

The draft Bill proposes that ASIC must not make a product intervention order unless it has consulted persons who are reasonably likely to be affected by the order. We broadly support this proposal, but note our concern that the consultation process should not prevent ASIC from acting in a timely and expedient manner.

Our preferred approach is that taken by the UK's FCA. The FCA can make temporary product intervention rules without consultation which lapse after 12 months. During the 12 month period, the FCA consults on and makes permanent rules. We consider that this approach would enable ASIC to respond quickly to consumer harm.

9. The definition of 'significant detriment' should include low value financial losses that may have a considerable impact on disadvantaged consumers

We refer to the proposed amendment to the Corporations Act in schedule 2, section 1022CD of the draft Bill, and the proposed amendment to the Credit Act in section 301D of the draft Bill.

We support the draft Bill's proposal that the intervention power can be used where ASIC is satisfied that a product is likely to result or has resulted in significant detriment to relevant persons. ASIC should be able to intervene in circumstances where the risks to consumers are not necessarily significant in terms of financial loss to the consumer, but rather involve

small losses to multiple consumers, or affect a class of vulnerable consumers, for example, those entering into payday loans or involved in consumer lease disputes.

We note the suggestions in the Treasury's Proposals Paper that:

- exercise of the power should take into account whether a particular class of consumers is vulnerable or more likely to experience hardship as a result of the product, and
- a detriment affecting a particularly vulnerable class of consumers is more likely to warrant investigation by ASIC.

Legal Aid NSW supports these suggestions. The Explanatory Memorandum notes that the factors listed in subsections 1022CD(1) and 301D(1) of the draft Bill are non-exclusive. However, we recommend that ASIC should be specifically required to consider the class of consumers likely to be affected by the product, in particular whether those consumers are likely to be experiencing hardship or vulnerability, when ASIC determines whether detriment resulting from a financial product is significant.

10. ASIC should be empowered to make interventions in respect of staff training and remuneration

We refer to the proposed amendment to the Corporations Act in schedule 2, subsection 1022CC(6) of the draft Bill, and the proposed amendment to the Credit Act in subsection 301C(5) of the draft Bill.

The draft Bill proposes that a product intervention order cannot require that a person satisfy a standard of training or impose requirements in relation to a person's remuneration, other than so much of the remuneration as is conditional on the achievements of objectives directly related to the financial product. We understand this expression to be referring to remuneration that takes the form of commissions, bonuses and remuneration contingent on sales targets.

In our experience, much of the harm suffered by consumers is a result of poor selling practices, often due to inadequate staff training and/or sales incentive remuneration schemes. This is the case despite some guidance and obligations in respect of training and professional standards requirements. For example, credit licensees must comply with the organisational competence obligation in section 47(1)(f) of the Credit Act and must ensure that their representatives are adequately trained and competent to engage in credit activities under section 47(1)(g) of the Credit Act.

As noted in the Explanatory Memorandum, we acknowledge that these poor selling practices could be dealt with by legislative reforms to professional standards and remuneration schemes. However, we consider that the intervention power is a more effective and consistent way to limit consumer harm in these areas. As a result, we recommend that ASIC be empowered to make interventions in respect of issues relating to training.

Summary of Recommendations

In summary, Legal Aid NSW supports the draft Bill, with the following proposed amendments:

1. The design and distribution obligations should apply to all financial products, including credit and financial products not regulated by the Corporations Act.
2. Product issuers should be required to review the appropriate target market within a prescribed maximum period of 12 months from the date of the target market determination.

3. The obligations should apply to products not previously made available to consumers six months after the Bill receives Royal Assent; and existing products 12 months after the receives Royal Assent.
4. A product falling within the target market should be suitable for the likely objectives, financial situations and needs of the persons in the target market.
5. Consumers should have access to redress where a product is sold as a result of an inappropriate target market determination and consumers should be able to rescind the contract where the proposed laws are contravened.
6. The product intervention power should apply to all financial products, including credit not regulated by the Credit Act and financial products not regulated by the Corporations Act.
7. ASIC should have the power to make permanent intervention orders. In the alternative, should intervention orders be limited to an 18-month period, there must be a clearly defined process for the Government to consider and address the intervention order in a timely manner.
8. ASIC should have the power to implement interim intervention orders for a period of 12 months, without consultation.
9. The definition of 'significant detriment' should include low value financial losses that may have a considerable impact on disadvantaged consumers or a large class of consumers. Subsections 1022CD(1) and 301D(1) of the draft Bill should be amended to insert "the class of consumers likely to be affected, in particular whether those consumers are likely to be experiencing hardship or vulnerability" as a factor for ASIC to consider when assessing if a product results in or is likely to result in 'significant detriment to relevant persons'.
10. ASIC should be empowered to make intervention orders in respect of issues relating to training financial services staff.

Again, we are grateful for the opportunity to comment on the draft Bill, and welcome the introduction of design and distribution obligations and a product intervention power. If you have any questions about the matters raised in this letter, please contact Dana Beiglari, Senior Solicitor, Combined Civil Law Specialist Team, Civil Law Division on [REDACTED] or [REDACTED]

Yours sincerely



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