Submission to the Productivity Commission Inquiry into Australia's Consumer Policy Framework

June 2007

Table of contents

List of acronyms

ABS	Australian Bureau of Statistics
ACCC	Australian Competition and Consumer Commission
ACMA	Australian Communications and Media Authority
ACR	Australian Capital Reserve
ADR	Alternative Dispute Resolution
ASIC	Australian Securities and Investments Commission
BCC	Business Cost Calculator
BIA	Business Impact Assessment
CAV	Consumer Affairs Victoria
COAG	Council of Australian Governments
ESC	Essential Services Commission of Victoria
FSA	Financial Service Authority (UK)
ICT	Information and Communications Technologies
MCCA	Ministerial Council on Consumer Affairs
NCC	National Consumer Council (UK)
OECD	Organisation for Economic Cooperation and Development
OBPR	Office of Best Practice Regulation
OPC	Office of the Privacy Commissioner (Federal)
RBA	Reserve Bank of Australia
RIS	Regulatory Impact Statement
SCOCA	Standing Committee of Officials of Consumer Affairs
SCM	Standard Cost Model
TPA	*Trade Practices Act 1974* (Cth)
UCCC	Uniform Consumer Credit Code
VCAT	Victorian Civil and Administrative Tribunal
VCEC	Victorian Competition and Efficiency Commission

Executive Summary

The Productivity Commission inquiry into Australia's consumer policy framework provides a much-needed opportunity to update the framework.

Why does our consumer framework need to be updated?

Our current consumer policy framework was designed when an old way of thinking about consumer transactions prevailed. Major changes in consumer markets in the past three decades are not reflected adequately in our current framework. Our framework is also rusty; it is operating on old assumptions and does not incorporate the latest understandings about how consumers behave, which could help it be more targeted and effective.

Market changes

There are a number of significant changes in consumer markets that justify updating the framework.

Product bundling is increasingly prevalent across a range of sectors, including those that provide essential services. However, our consumer policy framework does not address the challenge of how to encourage legitimate innovation in product and service offers while discouraging the use of product bundling to confuse consumers or lock out potential competitors. Nor does it address the unwanted effects of bundling on disadvantaged members of our community, where it can lock them out of accessing lower prices.

Organic market mechanisms have developed in response to changing conditions. In particular, the growth in the use of *intermediaries* is a predictable market response to the emergence of new, and more complex, markets. It is often going to be more efficient for consumers to use intermediaries to help them make choices in these markets rather than pay the costs (both direct and opportunity) of informing themselves of all relevant matters, particularly for complex and one-off or irregular purchases.

However, in practice intermediaries are often conflicted, typically through commissions or other payments from suppliers. The use of intermediaries can make it difficult to ascertain responsibility in disputes and they can exacerbate, rather than address, consumer information problems. This is the result of market forces operating without the anchor of long-term consumer interest, as it is more lucrative for individual intermediaries to source income from suppliers. This also allows these intermediaries to compete more strongly for consumer business by seeming to offer their services at a cheaper price than intermediaries who offer services on a fee-for service basis. Suppliers then compete to offer greater payments to intermediaries as consumers make more and more use of them.

Current policy responses in the financial sector rely heavily on disclosure tools rather than more prescriptive regulation or "interference" with the market, but this has been inefficient and ineffective. A simpler and more effective way to deal with the problem would be to amend the law to state simply that finance brokers act as agents of lenders, rather than consumers. This example demonstrates that consumer policy has a role to play in monitoring and where necessary regulating emerging market mechanisms such as intermediaries.

Recommendation 1:

Amend the law to provide that a finance broker acts as an agent of the lender (or other supplier), rather than the consumer, where the broker is remunerated by the lender.

Consumers increasingly use the *internet* as a source of information about products. However the quality of information available on the internet, and consumers' search and appraisal skills, vary. E-commerce and internet use also exposes consumers to a broad range of scams and other fraudulent activities that require new types of consumer protection. Despite increasing internet use there remains a "digital divide" among Australian consumers. Lack of access and usage of the internet among disadvantaged and low-income consumers places core groups at further disadvantage in the marketplace.

The use of *standard form contracts* is now ubiquitous across many products and markets, as we have moved away from individual bargaining due to the development of mass marketing, production and consumption in our modern industrial society. Theoretically, the use of standard-form contracts, as a process, is an efficient market arrangement. However, the content of these contracts may not be fair or efficient. Standard-form contracts, of their nature, do not involve negotiation and the reality is that standard-form contracts across many sectors and industries include unfair terms causing serious consumer detriment.

Since consumers do not have the option (or capacity) to "shop around" driving competition for better contract terms, some intervention is required in markets that rely on standard-form contracts that contain unfair terms. This does not need to interfere with the process of standard-form contracting, which is more efficient than suppliers negotiating each contract individually but does need to address the problem of lack of competitive discipline on suppliers as this allows them to include undesirable terms in their contracts, which can undermine the gains made by the streamlined contracting process. Unfair contract terms legislation has recently been introduced in Victoria and the United Kingdom and these represent a template for updating Australian laws.

Recommendation 2:

Introduce unfair contract terms amendments to the *Trade Practices Act* and *Australian Securities and Investments Commission Act* modelled on legislation introduced in Victoria and the United Kingdom, including coverage of credit contracts.

At the same time that these changes have taken place, privatisation, deregulation and competition policy together with technological advances have allowed *new and more complex markets and products* to emerge in recent years. Some of these markets provide essential services that were previously provided by a single government supplier. Compounding problems in negotiating these markets, consumers now work more hours each week so they are increasingly *time poor* and unable to analyse all the information relating to every transaction they make; if they did so our markets would grind to a halt.

Our consumer policy framework relies heavily on informing and educating consumers so that they can make rational choices and drive competition in markets. However, research has shown that too much choice is actually demotivating and results in consumers using simple heuristics or "rules of thumb" when faced with more complex choices. This challenges the assumptions currently underpinning our framework and points to the need for a consumer protection framework that allows consumers to act with confidence in new and complex markets with consumer information and education one part of the policy response but not over-relied on.

Data indicates that Australian *consumer debt* levels have increased significantly in the past 20 years. These trends have been paralleled by an increase in bankruptcies and foreclosures in recent years. The marketing practices of lenders contribute partly to this, including mainstream lenders that aim to get consumers "hooked" into credit products such as credit cards. Consumers are increasingly using debt as a means of funding transactions in the marketplace. This leads to inefficiencies as funds are directed to service debt rather than to other areas of the market. Heavily indebted consumers are vulnerable to predatory lending practices such as "equity stripping". These new practices create an additional market distortion that inhibits the Government's ability to use market levers such as monetary policy. This is a significant issue that requires its own review of policy and regulatory options to address consumer debt problems.

Recommendation 3:

The Productivity Commission should be tasked to undertake a review of policy and regulatory options to address the problems associated with increasing consumer and household debt, foreclosures and bankruptcies and to protect disadvantaged and vulnerable consumers from predatory practices such as pay-day lending and unsolicited increases on credit card limits.

International developments

When the *Trade Practices Act* was first introduced in 1974, it set an international standard in the regulation of anti-competitive conduct and the protection of consumer rights. Unfortunately, while Australia's competition policy framework has been systematically reviewed and significantly changed since the introduction of the TPA, Australia has not generally kept pace with international developments in consumer policy and protection, nor sought to.

We have not kept pace with new initiatives designed to achieve the long-standing goal of promoting *fair trading*. These include unfair contract terms laws protections and general duties to trade fairly, as well as administrative and enforcement tools such as super-complaints to regulators, stop-now orders to stop a business from breaching certain legislation and general market investigation powers where markets do not appear to be operating effectively.

Consumers are not simply passive beneficiaries of competition, they drive it. However, our consumer policy framework does not reflect new understandings and evidence regarding the importance of consumer behaviour in markets. Treatment of issues such as transaction and switching costs, product bundling, complexity in markets and conflicts of interest are ad hoc and inconsistent. Tools to ensure these issues can be addressed consistently are needed as part of the framework.

Behavioural economics examines actual consumer behaviour and identifies systematic biases and departures from the perfectly rational consumer that is assumed by our current consumer policy framework. These systematic biases or departures need to be considered in determining whether intervention is necessary and in judging the efficacy of proposed responses to problems. Failing to consider behavioural principles can be seen in the use of disclosure regimes in the financial services market. Not only are consumers highly unlikely to actually read complex and detailed disclosure documentation, other forms of disclosure, such as disclosure of conflict of interest, can have the opposite effect to that intended by raising trust rather than promoting caution. Australia should use the examples of efforts to help apply behavioural economics principles in policy design in the United Kingdom and New Zealand to develop similar applications in Australia.

Recommendation 4:

Commonwealth Treasury should review the examples of efforts to help apply behavioural economics principles in policy design in the United Kingdom and New Zealand. These should be used to develop similar applications in Australia.

What do we want our consumer policy framework to achieve?

Our understanding of the potential for consumer policy to improve economic and social outcomes for the community has greatly progressed over the past few decades. Consumer policy in its modern form emerged in the 1960s with a focus on social justice, especially the fair treatment of consumers generally. The recognition that low-income and disadvantaged consumers faced particular problems in consumer markets came later. Growing understandings from competition, consumer and behavioural economics provide scope for a more sophisticated approach to consumer policy that recognises its potential to improve market outcomes, as well as achieving socially just outcomes, attracting a more overtly economic focus.

Modern consumer policy should therefore play a variety of roles and has both an economic and social character. Our consumer protection framework needs to promote competition and reflect broader social goals such as equity and fairness, access to essential services and protection of disadvantaged and vulnerable members of the community. On the one hand, the framework should empower consumers; on the other, it should protect them.

A set of principles that should guide the redevelopment of the framework can be identified:

Principle 1: Support the demand side of the market
Base policy on a comprehensive understanding of the issues consumers face in the marketplace and which limit their ability to actively participate in markets.

Principle 2: Ensure there is supply side competition and fair trading
Correct supply side problems so that incumbent suppliers cannot distort markets to discourage other potential suppliers from entering, consumers can seek redress where necessary and systemic unfair conduct is more effectively addressed, including unfair terms in standard form contracts, with regulators actively enforcing the rules.

Principle 3: Protect vulnerable and disadvantaged consumers
Use emerging sophisticated approaches to addressing disadvantage to address concerns about practices affecting disadvantaged and vulnerable consumers.

Principle 4: Ensure access to essential services
Ensure that all consumers have fair and reasonable access to services, especially essential services, in terms of pricing and market and product configurations.

Principle 5: Have regard to international developments
Update policies and strategies in line with international best practice.

Principle 6: Approaches should be evidence based.
Commit to measuring costs and benefits to consumers as well as business, including by undertaking consumer research to provide relevant evidence and proper consultation with consumers and their representatives.

Principal 7: Ensure efficient national coordination

Commit to proper resourcing and public reporting of consumer administrative and coordination processes and improve accountability through a national Minister for Consumer Affairs.

Principal 8: Flexibility
Adopt a non-linear approach, so that no one approach or tool is automatically preferred over others, and complex problems attract a range of tools and approaches.

How can we ensure our consumer policy framework is effective?

Once we know what we want our consumer policy framework to achieve, we need to ensure both that the general framework promotes effectiveness and that the specific policy tools used are the right ones.

The general framework

The general consumer policy framework should focus on ensuring that policies and regulation are effective to do the job that they were designed for, including being structured to enable consumers to fully participate in the market and feel confident that a baseline of protection is in place.

The Office of Best Practice Regulation and relevant State and Territory regulatory gate keeping processes must be urgently reviewed as they currently focus almost solely on burdens to business – their approach must be broadened, with a focus on the effectiveness of the regulation as well as costs and benefits. Arbitrary approaches that measure the number of pages of regulations, or which promulgate a “one in, one out” approach, are useless in assessing the effectiveness of regulation.

These processes need to develop tools to assist in assessing the benefits of regulation, not just the costs. This requires them to incorporate and support qualitative measures. Consumer detriment surveys can be used to measure costs, while techniques borrowed from other regulatory or policy processes, for example Consumer Impact Statements, could help with qualitative assessment. Assessments of effectiveness of a proposed regulation also need to include robust testing of the effectiveness of the compliance, enforcement and redress regime that will apply to it.

Australian regulatory processes need to incorporate international best practice. The OECD Consumer Policy Committee has developed a template for assessing regulatory change that provides a comprehensive checklist which begins with questions assessing both the supply side and the demand side of the market. It also requires assessment of whether costs are falling on vulnerable or disadvantaged groups and if so, what policies to compensate or protect these consumers are needed.

Recommendation 5:

Undertake an urgent renew of the Office of Best Practice Regulation (and relevant State and Territory agencies and processes) with the objective of:

- Broadening the approaches that are used to measure regulatory impact with a focus on the effectiveness of the regulation as well as costs and benefits;
- Developing tools to assist in assessing costs and benefits to consumers;
- Including consumer benefit or detriment in measures of regulatory burden;
- Incorporating qualitative measures and considering Consumer Impact Statements; and
- Incorporating best practice models such as that developed by the OECD Consumer Policy Committee.

Evidence is needed to support these processes and the consideration of possible policy and regulatory responses to consumer problems. Governments need to commit to obtaining real evidence by resourcing consumer research and incorporating understandings of consumer experience and behaviour in markets in policy and regulatory making processes. This could be most effectively achieved through the establishment of an independent national consumer body to undertake research on issues affecting consumers, including research on consumers' behaviour and experience in markets.

Recommendation 6:

MCCA members should commit to:

- Incorporating the latest evidence and knowledge about consumers' experience and behaviour in markets into consumer policy. The consumer policy work in the OECD, United Kingdom and New Zealand should be reviewed as part of this process; and
- Providing resources to compile available evidence regarding consumer experiences in markets encourage the development of additional research and commission work.

It also requires a commitment to consultation with consumers and their representatives on issues that affect them. Appropriate funding and resources for a peak body that represents consumer organisations from around Australia is urgently required. This will strengthen the consumer voice and provide much-needed consultation addressing consumer interests in policy development. A peak body with appropriate funding could undertake vital work across four key areas: policy advocacy; networking and information sharing; coordinating consumer representation; and development of best practice models.

Recommendation 7:

The Federal Government should establish an independent national consumer body to undertake research on issues affecting consumers, including research on consumers' behaviour and experience in markets.

Recommendation 8:

Provide appropriate funding and resources for a peak body that represents consumer organisations from around Australia. This will strengthen the consumer voice and provide much-needed consultation addressing consumer interests in policy development. A peak body with appropriate funding could undertake vital work across four key areas: policy advocacy; networking and information sharing; coordinating consumer representation; and development of best practice models.

Finally the framework cannot be effective without appropriate administration and coordination at a national level. Without a Federal Minister for Consumer Affairs, there has been a lack of government accountability nationally for consumer policy development, implementation and review. Further current MCCA and SCOCA processes are undermined by lack of resources and limited public reporting of timeframes, work plans and outcomes.

Recommendation 9:

MCCA members should commit to providing adequate resourcing to SCOCA processes. In defining 'adequate' it should refer to the staffing and administrative requirements required to conclude SCOCA's current work program within 12 months.

Recommendation 10:

MCCA members should commit to public reporting of meeting agendas and outcomes, a published work plan and monthly reporting of progress against the work plan.

Recommendation 11:

The Federal Government should re-instate the position of National Minister for Consumer Affairs.

The right tools for the job

With a general framework focused on effectiveness in achieving economic and social goals, as described above, it becomes possible to construct a flexible and effective policy toolkit.

The policy toolkit should includes a range of possible policy responses to deal with the issues experienced by Australian consumers, including those that improve overall market efficiency; those that ensure fair trading; those that target vulnerable and disadvantaged consumers; and those that are specific to certain industries. This requires a balance between generic, targeted and industry-specific approaches as needed.

Most importantly, the focus should be on choosing the right tools for the job, rather than preferring certain tools over others or a linear approach to regulation. No one tool should be automatically preferred. For example, self-regulatory regimes are often looked to first in Australia due to their perception as low-cost, however we are unaware of any successful self-regulatory models in consumer markets in Australia, and in fact they have often led to market distortions as responsible businesses comply, taking on additional costs, while other businesses do not. Co-regulatory approaches may be more effective in some cases as they provide a regulatory hook.

Industry-specific regulation, appropriately directed, should be seen as a complement of general regulation. While in some cases reducing reliance on industry-specific regulation may reduce duplication and inconsistency, there are examples where industry-specific regulation is essential for improving market efficiency (with benefits for consumers and business) and improving consistency across jurisdictions within particular markets. For example, specific protections in the Victorian energy market provide certainty around issues specific to this market, including billing cycles and disconnection. By contrast the lack of specific protections applying to debt collection has led to the need to produce guidelines for the industry and continuing problems in enforcing general fair trading obligations. There are also particular situations in which it can be identified that industry-specific regulations will be required, including markets for essential services, new markets, markets for credence goods and markets for high risk products, where general protections do not and should not target specific concerns.

It is particularly important to identify appropriate policy responses when grappling with problems that affect disadvantaged or otherwise vulnerable consumers, particularly as modern consumer markets do not necessarily distribute benefits equally nor equitably, thus a market may be highly competitive but be causing significant detriment to certain groups.

It is generally accepted that we do not want to see entrenched disadvantage in our consumer markets but there are questions about how to best to meet the needs of such consumers and whether policies attempting to do so may impose net costs on the wider community. Consumer policy has traditionally been one of the principal tools used to address problems affecting low-income, disadvantaged or otherwise vulnerable consumers but some argue this is less efficient than using the “tax and transfer” system to redistribute the benefits of efficient markets. However, there is still an important role for consumer policy in addressing the needs of disadvantaged and vulnerable consumers because:

1) In many cases, a problem that appears to affect disadvantaged or vulnerable consumers may, in fact, be a market-wide failure.

There is a tendency to assume that market problems that affect disadvantaged consumers harshly are limited to those consumers, because it is difficult to assess the impact on the broader community. However, once a market problem is identified, a more sophisticated approach asks whether further investigation is needed to determine if the problem points to a broader market failure, for example by using consumer detriment surveys. For example, inappropriate lending may only be visible where consumers cannot repay the loans, but this does not mean other consumers who are managing to make repayments are not suffering detriment. Caution should be exercised before consumer policies are dismissed based on a cost-benefit analysis that only takes into account benefits to low-income and disadvantaged consumers

2) In-market solutions do not always have to be universal or inefficient. Consumer policy tools can also be designed to be targeted rather than general.

Where market problems truly do affect particular consumer groups rather than reflecting a wider market failure, targeted responses can ensure that these problems are addressed while avoiding unnecessary wider costs. Targeted policies do not need to be difficult to formulate or design, as long as it is understood and accepted that it is not possible to define definitively in advance which consumers should be targeted. This does not mean that such policies will be too broad, rather they will be flexible enough to address issues of disadvantage as they arise without imposing inefficient regimes on market operations. Financial hardship policies in the Victorian energy and water sectors are good examples of targeted policies that help low-income and disadvantaged consumers on the basis of their circumstances and need, rather than fixed traits, while benefiting suppliers and leading to better market outcomes.

3) Despite a net cost to the wider community, a consumer policy may be justified to ensure social justice and because the problem is unlikely to be addressed by the broader tax and social welfare systems. This is particularly so if any theoretical net cost imposed by the policy is only marginal.

Our tax and transfer system is far-removed from individual consumer markets and any problems manifesting within them. The overall tax and transfer system is also expected to deal with a range of social inequalities, not just consumer market failures, and in truth it will never fully deal with all of them. Trying to use this broader system to address individual market issues could also prove a blunt and imperfect tool. It will often be easier in practice to identify and implement market-based solutions to problems in a market, even if these problems leverage off the effects of poverty or income disparity, for example the inclusion of hardship policies in energy regulation. Targeted consumer policy has the potential to address problems where they occur, and without imposing limits on the overall functioning of the economy. Sometimes market practices need to be addressed in the overall interests of fairness and social justice, regardless of marginal inefficiencies. However, it is easy to lose sight of this if the problem is regarded solely from an economic point of view.

Recommendation 12:

Incorporate a formal requirement to analyse whether policies are required to address market problems affecting disadvantaged or vulnerable groups into formal policy making and regulatory impact assessment processes.

Where are there current problems?

While regulation may be well-designed and targeted, it will not be effective unless compliance is properly monitored and enforced, and effective and accessible redress is available for consumers when breaches occur.

Successful current approaches include the Victorian unfair contract terms regulation, which could have provided only private-action rights to consumers to challenge unfair contract terms but instead provides both individual rights and regulator powers to address unfair terms on a systemic basis. This is a significant measure, given that unfair contract terms relate to increased use of standard-form contracts, which are used industry-wide. The Code of Banking Practice has also been reasonably successful, with most banks now signatories. Attention to the mechanisms to ensure monitoring and enforcement has made this code more effective than other codes, including telecommunications consumer codes, because the code is enforceable between signatory banks and their customers and is properly monitored by a code Monitoring Committee.

These can be contrasted with a range of current areas where urgent attention is required to update the policy and regulatory regime.

Credit reporting

There are a number of serious shortcomings and problems related to credit reporting including complaints handling, enforcement and identification, and addressing of systemic issues. Not all of these problems relate to the design of the rules themselves, thus the Federal Government should initiate a review of the Office of the Privacy Commissioner, examining the culture, operating policies and financial resourcing of the OPC.

Recommendation 13:

The Federal Government should initiate a review of the Office of the Privacy Commissioner, examining the culture, operating policies and financial resourcing of the OPC.

Telecommunications

The regulatory regime for consumer protection in telecommunications is poorly designed. Contrary to the principles we set out for an effective consumer policy framework, it explicitly prefers one tool – voluntary self regulatory codes – to other tools. This process has been an abject failure in achieving any positive change on industry-wide problems such as the widespread use of unfair terms in consumer contracts and failure to establish procedures to deal with customers with genuine payment difficulties. Together with an inactive regulator, this has led to continued poor consumer practices by telecommunications service providers and to consumer detriment. An urgent review of this regime is needed.

Recommendation 14:

The Federal Government should initiate a review of the telecommunications consumer protection regime, examining:

- Elimination of the statutory preference for self-regulation under the *Telecommunications Act*;
- the need for mandated financial hardship obligations for telecommunications service providers; and
- Possible means to improve the consumer protection performance of the regulator.

Credit regulation

There are a range of problems in this area that have not been addressed, including the use of loopholes to avoid UCCC coverage, lack of access to ADR processes, predatory lending practices targeting low-income and disadvantaged consumers in particular and a lack of timely administration of the harmonised regime by state and territory governments. These problems have contributed to rising debt levels as discussed above. Responses in this area need to be urgently implemented, including fast-tracking current fringe lending and finance and mortgage brokers regulatory proposals, moving from a harmonised state regime to a national regime, providing for an up-front obligation on lenders to ensure a consumer has the capacity to repay a loan without substantial hardship before extending credit; capping the total cost of credit, including interest, fees and charges; and empowering Federal and State regulators to enforce consumer protections under the regime so that systemic issues can be properly addressed.

Recommendation 15:

Urgently amend consumer credit regulation in the following ways:

- Fast-track current MCCA proposals to amend the UCCC to close loopholes relating to fringe lending and to regulate finance and mortgage brokers;
- State governments should refer their powers to legislate for consumer credit to the Commonwealth so that it may be nationally regulated;
- Provide that intermediaries are the agents of the lender where they are paid by the lender;
- Tighten the rules around the use of comparison rates and undertake a targeted education campaign for consumers on using them;
- Require all consumer credit providers to join an approved ADR scheme;
- Provide for an up-front obligation on lenders to ensure a consumer has the capacity to repay a loan without substantial hardship before extending credit;
- Mandate financial hardship obligations on consumer credit providers;
- Cap the total cost of credit, including interest, fees and charges as has been done in NSW; and
- Empower Federal and State regulators to enforce consumer protections.

Remedies for wrongful conduct

The ACCC and ASIC are currently hampered in their ability to obtain effective redress where suppliers engage in conduct in breach of our consumer protection laws. While consumer protection obligations can be enforced, consumer compensation is particularly difficult to achieve. This limits the incentives for suppliers to comply with our general consumer protection regime. Legislation must be amended to allow the regulators to seek orders for the compensation of consumers, either individually or by way of cy pres arrangements, and for disgorgement of profits obtained as a result of wrongful conduct. Civil pecuniary penalties also need to be provided for so that regulators are not limited to more cumbersome criminal proceedings in every case of possible wrongdoing. These problems have been apparent for some time but have not been addressed despite a range of amendments to the competition provisions of the TPA.

Recommendation 16:

Amend the TPA and *Australian Securities and Investments Commission Act* as a matter of urgency to allow the regulators to seek orders for the compensation of consumers.

Recommendation 17:

Amend the TPA and *Australian Securities and Investments Commission Act* to provide for civil pecuniary penalties.

Recommendation 18:

Amend the TPA and *Australian Securities and Investments Commission Act* to allow the regulators to seek orders for cy pres compensation by wrongdoers and for disgorgement of profits obtained as a result of wrongful conduct.

Tackling unfair conduct generally

Australia's consumer policy framework does not incorporate international initiatives designed to promote fair trading, such as unfair contract terms laws, a duty to trade fairly or stop-now orders. We recommend updating our general framework in line with international best practice by adding these tools to our policy toolkit.

Recommendation 19:

MCCA members, including the Commonwealth, should commit to updating our general consumer policy framework in line with international best practice, by introducing:

1. National unfair contract terms laws, based on the European, UK and Victorian models.
2. A general obligation not to trade unfairly, based on the European and UK model, and drawing on lessons from the US.
3. Provision for super-complaints to regulators by designated groups, to ensure accountable regulator action on systemic consumer problems, based on the UK model.
4. Powers for regulators to issue stop-now orders where a supplier is in breach of consumer protection rules and this breach is causing substantial harm, based on the European and UK model.

Recommendation 20:

Amend the TPA to provide powers for the ACCC to pro-actively investigate the effectiveness of competition in particular markets.

Conclusion

Our consumer policy framework has not kept pace with market changes and international developments. Consumer regulation has become less effective as a result and this has affected vulnerable and disadvantaged consumers in particular. We need to update our consumer policy framework, taking account of significant changes in consumer markets as well as more sophisticated approaches to the questions of consumer behaviour and consumers' experience in markets. This requires an evidenced-based approach to consumer policy and regulation making that seeks to implement the best tools to achieve effective outcomes, rather than arbitrary approaches that look for least business cost regulation regardless of effectiveness and without assessing costs and benefits to consumers and the community as a whole. Measures to assist disadvantaged and vulnerable consumers are an essential part of this process and cannot simply be left to broader tax and transfer systems. There are a number of current areas that require urgent attention, but with an updated and more effective framework and flexible tools, these problems can be confidently tackled.

1.0 Introduction

1.1 About Consumer Action

Consumer Action is an independent, not-for-profit, campaign focused, casework and policy organisation. It is formed by the merger of the Consumer Law Centre Victoria and the Consumer Credit Legal Service and builds on the significant strengths of these two centres.

Consumer Action provides free legal advice and representation to thousands of vulnerable and disadvantaged consumers across Victoria and is the largest specialist consumer legal practice in Australia. 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 government level, in the media, and directly with industry and in the community.

Consumer Action also conducts significant outreach activities and provides training to other community sector workers.

We welcome the opportunity to make this submission to the Productivity Commission (the Commission) in response to its Consumer Policy Framework Issues Paper of January 2007 (the Issues Paper).

1.2 Need for this review

This review provides a much-needed opportunity to examine the changes in the Australian consumer environment over the past 30 years.

When the TPA, a central arm of our consumer protection framework, was introduced, it set an international standard in the regulation of anti-competitive conduct and the protection of consumer rights. Unfortunately, we now lag behind the rest of the world in significant respects when it comes to protecting consumers. Our consumer policy framework has not kept pace with the market changes resulting from the unparalleled microeconomic reforms since the 1980s, including competition policy and deregulation; nor has it effectively managed the increasingly complex products, market configurations and ways of transacting that have emerged since.

Consumer regulation has become less effective as a result. This has affected vulnerable and disadvantaged consumers in particular and has contributed to increasing household debt, an increased risk of consumer detriment and a less effective demand-side than needed to activate competition in many markets.

We now have an opportunity to pause and consider whether our policies and regulations are effectively protecting consumers. Given the increasing complexity of the consumer environment, a rigorous analysis of our existing regulation and its enforcement is vital. We need to consider whether updated or new provisions are necessary, and use the latest evidence to produce the most effective response.

This submission examines consumer issues in Australia and recommends changes to our consumer policy framework to ensure that Australia's consumer policies meet international standards for best practice. The discussion and examples in the Submission focus on the core elements of our consumer policy framework as exemplified by the TPA and related fair trading acts. It also discusses frameworks applicable in industries such as telecommunications, energy and financial services. It has not been possible to include discussion relating to a range of other markets such as food, health and pharmaceuticals. We suggest that many of the principles and approaches outlined in this submission can and should apply to other consumer markets.

In the next section we outline some of the key issues and trends, including the changes in society and the market which affect consumer's experiences, their likely responses and how to protect their interests. We examine changes in transaction methods, including product bundling, the use of intermediaries, internet and e-commerce issues and the prevalence of standard form contracts. We discuss how more complex product choice is affecting consumers' already limited time. We consider the implications of growing consumer debt, and how new evidence about consumer behaviour challenges the assumptions underpinning current policies. The analysis in this section helps us understand in which areas consumers are not effectively protected, particularly the disadvantaged and vulnerable.

Section 3 outlines key international development in relation to fair trading and consumer behaviour. We show that there have been a number of significant new approaches to promote fair trading that have not been adopted in Australia. We also discuss international research that illustrates the important role consumers play in effective competitive markets and new insights from behavioural economics that may assist in designing policy that ensures consumers are best able to carry out this role.

Section 4 outlines our framework for updating the policy response, including guiding principles and criteria for assessing regulatory burden. We show why measurements of regulatory burden should also assess the effect on consumers, and discuss ways of achieving this. We also discuss the need to base consumer policy on the latest evidence about consumer behaviour, including behavioural economics and the importance of consumer behaviour to market outcomes. We discuss the need to strengthen the consumer voice, including the need for an appropriately funded and resourced peak body for consumer organisations. We also recommend that an independent consumer research body be established to lead and coordinate consumer policy and research. In addition, we note that the position of Federal Minister for Consumer Affairs needs to be re-instated to strengthen government accountability for consumer policy and ensure that consumer issues are better coordinated.

In Section 5 we outline a toolkit of policy responses to deal with the issues currently experienced by Australian consumers. These responses aim to improve overall market efficiency, promote fair trading, and where necessary, target vulnerable and disadvantaged consumers and/or address problems specific to certain industries. We show that effective responses must be designed to match the issue being addressed. We identify situations where industry-specific regulations are required, including essential services, new markets, markets for credence goods and high-risk products. We also identify situations where vulnerable and disadvantaged consumers require protection. We then discuss the strengths and weaknesses of existing laws in protecting consumers, and identify areas where the existing laws should be strengthened. We also identify some areas in which laws need to be updated, and discuss the need to increase the effectiveness of regulators.

2.0 The consumer environment

2.1 New ways of transacting

There have been some major changes in consumer markets in the past three decades, in particular a dramatic shift from individualised transactions to mass markets with mass production and consumption and standardised trading terms. However, our current consumer policy framework was designed when an old way of thinking about consumer transactions prevailed. Below we discuss four major trends in the changing consumer marketplace that need to be considered in a modern consumer policy framework. These are product bundling; the emergence of intermediaries; the development of the internet; and standard form contracts.

2.1.1 Product bundling

Key points:

- Product bundling is increasingly prevalent across a range of sectors, including those that provide essential services (e.g. utilities and telecommunications).
- Bundling can have detrimental effects on competition and consumers, particularly vulnerable and disadvantaged consumers.

In recent years, the use of marketing strategies involving product bundling, where several products are offered for sale as one combined product, have increased. While this approach is arguably most suitable for high volume and low-margin products, the practice is now common across many sectors and industries. Bundling has traditionally been prominent in the information technology sector (for example, where software products such as a word processor, spreadsheet and database are bundled into a single office suite), but it is now also prevalent in utility markets (such as where gas and electricity products are bundled together) and in telecommunications (for example, where a home phone, mobile phone and internet service are supplied as one product or "deal"). Another form of bundling that is becoming more common is when a supplier of carriage services also controls the content that is provided, such as where particular content is only available by subscribing to a particular pay television or broadband internet service.

Suppliers commonly present bundling as a way for consumers to save money. By packaging several products or services into one "deal", they can obtain a discount. However, as each supplier puts together different bundles, it is difficult for consumers to compare products and services across suppliers. This reduces their ability to compare relative values. This also makes complex products and services even more complex (complexity is discussed further below in section 2.2).

Some research has found that bundling for digital "information goods" with close to zero marginal cost allows a bundler with an inferior collection of products to drive even superior quality goods out of the market place.[1] Similarly, the presence of an incumbent "bundling" supplier can discourage new market entrants, even if potential competitors are offering better value and quality.

[1] Bakos, Y. & Brynjolfsson, E. 2000. Bundling and Competition on the Internet. *Marketing Science*. 19(1): 63-82. http://portal.acm.org/citation.cfm?id=768983&dl=ACM&coll=portal (accessed 10/5/07).

This is amplified where suppliers enter into long-term bundled contracts with consumers.

Product bundling can have particular effects on low-income or disadvantaged consumers. Bundling increases the potential for these consumers to be excluded from accessing discounts that are offered as part of a bundle. For example, low-income consumers are less likely to get discounts for essential services such as a home telephone, if these are bundled with other telecommunications or internet services which they can't afford. This is despite the fact that these consumers are the least able to afford the higher price for the home telephone service. For example, a joint venture between the ACT government and utility supplier AGL has bundled electricity, gas, internet, home phone and mobile phone services together. If consumers bundle all five products together, they receive a 10 per cent discount on their electricity and gas bills. However, if a consumer is only able to purchase three services, they are ineligible for the discount.[2]

Bundling may also leave consumers more vulnerable to "double disconnection", where they lose access to all the services provided in a bundle if they are unable to meet payments for one or more of the services provided, particularly where one consolidated bill is used. Where essential services such as energy or telecommunications are bundled together, this could expose consumers to significant risk. While there are protections against double disconnection of gas and electricity services for low-income consumers in Victoria, the status of these is in doubt due to the current move to a national framework for regulating energy markets. No such protections exist for other services such as telecommunications. We note that this is one issue that may warrant industry specific regulation (we discuss this further in Section 5).[3]

We recognise that product and service bundling can be a legitimate innovation by suppliers, allowing them to offer more competitively priced goods and services to consumers. However, it is equally clear that it can have serious anti-competitive effects if undertaken in circumstances in which consumers have little ability to control the practice, particularly where an incumbent supplier or suppliers have significant market power or consumers cannot wade through the different "bundles" presented.

Our consumer policy framework currently does not address the challenge of how to encourage legitimate innovation in product and service offers while discouraging the use of product bundling to confuse consumers or lock out potential competitors. Nor does it address the unwanted effects of bundling on disadvantaged members of our community. In developing consumer policy for modern markets, a number of issues associated with bundling goods and services together need to be considered, especially in those markets where bundling is most prevalent.

[2] See: www.actewagl.com.au/bundles/residential/act/default.aspx.
[3] For example, the Victorian *Energy Retail Code* includes provisions relating to payment difficulties, instalment plans and disconnection, including the double disconnection protections.

2.1.2 Intermediaries

Key points:

- Intermediaries have emerged as a natural market response to consumer information problems with the increasing complexity of products in the marketplace.
- In practice, intermediaries are often conflicted, typically through commissions or other payments from suppliers.
- Intermediaries often do not act in the best interests of consumers.
- The use of intermediaries can make it difficult to ascertain responsibility (from an evidentiary point of view) in disputes in which intermediaries procure inappropriate products for consumers.
- Intermediaries can exacerbate *rather than* address consumer information problems.
- Consumer policy has a role to play in monitoring and where necessary regulating emerging market mechanisms such as intermediaries.

With an ever-increasing volume and complexity of products, coupled with limits on consumers' time (which are discussed further below), it seems clear that intermediaries will become a feature of many consumer markets. Indeed, intermediaries are a predictable market response to the emergence of new, and more complex, markets. It is often going to be more efficient for consumers to use intermediaries to help them make choices in these markets rather than pay the costs (both direct and opportunity) of informing themselves of all relevant matters, particularly for complex and one-off or irregular purchases. Intermediaries can, in theory, play a useful role by acting as a conduit between the consumer and the supplier, as envisaged by the Commission in its Issues Paper. In the paper, it refers to intermediaries as a positive market mechanism that has emerged to address consumer information problems.

In the financial sector in particular, the emergence of intermediaries has brought a huge shift in the way in which consumers access the market. For example, broker originated home loans now make up approximately 35 per cent of the new home-loan market.[4] Financial advisers and brokers now offer intermediation services for a wide range of products other than just home loans, such as insurance and investment products. Intermediaries are now beginning to emerge as important market participants in other consumer markets, including telecommunications, energy and even motor vehicles.

Currently however, the role of intermediaries is often conflicted, which means that

[4] Research by JP Morgan showed that the percentage of broker-originated new home loans increased to 35 per cent in 2005 from 30 per cent in 2004: see Moncrief, M. 2005. Bank home loan sector under siege. *The Age*. 19 October 2005. This represents a consistent annual increase in the volume of broker-originated loans in recent years; the Reserve Bank reported that broker-originated loans made up one quarter of new home loans in 2003: see Reserve Bank of Australia 2004. *Financial Stability Review - September 2004*, pp.39-40). A 2003 report by the Australian Prudential Regulation Authority also noted the increasing prevalence of broker originated loans, and found that broker originated lending is most prominent in the housing loan market: see Australian Prudential Regulation Authority. 2003. *Report on broker originated lending*. Sydney: APRA.

they do not necessarily act independently or in the best interests of the consumer. This conflict generally arises because the intermediaries' source of income is commission or another form of payment from the supplier rather than from the consumer. This is particularly common in the telecommunications and financial services sectors.

This form of remuneration can affect the services provided by intermediaries in several ways, including:

- Most obviously, being financially motivated by payments from the supplier, intermediaries have a strong incentive to promote the product or service that provides the greatest payment to the intermediary, rather than the best deal for the consumer;
- As intermediaries are often paid in commission-form as a percentage of the amount sold, there is a strong incentive to encourage consumers to take out a more expensive product than the consumer needs, in order to increase the commission;[5]
- Intermediaries often represent products as more complicated than they actually are, in an attempt to convince the consumer to use their services;[6]
- While brokers may be expected to offer the best mortgage based on price, there is industry criticism of brokers who "sell on price";[7]
- In some cases intermediaries offer only one product or a limited range of products, which may lead to the consumer buying an expensive product chosen by the intermediary based on the high commissions paid;[8] and
- Some intermediaries will try to act professionally, and will genuinely regard their role as arranging the best deal for the consumer. However, even in these circumstances commissions (or other incentives) can sway a recommendation.

[5] See, for example, the findings of a Choice Reverse Mortgage Shadow Shop investigation, which found that a majority of brokers and salespeople encouraged borrowers to take the maximum possible loan instead of the requested amount. The findings can be reviewed at: www.choice.com.au/viewArticle.aspx?id=105198&catId=100296&tid=100008&p=1&title=Reverse+mortgage+shadow+shop

[6] For example, a Google search of "mortgage maze" delivers over 400 Australian web sites.

[7] For example, Phil Colton, head of broker sales at BankWest, made the following comments about how brokers can increase their market share in *Broker Review* (published for Choice Aggregation Services, Autumn 2007): "The biggest challenge will be in educating the mortgage broking industry that price concerns shouldn't be leading the agenda. Brokers offer customers a relationship and if the industry encourages price to be the main concern, then the customer will ultimately start to value price over relationship, and look for a more direct way to obtain their finance". Further, the results of Mortgage Professional Australia's annual survey noted that: "Interestingly, while only 11% of brokers said price was a key consideration when choosing non-banks, when asked what would make them sell more non-bank products, 42% said improved pricing. This statistic could be a little disconcerting to those in the industry who argue that brokers should focus on adding value to the customer experience, rather than promoting discounts and the cheapest rates. A focus on price sees mortgages become increasingly commoditised, the argument goes, effectively diluting the need for consumers to use a broker in the first place. People can search for the cheapest loans via the internet." See *Mortgage Professional Australia*, Issue 7.3, March 2007, p.86.

[8] For example, real estate agents who refer tenants to utility intermediaries and car dealers who offer finance and insurance to car purchasers. The Victorian Energy and Water Ombudsman has identified cases where a utility connection service does not deliver the customer's choice of retailer: see Energy and Water Ombudsman Victoria. 2003. *Resolution: Bulletin 4*. Melbourne: EWOV.

For individual consumers, this is worsened by the fact that it is very difficult to obtain effective redress when something goes wrong. The lender may not even be considered directly responsible for the intermediary's conduct, despite relying on it for supply of business.

Cases dealt with by Consumer Action's legal practice have identified a number of issues with financial intermediaries, particularly when intermediaries have procured unsuitable loans on behalf of consumers. Consumers have also had trouble obtaining remedies against the lender where an intermediary was involved in procuring the loan on behalf of the consumer, if the broker, rather than the lender, was aware that the borrower was disadvantaged. For example, a broker knowing about a consumer's disability – which may make the loan unconscionable – will not usually be as relevant as the lender knowing about the disability.[9] Also, laws that place certain obligations on a linked credit provider may not apply if the consumer is referred to the lender via a broker rather than directly by the trader.[10]

Moreover, the use of intermediaries can make apparently simple transactions seem complex. In some cases that Consumer Action is aware of, there have been up to five parties involved in lending credit to a consumer. This can create confusion about the actual roles of all companies involved and make it difficult to determine responsibilities when that is necessary.

Case Studies 1 to 3 in Appendix A illustrate these issues and the effect on consumers.

Apart from the individual detriment suffered by consumers, this also affects the efficient operation of the market. Rather than working to address consumer information problems caused by the increasing complexity of products in the marketplace, intermediaries are exacerbating them by distorting consumer choices towards products and services that benefit the intermediaries. This greatly undermines consumers' abilities to be effective in the market and the likelihood of better products and services that may result through more rational choices.

These problems are not just unfortunate accidents. Rather, they are the result of market forces operating without the anchor of long-term consumer interest. In this unregulated environment, it is more lucrative for individual intermediaries to source income from suppliers. It also allows them to compete more strongly for consumer business by seeming to offer their services at a cheaper price than intermediaries who offer services on a fee-for service basis. As consumers make more and more use of intermediaries, suppliers will compete to offer greater payments to intermediaries to secure their referrals.

Current policy responses to these problems in the financial sector have relied heavily on the use of disclosure – requiring brokers and advisers to give consumers a mass of information about their advice and recommendations, the grounds for these recommendations and the manner in which they are paid – rather than more

---

[9] While s 118 and s 119 of the *Consumer Credit Code* hold a credit provider liable for certain representations by a linked trader, the Code does not modify the position at general law that, in the absence of an agency relationship, knowledge of the trader cannot be deemed knowledge of the credit provider.

[10] See Part Seven of the *Consumer Credit Code*. Under s 117, a 'linked' relationship will only be established where a credit provider and trader have close and direct ties, as evidenced by certain matters set out in s 117(1).

prescriptive regulation or "interference" with the market. This approach is now widely agreed to have been inefficient and ineffective. Another way of dealing with these problems would be to amend the law to state simply that finance brokers act as agents of the lenders, rather than consumers. While this might seem more interventionist, in fact it is relatively simple and might trigger market forces to correct the problem much more efficiently, as lenders would have a financial incentive to manage the conduct of intermediaries more closely.

These problems illustrate the perverse or unintended consequences of failure to effectively regulate the question of emerging markets.

Recommendation 1:

Amend the law to provide that a finance broker acts as an agent of the lender (or other supplier), rather than the consumer, where the broker is remunerated by the lender.

2.1.3 Internet use and e-commerce

Key points:

- Consumers increasingly use the internet as a source of information about products. However the quality of information available on the internet, and consumers' search and appraisal skills, vary.
- E-commerce and internet use expose consumers to a broad range of scams and other fraudulent activities that require new types of consumer protection.
- Despite increasing internet use, there remains a "digital divide" among Australian consumers. Lack of access and usage of the internet among disadvantaged and low-income consumers places core groups at further disadvantage in the marketplace.

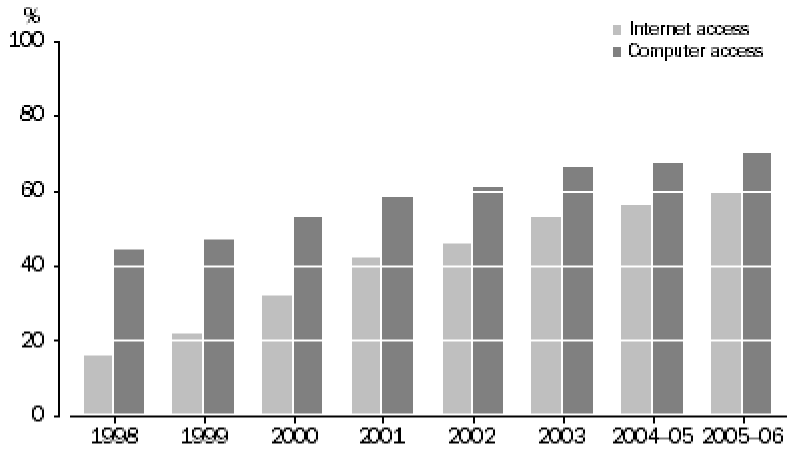
Many new issues for consumers have arisen with increasing use of the internet. These include the ways that consumers use the internet as a source of information and the potential for unscrupulous suppliers to more easily promulgate "scams".

The following data on internet use in Australia shows the importance of addressing related consumer issues.

At the end of the September 2006 quarter, there were more than 6.65 million active internet subscribers in Australia, comprised of 826,000 business and government subscribers and more than 5.83 million household subscribers. This represents an increase in the number of subscribers of more than 15 per cent since the end of March 2004, a trend which is expected to continue in the coming years.[11] In 2005-06, 60 per cent of Australian households had home internet access and 70 per cent had access to a computer (accessed at other sites such as a workplace, friend or relative's house or public library).[12] The increasing trend of Australians' access to computers and the internet is shown in the graph below.

[11] Australian Bureau of Statistics. *Internet Activity Australia*. September 2006.
[12] Australian Bureau of Statistics. *Household Use of Information Technology, Australia, 2005-06*.

Graph 1. Household Home Internet or Computer Access - 1998 to 2005-06



Source: ABS Household Use of Information Technology, Australia, 2005-06

Research has shown that search and appraisal skills among participants varies, with many reporting a limited awareness of how they found and evaluated internet-based information. This suggests a need to improve consumer internet search and appraisal skills.[13]

There are many "scams" that target internet users and therefore represent a new challenge for consumer protection. It is beyond the scope of this submission to discuss the types of internet scams in detail; however it is worth noting that scams are becoming increasingly sophisticated and cover an extremely broad range of products and services. Internet scams include identity theft (such as stolen credit cards); cases where consumers purchase products that they are billed for, but which are never sent; "phishing" to fraudulently acquire passwords; fraudulent online auctions; and stock market manipulation schemes.

The advent of e-commerce also raises several new challenges for the operation of markets. Consumer confidence is crucial to ensuring that consumers participate actively and effectively in markets, driving competitive outcomes. However there are significant concerns about trust among consumers participating in e-commerce as it is difficult to determine the credentials of on-line traders. Recent research has also shown that consumers are concerned about the lack of compensation in the event of online fraud.[14] E-commerce also results in more consumers purchasing goods and services from overseas markets, which raises new issues regarding redress should problems occur. These issues need to be considered in updating our consumer policy framework.

In response to these issues, government authorities have issued materials to help consumers in using the internet. For example, the ACCC provides information on a

---

[13] See for example, Peterson, G. Aslani, P. & Williams, K.A. 2003. How do Consumers Search for and Appraise Information on Medicines on the Internet? A Qualitative Study Using Focus Groups. *Journal of Medical Internet Research*: 5(4). www.jmir.org/2003/4/e33 (accessed 11/5/07).

[14] A recent survey in the United Kingdom, for example, showed that 75 per cent of consumers would be more likely to purchase products on-line if more businesses guaranteed that they would compensate them in the event of financial or identity fraud: see Muncaster, P. 2007. Low consumer confidence impacting on e-commerce. *IT Week*, at: www.itweek.co.uk/itweek/news/2184024/low-consumer-confidence (accessed 2 May 2007).

broad range of issues to assist consumers in using the internet, including how to choose an internet service provider; how to buy goods from online auction sites; information about internet scams; consumers' rights to refunds when buying products online and information about spyware, internet dialers and other internet security matters.[15] In March 2006 the Commonwealth Government also released *The Australian Guidelines for Electronic Commerce.* The guidelines address issues for businesses conducting e-commerce, including fair business practices; accessibility issues; advertising and marketing; engaging with minors; information requirements for contracts and identifying the business; privacy issues and security and authentication.[16] The Ministerial Council on Consumer Affairs has also released the brochure *Shopping in the Electronic Age*, which provides information about direct marketing; shopping on the internet; and electronic banking.[17]

Despite the increasing proportion of Australian consumers with access to computers and the internet, however, there remains a "digital divide" among consumers, which results from unequal access to and usage of, information and communications technologies.

Research indicates that age, geographic location, education and socioeconomic status influence consumers' access and ability to use information technologies such as the internet. For example, research by the Smith Family in 2002 showed that only 32 per cent of financially disadvantaged households had this access. This is roughly half the proportion of all households that had access.[18] Similarly, ABS data for 2005-06 shows that only 47 per cent of households with an annual income less than $40,000 have access to a home computer, compared to 95 per cent of households with an annual income $120,000 or over.[19]

This data suggests that the Commission needs to be aware that the potential for the internet to be used in constructive ways (such as empowering consumers through access to information) may not extend to the more vulnerable and disadvantaged members of the community. Moreover, "the digital divide is compounding disadvantage for some, because having access to ICT is becoming so central to being able to fully participate in the economic, social, political and cultural spheres of society".[20] Consumer policy that uses the internet needs to be careful not to leave sections of the community behind.

---

[15] This information can be viewed at: http://www.accc.gov.au/content/index.phtml/itemId/8135.
[16] Commonwealth of Australia, 2006, *The Australian Guidelines for Electronic Commerce*, available at: www.treasury.gov.au/documents/1083/PDF/australian_guidelines_for_electronic_commerce.pdf
[17] See www.consumer.gov.au/html/shoppingelectronicage/brochure.html.
[18] See McLaren, J. & Zappala, G. 2002. *The new economy revisited: an initial analysis of the digital divide among financially disadvantaged families*. The Smith Family, Research and Policy Team.
[19] See Australian Bureau of Statistics. *Household Use of Information Technology, Australia, 2005-06*. Canberra: ABS.
[20] McLaren & Zappala, as above, p.vi.

2.1.4 Standard-form contracts

Key points:

- Standard-form contracts, of their nature, do not involve negotiation.
- Standard-form contracts that include unfair terms are prevalent across many sectors and industries.
- Theoretically, the use of standard-form contracts, as a process, is an efficient market arrangement. However, in reality the content of these contracts may not be fair or efficient.
- Since consumers do not have the option (or capacity) to “shop around” for better contract terms, some intervention is required in markets that rely on standard-form contracts that contain unfair terms.
- Unfair contract terms legislation has recently been introduced in Victoria and the United Kingdom. These statutes represent a template for updating Australian laws.

The increasing prevalence of standard-form contracts and the imbalance in the terms they contain is one of the most significant issues to be addressed in a modern consumer policy framework.

These contracts are now ubiquitous across many products and markets, including products bought on the internet (for example, software end-user license agreements). This movement from individual bargaining to standard-from contracts is a natural development that has resulted from mass marketing, production and consumption in our modern industrial society.

Consumer Action recognises that standard-form contracts were originally developed as a way of reducing transaction costs, thus improving market efficiency by eliminating the need for suppliers and consumers to negotiate the detail of sale terms each time a product was sold. Thus we agree that standard-form contracts, as a *process*, are efficient and may benefit consumers.

However, this does not mean that the *content* of standard-form contracts produces fair or efficient outcomes. In practice, they cause many concerns.

Standard-form contracts are usually entered into between parties with unequal bargaining power and in fact many consumers may not read or understand the terms. The consumer is generally unable to negotiate the terms of the contract and must accept the terms offered if they wish to purchase the product or service offered for sale under the contract. This gives the supplier a significant incentive to weight the terms of the contract strongly in their own favour. Indeed it has been widely reported, including by the United Kingdom Office of Fair Trading and CHOICE (then the Australian Consumers’ Association) that the use of unfair terms in contracts is increasingly common for a range of products and services, including mobile phones, vehicle hire, home improvements, package holidays, air travel and financial services.[21]

Some common unjust terms include those which allow the supplier to avoid all

[21] See, for example, Standing Committee of Officials of Consumer Affairs Unfair Contract Terms Working Party. *Unfair Contract Terms*. January 2004.

liability; those which permit the supplier to avoid or limit the performance of a contract; those which allow the supplier to unilaterally modify the terms of the contract (to vary the product or service, or what is charged including the addition of new charges); those which allow the supplier to terminate the contract prematurely or to suspend a service without good reason and/or without compensation to the consumer; and terms that permit the supplier to charge a penalty fee under the contract (that is, a fee that is more than a reasonable pre-estimate of loss arising from a breach).[22]

The Standing Committee of Officials of Consumer Affairs Working Party's discussion paper, *Unfair Contract Terms – A Discussion Paper* (2004) has provided a good summary of some of the issues associated with the use of standard from contracts:

> It has become increasingly clear that many such standard form contracts contain clauses which are unfair or unnecessarily one-sided to the detriment of the purchaser. One reason that these have become so prevalent is that there is little, if any, competition in this regard. Purchasers do not usually "shop around" on the basis of the best contract terms: it would be too impractical an exercise for the vast majority of people to decide, for example, which hire-car company to use based on the best contract terms. Purchasers predominantly focus on price and the quality or characteristics of the product. They may not appreciate that a "good" price has been achieved through the imposition of onerous terms. As a result, terms may well be standard across an industry and even if the purchaser went elsewhere, they would be faced with a similar situation.[23]

In short, lack of consumer bargaining power, an absence of competitive market pressures and significant imbalances of information between businesses and consumers about the nature and effect of terms and conditions can result in highly one-sided, "take it or leave it" contracts that can, and regularly do, lead to enormous consumer detriment.[24]

Consider various well known examples in the telecommunications market. Telstra relied on a unilateral variation clause to place a "cap" on what had previously been genuinely unlimited download limits. This change was imposed on consumers who had entered into "unlimited" contracts. The justification for this was that forecasting by Telstra had failed to predict levels of uptake and limits needed to be retrospectively imposed.

In its "solution", Telstra ignored the fairer option of providing the capped limits to new customers whilst allowing existing customers to maintain their unlimited contracts until they expired.

Apart from the detriment to many consumers, using such clauses to make such fundamental changes to contracts arguably also reduces incentives for suppliers to consider such issues in product planning.

While theoretically a consumer is able to "shop around" for better terms, in many instances where standard-form contracts are used there is little to no competition in relation to terms and conditions beyond price and key features. Often very similar terms are offered by all suppliers.

---

[22] Consumer Affairs Victoria. *Unfair Terms in Consumer Contracts Industry Factsheet*. March 2006.
[23] Standing Committee of Officials of Consumer Affairs Unfair Contract Terms Working Party, as above, p.17.
[24] See case studies in Appendix A for some further examples.

Where the free operation of the market fails consumers through a lack of competition pressure, resulting in demonstrable and serious consumer detriment, market intervention is warranted to protect consumers.

Such intervention does not need to interfere with the process of standard-form contracting, which is more efficient than suppliers negotiating each contract individually. However, it does need to address the problem of lack of competitive discipline on suppliers as this allows them to include undesirable terms in their contracts, which can undermine the gains made by the streamlined contracting process.[25]

For example, if mobile phone suppliers had to negotiate terms with consumers individually, they would soon learn that consumers signing up for a 24-month mobile phone plan would prefer that phone services being offered and price and call charges were agreed to remain consistent over that period. Instead, suppliers do not have to properly assess whether they are offering their services at a sustainable price over two years. Instead, they can rely on a term in their contracts that allows them to alter services or prices unilaterally down the track, with the consumer locked into the contract for the remainder of the fixed term. This is clearly detrimental to the mobile phone market, as suppliers can undercut competitors while risking potentially unsustainable pricing in order to attract consumers – knowing that losses can be avoided down the track if necessary. Consumers are then locked in and unable to switch provider.[26] **Case study 6 in Appendix A** illustrates this point.

There are two general ways in which this problem could be addressed in an efficient manner. The first would be some form of collective bargaining on behalf of consumers to maintain the efficiency of the process while improving the contract content with consumer input. The second is regulation of the content so that the process can continue to be followed without allowing suppliers to include unfair and inefficient content without scrutiny.

Collective bargaining is a well-accepted concept in other areas, such as employer-employee contracts, but is not necessarily viable in the Australian consumer context. This is because, in practice, Australian consumers lack the same scale of representation and it would be difficult to establish structures that would allow for consumer collective bargaining. However, it is not impossible, as the model in the Netherlands under the oversight of the Dutch Social and Economic Council, shows.[27]

In the absence of this form of collective consumer bargaining, the most effective means of preventing unfair content in standard form contracts is to allow suppliers to continue to set mass contracts, but with some standards in place to ensure they do not do so unfairly and inefficiently.

---

[25] See for examples John Vickers, "Economics for Consumer Policy", British Academy Keynes Lecture, 29 October 2003.
[26] Consumers also tend to be "sticky" where the market is complex (such as mobile phone contracts, each with different pricing structures and services) and switching costs are high enough to discourage change; thus once consumers have made a choice and signed up with a supplier, it is less likely they will switch even if the supplier later raises prices: see Klemperer, P. 1995. Competition when consumers have switching costs: An overview with applications to industrial organization, macroeconomics, and international trade. R*eview of Economic Studies.* 62: 515–539.
[27] See www.ser.nl/overdeser/default.asp?desc=en_consumer.

In an Australian context, the Victorian Government has recently followed this path, making amendments to the *Fair Trading Act 1999* (Vic). Under the amendments, Victorian businesses must now ensure that their consumer contracts do not contain unfair terms.[28] In assessing if a term is unfair, the revised legislation also deals with the appearance and context of terms within a contract. The legislation thus recognises that there are factors other than the meaning of individual terms that can make a contract term unfair. For example, the revised legislation specifies a minimum point size for fonts used in contracts and covers factors including excessive long sentences or clauses, cross-referencing, failure to define key terms and use of technical terms and jargon.

The legislation makes unfair terms in a contract void and enables regulations to prescribe certain terms in standard form contracts as being unfair, making it an offence to use them. The Victorian initiative was based largely on the United Kingdom *Unfair Terms in Consumer Contracts Regulations 1999*, which stipulate that written contracts must be in plain intelligible language and that unfair terms are not binding on consumers. Consumer Action believes that unfair contract terms are a serious problem for Australian consumers that needs to be addressed as part of this Inquiry.

The Victorian and UK legislation provide precise definitions of what constitutes an unfair contract term, which can be used as a starting point for updating national legislation to void unfair terms in consumer contracts. For example, section 32W of the *Victorian Fair Trading Act* provides that:

> A term in a consumer contract is to be regarded as unfair if, contrary to the requirements of good faith and in all the circumstances, it causes a significant imbalance in the parties' rights and obligations arising under the contract to the detriment of the consumer.

Section 32X provides further guidance as to whether a term may be considered unfair. It provides that:

> Without limiting section 32W, in determining whether a term of a consumer contract is unfair, a court or the Tribunal may take into account, among other matters, whether the term was individually negotiated, whether the term is a prescribed unfair term and whether the term has the object or effect of [doing a range of things including]:
>
> …(a) permitting the supplier but not the consumer to avoid or limit performance of the contract;
>
> …(b) permitting the supplier but not the consumer to terminate the contract;
>
> …(c) penalising the consumer but not the supplier for a breach or termination of the contract;
>
> …(d) permitting the supplier but not the consumer to vary the terms of the contract;
>
> … (f) permitting the supplier to determine the price without the right of the consumer to terminate the contract;
>
> …(h) permitting the supplier unilaterally to determine whether the contract had been breached or to interpret its meaning.
>
> …(j) permitting the supplier to assign the contract to the consumer's detriment

[28] *Fair Trading Act 1999* (Vic) Part 2B: see Consumer Affairs Victoria. *Unfair Terms in Consumer Contracts Industry Factsheet*. March 2006.

without the consumer's consent.

Moreover, it is clear that there are two basic elements to the test of whether a contract term in a consumer contract is unfair:

1) The term causes a significant imbalance in the rights and obligations of the parties to the contract, which acts to the detriment of the consumer; and

2) This occurs contrary to the requirements of good faith and in all the circumstances.

Therefore, the context of a term in a contract is relevant to the test of whether it is unfair. For example, if a term was specifically negotiated in exchange for an additional term elsewhere in a contract, it would be likely that "in all the circumstances" the term would not be unfair even if it might otherwise, on the face of it, appear unfair. Consumer Affairs Victoria, the Victorian government agency responsible for consumer protection laws, has adopted the following definition of "good faith" in its preliminary guidelines to the legislation:

> A principle of fair and open dealing; that is 'playing fair', especially when one party is in a position of dominance over a consumer who is vulnerable relative to that dominance or power.[29]

Similarly, the test of whether a term is unfair in the United Kingdom *Unfair Terms in Consumer Contracts Regulations 1999* is if:

> Contrary to the requirement of good faith it causes a significant imbalance in the parties' rights and obligations under the contract, to the detriment of consumers.

Further, under both the Victorian and the UK model, both individual consumers affected by an unfair term *and* the regulator are able to use the regulation to tackle unfair terms. In fact, one of the principal benefits of the laws is that it gives the regulator tools to address unfairness proactively, rather than waiting for consumer complaints and dealing with detriment after the fact, making better use of regulator resources.

For example, in the UK, the Office of Fair Trading has used the laws to tackle excessive credit card late payment fees, which not only recover credit card-issuer costs if a customer defaults, but significantly over-compensate the issuers. It was difficult and cost-prohibitive for one person to take legal action against a bank over a 30 pound dispute, but the regulator was able to tackle it as an industry-wide issue.[30]

In Victoria, CAV has used the laws to negotiate a range of changes to terms in consumer contracts across a number of industries, including the hire car, fitness, mobile phone, pay TV, carpets and curtains industries.[31] In the mobile phone

[29] Consumer Affairs Victoria. *Preventing unfair contract terms in consumer contracts*. Guidelines, November 2003.
[30] See Office of Fair Trading. 2006. *Calculating fair default charges in credit card contracts: A statement of the OFT's position*. London: Office of Fair Trading.
[31] See, for example, the following Minister for Consumer Affairs media releases: 'Telcos warned again over unfair contract terms' (18 October 2004); 'Victoria drives hire car contract reform' (22 April 2005); 'Victoria continues charge for fairer contracts' (16 August 2005); 'Foxtel revises digital pay TV contracts' (4 May 2006); 'VCAT disconnects unfair mobile phone contracts' (2 August 2006); and 'Victorian consumers protected on loyalty contracts' (4 October 2006).

industry, CAV has been able to ensure that mobile phone suppliers change their contract terms, so that none of the major mobile phone businesses continue to include terms in their contracts that allow them to lock consumers into fixed term contracts and later change the price or services, such as was described earlier. This does not necessarily mean that suppliers no longer reserve a right to propose changes unilaterally to services or prices. However, they must provide sufficient notice to those affected and these consumers are able to terminate their contracts at no cost.[32] This is clearly a much fairer and more balanced result.

It has been argued that the law of unconscionability could be used in dealing with unfair contract terms. Whilst this may be theoretically possible[33], there are two key reasons why this is unlikely to be successful in the Australian marketplace. First, to date Australian courts have displayed a general reluctance to extend unconscionability principles beyond a behavioural focus. This is despite strong indications from the legislation framers that their scope is intended to be broader than common law doctrines of unconscionability (which focus on individual circumstances and 'special disadvantage'). It is highly unlikely the courts' approach to this issue will change sufficiently to address the effects of unfair contract terms without significant legislative amendment.

Secondly, even with amendments to unconscionability provisions, the enforcement framework remains focussed on individual action (and indeed circumstances). This means an understanding of the scope of the provisions through case law will be slow and piecemeal. This is unsatisfactory given the prevalence of standard form contracts and unfair contract terms.

Victoria's actions have had a national impact in many of these areas, with larger businesses that use similar contracts across state borders amending their terms to comply with Victoria's requirements. However, this in itself indicates the national import of trading and contracting. For this reason, Consumer Action strongly supports national regulation to address unfair terms in consumer contracts.

An additional element in the UK model is that in addition to giving a right of action to consumers and regulators, it conveys a similar right on prescribed consumer organisations. We submit this would be a useful addition to an Australian framework.

In summary, we are not suggesting that the use of standard form contracts should be eliminated. On the contrary, Consumer Action accepts that, overall, the process of using standard form contracts can be an effective market arrangement with associated efficiency benefits.

---

[32] See, for example, *Director of Consumer Affairs v AAPT Ltd* (Civil Claims) [2006] VCAT 1493 (2 August 2006); Minister for Consumer Affairs, 'VCAT disconnects unfair mobile phone contracts', *Media release* 3 August 2006: www.dpc.vic.gov.au/domino/Web_Notes/newmedia.nsf/798c8b072d117a01ca256c8c0019bb01/c4842d79e477649eca2571bf000971c6!OpenDocument.

[33] We note this reflects to some degree the approach in the US where courts consider substantive as well as procedural issues in determining whether or not conduct is unconscionable. Thus for example where a standard form contract contains unfair terms, the fact that the consumer had no opportunity to negotiate may be sufficient on the procedural side. If on the other hand a transaction involves little or no issues of a substantive nature, the unfairness on the procedural side must be greater in order to give rise to unconscionability. See for example Craig Combs and Roberta Toher v. Paypal Inc; Case No.C-02-1227 JF US District Court, Northern District of California, San Jose Div.

Rather, we are concerned about the outcomes that the use of standard form contracts currently leads to, particularly in relation to the inclusion of unfair terms in such contracts. There is an urgent need to address this issue at a national level in a modern Australian consumer policy framework.

Recommendation 2:

Introduce unfair contract terms amendments to the *Trade Practices Act* and *Australian Securities and Investments Commission Act* modelled on legislation introduced in Victoria and the United Kingdom, including coverage of credit contracts.

2.2 Time, choice and new markets

2.2.1 Time and complexity of choices

Key points:

- Consumers now work more hours each week, so they are increasingly time poor. At the same time the volume and complexity of choices in the marketplace has increased.
- Research has shown that too much choice is actually demotivating, and results in consumers using simple heuristics or "rules of thumb" when faced with more complex choices. This challenges some of the assumptions of the consumer policy framework, (e.g. that consumers exhibit rational choice.)
- It also creates challenges in addressing advertising and marketing messages, which are designed to sell rather than simply inform – but which consumers rely upon to help them make "informed" choices.

The fact that consumers are becoming increasingly time poor (due to factors such as longer worker hours), at the same time as the volume and complexity of product choices in the marketplace has expanded, also needs to be considered in designing an effective consumer policy framework.

According to the ABS, working hours have increased over the past two decades for both full-time and part-time workers. For example, average full-time working hours for men increased by 1.9 hours per week to 43.2 hours between 1985 and 2005, and for women by 1.7 hours to 39.3 hours. The number of part-time hours worked also increased over this period: part-time hours worked by men increased 0.7 hours to 16.4 hours, and the number of part-time hours worked by women increased by 1.4 hours to 16.9 hours per week.[34]

These increases impose limits on our ability to balance our various other roles in families and communities.[35] In turn, this imposes limits on our capacity to analyse and comprehend the ever-increasing array of choices that we face as consumers. While this has implications for the issues discussed above (such as the time available to compare contracts), it also raises issues about consumers' ability to comprehend the increasingly complex choices offered in the marketplace.

It is commonly assumed that more choice motivates people and enhances

[34] Australian Bureau of Statistics. *Australian Social Trends, 2006*.
[35] Cox, Eva. Making time and taking our time. *New Matilda*. March 2007.

performance. Recent research has shown, however, that too much choice can actually be demotivating.[36] This brings into question some of the assumptions that underlie classical economic theory, and provides insights into consumer behaviour that can inform the consumer policy framework review. In short, new research has shown that the commonly accepted link between choice and increased motivation is based on studies that may have presented too few options to enable a rigorous analysis. Moreover, prior research has actually shown that choice among relatively limited alternatives is more beneficial than no choice at all'.[37]

There is also a growing body of research which suggests that people find it difficult to manage complex choices, and that there is a tendency for people to consider fewer choices and process a smaller proportion of the available information as the number of options and the information about each option increases. A simple example of this is an experiment in a grocery store in California where consumers were presented with a tasting booth that displayed either six flavours of jam or 24 flavours of jam. The study found that there was virtually no difference between the number of jams sampled at each booth, and that nearly 30 per cent of consumers presented with the six-jam booth bought a jar of jam compared to only 3 per cent presented with the 24-jam booth. Moreover, consumers with fewer choices were far more likely to purchase the product than consumers who had a much larger set of options.

This research also suggests that "when people have 'too many' options, they simply strive to end the choice-making ordeal by finding a choice that is merely satisfactory, rather than optimal."[38] These findings challenge the assumption that consumers exhibit rational choice. They also suggest that some of the assumptions underlying the consumer policy framework need to be revisited, particularly when coupled with the increasing limits on consumers' time as the number of hours in paid work increases each year. They suggest that in an environment of ever-increasing and complex consumer choice, which is also characterised by increasing limits on time, consumers may experience "choice overload". This means consumers may make uninformed choices, and may act with less confidence in the marketplace and indeed make fewer choices.

In practice, we see that in their tendency to rely on "rules of thumb"[39], consumers may draw on simple advertising messages for "information" to guide their choices (even though advertising is primarily designed to sell rather than simply inform) rather than making truly informed decisions. For example, CHOICE recently reported in its low-fat yoghurt test that the two highest-kilojoule yoghurts made "fat-free" claims. One claimed to be 96% fat-free and the other 94% fat-free (these claims also involve the use of "framing", discussed further in section 2.4 below). Thus, with a range of confusing claims, consumers seeking a healthy yoghurt choice are reasonably likely to buy one that claims to be low in fat but in fact is very high in kilojoules.[40]

This phenomenon is even more problematic in relation to more complex products. For example, there have been recent and high profile cases of property investment scheme collapses by Fincorp and ACR. Despite the fact that both groups issued

---

[36] Iyengar, S. & Lepper, M.R., When Choice is Demotivating: Can One Desire Too Much of a Good Thing? *Journal of Personality and Social Psychology*. 2000. 79(6): 995-1006.
[37] Iyenger & Lepper, as above, p.996.
[38] Iyenger & Lepper, as above, p.999.
[39] This is discussed further in Section 2.4 below.
[40] Choice, 'Low-fat yoghurt', May 2007, see: www.choice.com.au/viewArticle.aspx?id=105735&catId=100289&tid=100008&p=1&title=Low-fat+yoghurt (accessed 8 June 2007).

prospectuses that included information about the nature of the investments and risk involved, many retirees were influenced by the advertising employed instead, which was deliberately targeted at them and portrayed the investments as safe, secure and low-risk products suitable for older people. In these cases, the regulator's actions focused on improving disclosure in the prospectuses,[41] which clearly did not have a significant effect on the decisions made by the investors, in contrast with the advertising.[42] This is a clear pointer to the need for different responses to such consumer problems.

2.2.2 New markets and products

Key points:

- As a result of privatisation, deregulation and competition policy, together with technological advances, new and more complex markets have emerged in recent years. Some of these markets provide essential services (e.g. utilities and telecommunications) that were previously provided by a single government supplier. Consumers therefore now have to understand and navigate an increasingly complex range of products and choices in these markets.
- In reality consumers have little time to analyse all the information relating to every transaction they make, and if they did so our markets would grind to a halt.
- Thus to enable markets to function effectively, a consumer protection framework that allows consumers to act with confidence in these new markets is needed, with consumer information and education one part of the policy response, but without an over-reliance on such strategies.

In addition to the increasing range of choices in traditional markets, in recent years new markets have emerged that consumers must now navigate and understand. These new markets have developed largely as a result of the privatisation of services that were previously provided by the public sector, through technological advances and deregulation.

Consumer Action is neither pro- or anti-privatisation. Rather, we are concerned with critical assessment of whether a market-based approach will bring the best results, so that markets engender effective competition and allow full participation by consumers. Evaluation and performance regimes, contract arrangements, monitoring, adequately empowered and resourced regulators and redress mechanisms will be relevant in determining the best response to these issues. In some sectors, equity and access issues are also important. For example, while there may be scope for competitive markets to develop in health and education, market incentives may not always be compatible with other societal goals, such as equity of access. In such instances government regulation of markets will be required.

Financial services, utilities and telecommunications are examples of sectors which provide important and often essential services to consumers that have been deregulated and opened to competition in recent years. However, deregulation,

[41] For example, see: D'Aloiso, T. *Statement on Australian Capital Reserve*. Australian Securities & Investments Commission, 30 May 2007.
[42] See, for example, the transcript of the story 'Property market casualty list grows with demise of ACR' from ABC television current affairs program *The 7.30 Report, 7* June 2007, which outlined the television advertising that was used to promote ACR to investors. See: www.abc.net.au/7.30/content/2007/s1945496.htm.

together with advances in technology leading to new product possibilities (especially in telecommunications), has led to a far more complex range of products and services that consumers need to understand in order to participate in these markets. As the structure of these markets has been transformed significantly in recent years this has, as noted by Michael Jenkin, Chair of the OECD Consumer Policy Committee, "created environments in which consumers who were used to buying services that came from a monopoly supplier that was highly regulated must now function in a marketplace that involves very careful analysis of what they're buying and looking carefully at the service providers."[43]

While privatisation and deregulation have provided more choice and other potential benefits for consumers (such as new and innovative products and price competition between suppliers), they have also required consumers to have far greater skills in understanding and discerning between products, services and suppliers. Greater choice has also led to far greater complexity in the marketplace.

Despite this reality, the emphasis is still on consumer education and information as a policy response. It is unrealistic to think that consumer education can ever keep up with the increasing range of products and services and their increasing complexity. Even if it could, consumer information and education would not be directed at the problem, since it would not be practical or efficient for consumers to apply such information in all their market choices. Thus it can only ever form part of an effective policy response.

2.3 Increasing consumer debt

Key points:

- Data indicates that debt levels among Australian consumers have increased significantly in the past 20 years. These trends have been paralleled by an increase in bankruptcies and foreclosures in recent years.
- The marketing practices of lenders contribute partly to this, including mainstream lenders that aim to get consumers "hooked" into credit products such as credit cards.
- Increasing debt levels are preventing consumers from actively participating in markets. Consumers are increasingly using debt as a means of funding transactions in the marketplace. This leads to inefficiencies as funds are directed to service debt rather than to other areas of the market.
- Disadvantaged and vulnerable consumers who are in debt are exposed to predatory lending practices such as "equity stripping".
- We need to be aware of developments in the sub-prime lending market in the United States, where there have been a high number of defaults on loans after initial discount periods expired.
- These new practices create an additional market distortion that inhibits the Government's ability to use market levers such as monetary policy.

In the past two decades a number of trends have emerged in relation to consumer debt that have significantly weakened the position of consumers and, in some cases,

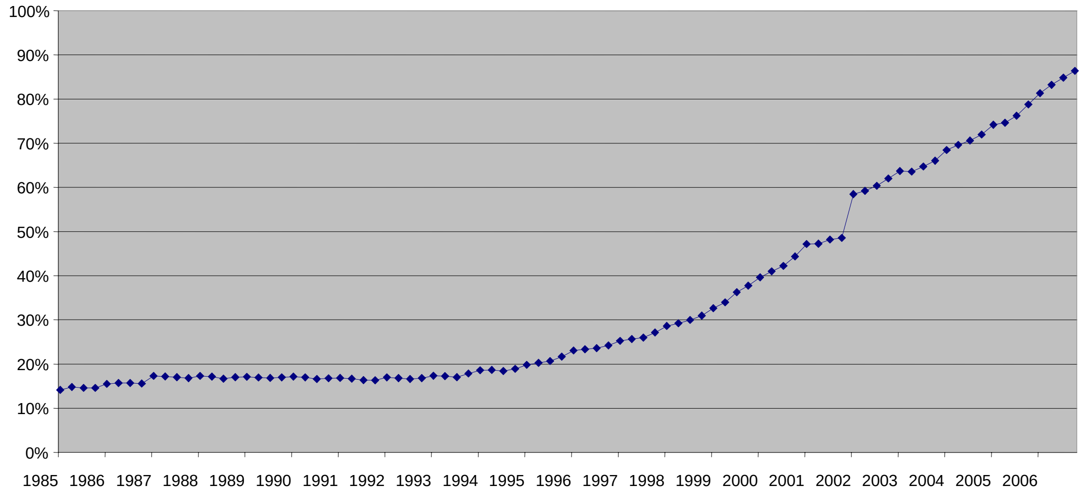
[43] Jenkin, M. 2007. What's Hot and What's Not – Consumer Policy on the Global Stage. Paper presented at the National Consumer Congress, Melbourne, 14 March 2007.

led to new problems such as equity stripping that have adversely affected disadvantaged and vulnerable consumers (this is discussed further below). Key trends include rising debt as a percentage of income; increases in personal bankruptcies; increases in foreclosures; an increase in access to credit (including low documentation loans and 100 per cent finance loans); and increases in credit card debt. These trends and their implications for consumer policy are outlined below.

Household debt as a proportion of disposable income has increased dramatically in the past 20 years, from 12 per cent in December 1986 to 158.1 per cent in December 2006. This upward trend has also been mirrored by other measures of household debt. For example, households' debt to asset ratio increased from 8.1 per cent in December 1988 to 17.3 per cent in December 2006, and the ratio of housing debt to housing assets increased from 10.4 per cent to 26.1 per cent over the same period.[44]

Credit card debt as a percentage of annual average income has also increased markedly. There is sometimes a perception that credit card debt is a "small" component of consumer debt. However, to put credit card debt in perspective, the graph below illustrates very clearly an upward trend. The graph shows that in 1985 credit card balances were at 14.5 per cent of average annual income. In November 2006, despite increases in average annual income, credit card balances were at 86.39 per cent.

Graph 2. Credit Card Debt as Percentage of Annual Average Income



Source: ABS and RBA

Credit card debt is commonly understated because it is argued that consumers have increasingly used credit cards as a transaction tool. Much of the "debt" is said to be credit card balances that are paid off in credit cards' interest-free periods each billing cycle. However, RBA data clearly shows that 72 per cent of overall debt owing on credit cards is accruing interest.[45] Research also suggests that approximately two thirds of households do manage to pay off their monthly balance without accruing interest, and the third that do not pay their monthly balance owe a lot more debt relative to income.[46] The ABS reports that over two-thirds (69 per cent) of high wealth

[44] Reserve Bank of Australia. Debt to disposable income ratio - Household Finances – Selected Ratios - B21.
[45] RBA. Credit and Charge Card Statistics - CO1.
[46] According to the 2002 report by Visa International, *The Credit Card Report: Credit card*

households had credit card debt compared to 59 per cent of middle wealth and 38 per cent of low wealth households. However, while fewer low wealth households had credit card debt, those who did on average had a similar amount owing ($3,200) to both middle ($3,400) and high wealth households ($3,700).[47]

These trends in consumer debt have been paralleled by an increase in bankruptcies and foreclosures in recent years. For example, data published by the Insolvency and Trustee Service Australia showed that there was a 12.1 per cent increase in personal insolvency activity in the March 2007 quarter compared to the March quarter 2006. This included 6,585 new personal bankruptcies in the March 2007 quarter, an increase of 8.9 per cent against the March 2006 quarter,[48] and 1,492 new personal debt agreements in the March 2007 quarter, an increase of 28.7 per cent on the March 2006 quarter figures.[49] The Insolvency and Trustee Service also reported that the excessive use of credit was responsible for 26 per cent of personal bankruptcies in 2006 (second only to unemployment as the leading cause of personal bankruptcy).[50]

There are a number of issues related to these trends which should be considered as part of this review, including lending practices and the need for hardship provisions for consumers who are struggling to repay mortgages and credit card debts. While these issues are discussed later in this submission, it is important to highlight that lenders often claim that the causes of debt problems usually relate to unemployment, illness, relationship breakdown and/or other unexpected events.[51] While there is some research that suggests this is partly correct; the casework of financial counsellors suggests that it is the high debt levels that many consumers already carry that leave them more vulnerable to life events such as unemployment and illness in the first place. In other words, current lending practices and high debt levels are leaving less of a “buffer” to manage the vicissitudes of life.

These lending practices now include extensive marketing of consumer credit, especially home loans and credit cards, and greater ease in obtaining credit, particularly when compared to the past two decades. For example, mainstream lenders now regularly send existing credit card customers unsolicited offers to increase their credit card limit. There is also little doubt that consumer credit marketing aims to get consumers “hooked” into credit products, focusing on the “benefits” associated with it, rather than the fact that it involves debt. Recent marketing campaigns, for example, have portrayed credit cards as, variously, a way to earn rewards;[52] a status symbol;[53] and even a fashion statement.[54]

---

spending in perspective, 64% of all households with credit cards in use did not pay credit card interest.

[47] Australian Bureau of Statistics. Household Wealth and Wealth Distribution, Australia, 2003-04.

[48] Insolvency and Trustee Service Australia. Media release: Provisional Bankruptcy Statistics. 11 April 2007.

[49] As above.

[50] Australian Government Inspector-General in Bankruptcy. 2005-2006 Annual Report on the Operation of the Bankruptcy Act.

[51] See, for example, ANZ/Chant Link & Associates. *A report on financial exclusion in Australia*. November 2004.

[52] For example, ANZ’s 2007 campaign to “convert bills into rewards”; Westpac’s new “Earth” credit card.

[53] For example, American Express campaigns; cf Virgin credit card campaigns targeting a younger market segment.

[54] For example, the NAB Visa Mini campaign in 2006.

Debt issues are important for this inquiry because data shows Australian consumers are increasingly using debt as a means of funding transactions in the marketplace. The ratio of debt to disposable income over the last twenty years has risen dramatically from one which was very low by international standards in the mid-1980s to one that is now very high by international standards. Moreover, in the past twenty years the household saving ratio has declined, and has been negative since 2002-03.

This household debt situation affects markets as available funds are increasingly used for debt servicing rather than being channelled into more efficient areas of the marketplace. These trends indicate that we need a better way of measuring costs and benefits in relation to debt and saving issues. For example, compulsory superannuation was a highly regulated response to decreasing levels of saving among Australian households, imposing an initial cost on the supply side of the market. However, it has been a successful response to the trend of declining saving, and has helped grow Australia's financial services sector.

The high incidence of household debt has also led to new problems and issues in the past five years. For example, Consumer Action is concerned that increasing debt levels among consumers expose disadvantaged and vulnerable consumers to predatory practices that are offered to them as a "debt solution", but which actually increase their level of indebtedness or reduce their equity in assets.

An example of these predatory practices is "equity stripping". This can take a number of forms, including, in the extreme, situations where consumers who are facing foreclosure on their home loan unwittingly sign away the property rights and equity in their home to companies in exchange for remaining in the property as a tenant. However, more commonly "equity stripping" in Australia takes the form of consumers entering into expensive home loan refinancing arrangements in an (often emotional) attempt to save the family home from foreclosure. These refinancing efforts often do not prevent the loss of the home, however, as due to the additional costs of refinancing, the consumers lose more of the equity than they would otherwise have retained. It is stripped by the refinancing costs and extra interest.[55] **Case studies 7-9 in Appendix A** illustrate how equity stripping can take place.

In this context, it is worth looking at the sub-prime lending market in the United States. The sub-prime market provides high-interest loans to borrowers with impaired credit histories, and has expanded significantly in the US over last five years. In 2006 sub-prime loans accounted for approximately one fifth of new US mortgages.[56] In the past few years, there have been a high number of defaults on sub-prime loans in the US. This often occurs after an initial discount rate expires, after which borrowers struggle to maintain loan payments. The RBA reports that it has not been uncommon recently for the repayments of some sub-prime borrowers to rise by 50 per cent or more after the introductory interest rate period has expired. According to First American Loan Performance, the proportion of sub-prime loans that were 90 or more days in arrears or in foreclosure increased from 6.5 per cent in mid 2005 to almost 13 per cent in January 2007.

The initial discount rates that are offered on these loans, which effectively delay debt problems, create a market distortion which makes it difficult for government monetary policies to take effect. Specifically, this means the effect of macroeconomic levers, such as interest-rate adjustments, used by reserve banks, is delayed. This reduces

[56] Reserve Bank of Australia. Financial Stability Review – March 2007.

their effectiveness in managing these issues. Similarly, consumers' ability to refinance if they fall into financial difficulties, has the same blunting or delaying effect on these traditional macroeconomic tools used to control debt and spending.

While Australia is not yet seeing the same level of problems as the US with issues such as sub-prime lending, increasing debt levels among Australian consumers and increasing use of fringe and sub-prime lending services (such as fringe refinancing) are challenges for consumer policy, particularly in protecting the interests of the disadvantaged and vulnerable. If present trends continue, these problems seem likely to significantly affect the broader market.

Later in this submission we analyse whether current arrangements effectively deal with these issues and present a range of recommendations to improve the framework to deal with the problem of increasing consumer debt.

Recommendation 3:

The Productivity Commission should be tasked to undertake a review of policy and regulatory options to address the problems associated with increasing consumer and household debt, foreclosures and bankruptcies and to protect disadvantaged and vulnerable consumers from predatory practices such as pay-day lending and unsolicited increases on credit card limits.

3.0 International developments

Australia's competition policy framework has been systematically reviewed and significantly changed since 1974. A key examples is the comprehensive *Review of the Competition Provisions of the Trade Practices Act* (commonly known as the Dawson review) in 2001-2003. This review gave stakeholders across Australia, including consumer and business organisations, the chance to comment on the competition and authorisation provisions of the Act and recommend changes. It was also an opportunity for Part IV (and Part VII) of the Act to be amended to reflect international developments in competition policy. Indeed, recommendation 1.1 of the Federal Government's response to that review was that "consideration of possible changes to Australia's regulatory framework should continue to have regard to international developments in the area of competition."[57]

By contrast, Australia has not generally kept pace with international developments in consumer protection, nor sought to[58]. Key international developments fall broadly into two streams – new initiatives designed to achieve the long-standing goal of promoting fair trading and policy design that reflects new understandings and evidence regarding the importance of consumer behaviour in markets and behavioural economics.

3.1 Fair Trading

As noted above, the United Kingdom has introduced unfair contract terms laws, which give UK consumers broad protection against unfair contract terms in standard form contracts. The UK's unfair contract terms laws are part of the 1993 European Council Directive on unfair terms in consumer contracts,[59] which was also adopted by member states across the entire European Union.[60] This directive was first mooted in 1984, with public debate resulting in the directive in 1993.[61] Thus unfair contract terms protections are not, in fact, a recent development.

The European Council also adopted the Unfair Commercial Practices Directive in May 2005.[62] This directive generally prohibits unfair commercial practices in business

---

[57] Commonwealth Government Response to the Review of the Competition Provision of the Trade Practices Act 1974. See:
www.treasurer.gov.au/tsr/content/publications/TPAResponse.asp

[58] There are some notable exceptions including the introduction of Unfair Contract Term laws in Victoria, and various jurisdictions' responses to phenomena such as payday lending. However viewed from a national framework perspective these efforts have been piecemeal and lack the cohesive coordinated approach that has been taken in relation to competition policy.

[59] *Council Directive 93/13/EEC of 5 April 1993 on unfair terms in consumer contracts*. For example, article 3 of the Directive states that: "A contractual term which has not been individually negotiated shall be regarded as unfair if, contrary to the requirement of good faith, it causes a significant imbalance in the parties' rights and obligations arising under the contract, to the detriment of the consumer".

[60] See *Report from the Commission on the implementation of Council Directive 93/13/EEC of 5 April 1993 on unfair terms in consumer contracts*, COM/2000/0248, available from: http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:31993L0013:EN:NOT

[61] As above at Part I.

[62] *Directive 2005/29/EC of the European Parliament and of the Council of 11 May 2005 concerning unfair business-to-consumer commercial practices in the internal market and amending Council Directive 84/450/EEC, Directives 97/7/EC, 98/27/EC and 2002/65/EC of the European Parliament and of the Council and Regulation (EC) No 2006/2004 of the European Parliament and of the Council*.

to consumer transactions, and is to be adopted by European Union member states by June 2007. A general prohibition on unfair commercial practices could also be characterised as a general obligation to trade fairly, which is one of the underlying rationales for consumer policy. Thus these initiatives can be described as new means of achieving long-standing objectives. As the UK Department of Trade and Industry's notes:

> The coming into force of the Unfair Commercial Practices Directive will mark a new era in UK fair trading history. The Unfair Commercial Practices Directive will allow enforcers to tackle those practices that are unfair but not currently unlawful, taking either civil or criminal enforcement action as appropriate. Simplification and modernisation of the existing framework will also make the law easier for its users – business, consumers and enforcers – to understand and apply. The Government is confident that the wide-ranging changes set out below will help it meet its objective of raising the UK's consumer protection regime to the level of the best in the world.[63]

US law also contains general duties to trade fairly. For example, the *Federal Trade Commission Act*[64] outlaws unfair methods of competition, and unfair or deceptive acts or practices, in or affecting commerce.[65] Article 1-304 of the Uniform Commercial Code (enacted by the various US states) also provides for an obligation of good faith in the performance and enforcement of all contracts and duties under the Code.

Other international developments include UK super-complaints to regulators and stop-now orders to stop a business from breaching certain legislation, where the contravention harms the collective interests of consumers – again, based on a European Council directive.[66] General market investigation powers have also been introduced where markets do not appear to be operating effectively (whether from a supply-side or demand-side perspective). These measures aim to enforce consumer regulation more effectively, rather than change the content of the rules themselves.[67]

[63] UK Department of Trade and Industry, Government Response to the Consultation Paper on Implementing the Unfair Commercial Practices Directive, December 2006, p.3.
[64] 15 U.S.C. ss. 41 – 48.
[65] 15 U.S.C. s. 45(a)(1).
[66] *Directive 98/27/EC of the European Parliament and of the Council of 19 May 1998 on injunctions for the protection of consumers' interests*.
[67] Consumer Action is presently undertaking a project that makes a detailed stock take of international consumer protection initiatives and compares them to protections available under the TPA. We expect this work to be available to the Commission prior to its second round of consultation.

3.2 Consumers and competition

Key points

- Consumer policy needs to use the findings that emerge from the experience of consumers in the market place, and particularly the features of goods, services or the market itself that prevent consumers from performing their part in the competition equation.
- Our consumer policy framework must also be based on the latest evidence about consumer behaviour, such as the growing knowledge in behavioural economics.
- Interventions which assume that consumers always behave "rationally" will continue to risk being ineffective and may result in a misdirection of policy effort and resources.
- Drawing on the experience of consumers in markets and the evidence from behavioural economics will better equip us to select the right tools for the right job (rather than taking a linear approach to policy or enforcement). This approach is crucial in optimising outcomes.
- Using these principles will also help identify situations where the experiences of consumers in general and the experience of disadvantaged and vulnerable consumers diverge (or converge) – suggesting that targeted (or general) responses may be appropriate.

3.2.1 Introduction

Consumer policy has been significantly, if not fundamentally, affected by competition policy. Commitment to competition principles was first comprehensively evident in the *Trade Practices Act*. For example, in concluding his second reading speech on the Trade Practices Bill on 30 July 1974 in the Senate, Lionel Murphy said:

> Mr President, it will be apparent to honourable senators that the Bill is of great importance. It represents a great advance in areas of restrictive trade practices and consumer protection and attends to a wide variety of problems. This is intended to promote efficiency and competition in business, to reduce prices and to protect all Australians against unfair practices.

Since the inception of the Act enormous policy and legislative energy has been directed at ensuring conditions for effective competition cross the Australian marketplace, and that efforts across Federal, State and Territory governments are applied as consistently as possible.[68] These efforts have generally tried to achieve long-term results for consumers, and significant benefits have been achieved. Preventing anti-competitive conduct is fundamental to the welfare of Australian consumers. Fair, effective and competitive markets generally deliver the best price, quality and access to goods and services to the majority of consumers. However, in Australia, the benefits of competition have not been distributed evenly, and some disadvantaged and vulnerable consumers have missed out altogether or may be worse off.

However consumers are not simply passive beneficiaries (or not) of competition – they play a critical role in its success. Ensuring the soundness of the supply side of the market is only half of the answer. Much consumer protection is pro-competitive

[68] The contrast with the approach to consumer policy is notable.

when viewed through this lens. Nevertheless, for effective competition to be achieved policy makers and regulators need to pay more attention to the role of consumers in markets, or the demand side of the equation. Two areas of discourse, in particular, suggest areas for attention.

First are the findings from the experience of consumers in the market place, and more particularly to features of goods, services or the market itself that stop consumers from playing their part in the competition equation. Second are developments in behavioural economics. These challenge traditional economic assumptions regarding *homus economicus* – the notion that consumers in general will act with rational self-interest. Behavioural economics identifies systematic biases and departures by consumers from the perfectly rational model. These help to identify failures in the market and in designing the most effective response.

These two areas of discourse are not new. Relevant work has been undertaken for decades. However, drawing this work together to provide a policy framework is more recent and is continuing. Both ideas are discussed further below with reference to “consumers’ experience in markets” and “consumers’ behaviour in markets”. Before doing so, however, we outline three key reasons why these principles should be considered in a consumer protection (and competition) context:

1. As competition principles become more embedded it is imperative that all opportunities and ways of improving its ability to achieve its objectives are explored.

2. Improving our ability to understand consumers in markets improves our ability to select the right tools for the right job (rather than taking a linear approach to policy or enforcement). This is crucial to optimise outcomes. Thus the ability to apply these principles and to obtain relevant evidence may reduce the need for regulation in some areas and point to effective regulatory approaches in others.

3. Using these principles may also help identify situations where the experiences of consumers in general and the experience of disadvantaged and vulnerable consumers diverge (or converge) – suggesting that targeted (or general) responses may be appropriate.

3.2.2 Consumers’ experience in markets

Recognising and focusing on the consumers’ role in achieving effective competition is not new. For example, Ron Bannerman, the then Chairman of the Trade Practices Commission, said in the Commission’s 1984 Annual Report that:

> Consumers not only benefit from competition, they activate it, and one of the purposes of consumer protection law is to ensure they are in a position to do so.

The Productivity Commission has itself stated that ‘the potentially important role of consumer protection regulation in facilitating the efficient functioning of markets has long been recognised’.[69] However, as methods for approaching supply-side competition problems have become more sophisticated, approaches to demand-side or consumer problems in markets appears to have lagged behind. Treatment of issues such as transaction costs in personal banking, product bundling, complexity in the telecommunications markets and conflicts of interest are ad hoc and inconsistent.

[69] Productivity Commission. 2004. Discussion draft for the *Public Enquiry Review of National Competition Policy Reforms*, 27 October 2004, p. 218.

The view of consumers as passive beneficiaries of competition, rather than critical actors in its success, contributes to this problem. It can also be argued that regulators need new tools to effectively explore and address these issues. Far from being a burden, consumer policy which aims to improve consumers' ability to act in markets, should be pro-competitive (when properly enforced).

The importance of this type of focus is the subject of an emerging body of work. In the UK, writers such as Waterson, Waddams and Klemperer discuss the effect of barriers to consumers effectively exercising their power in the market place.[70] As well as the affect on individuals, often including sub-optimum price outcomes, they point to significant effects on competition and efficiency. Waterson, for example, examines levels of consumer switching across a number of markets, showing how very different behaviour across "…relatively similar industries leads to markedly different results in performance."[71] He identifies five propositions that demonstrate the importance of switching and search costs for the overall outcome in a market. These are that:

1. Subject to some mild restrictions, if each consumer searches only one firm prior to the purchase decision, the pricing outcome is at the monopoly level, regardless of the number of firms in the market.
2. The higher the proportion of active searchers, the greater the proportion of low-cost firms. The high-cost firms charge monopoly price; the low-cost firms charge breakeven price equal to the average cost of their full capacity.
3. In markets where consumers' search costs are significant, the monopoly price can be the Nash equilibrium outcome [i.e. where no participant in the market has anything to gain from changing their current strategy]. This is the more likely, the *larger* the number of firms in the industry.
4. In markets where firms can discriminate between old and new customers, and switching costs are significant, prices are lower in the first (new) period and higher in the second (old) period than if there were no switching costs in the second period.
5. In markets where no discrimination between old and new customers is feasible then, subject to certain parameter configurations, firms' prices are higher with switching costs than in their absence. In steady state, given switching costs, prices increase as the turnover of customers falls and as customers become more particular about which product they buy.[72]

Klemperer identifies six key switching costs – that is "a cost [that] results from a consumer's desire for compatibility between his current purchase and a previous investment."[73] These are:

[70] See for example Waterson, M. *The Role of Consumers in Competition and Competition Policy*. University of Warwick Economic Research paper no.607; Klemperer, P. 1995. Competition when Consumers have switching Costs: An Overview with Applications to Industrial Organization, Macroeconomics, and International Trade". R*eview of Economic Studies.* 62: 515–539; and Waddams, C., Giulietti, M. & Waterson, M. 2005. Consumer Choice and Industrial Policy: a study of UK Energy Markets. *The Economic Journal*. 115: 949-968. See also from the United States: Camerer, C., Issacharoff, S., Lowenstein, G., O'Donoghue, T. & Rabin M. *Regulation for Conservatives and the Case for "Asymmetric Paternalism"*. 2003. University of Pennsylvania Law Review. 151: 1211-1254.
[71] Waterson, M., as above, p.7.
[72] Waterson, as above, pp.4-5.
[73] Klemperer, as above, p.517.

1. Need for compatibility with existing equipment;
2. Transaction costs of switching suppliers;
3. Costs of learning to use new brands;
4. Uncertainty about the quality of untested brands;
5. Discount coupons and similar devices; and
6. Psychological costs of switching or non-economic "brand loyalty."[74]

He concludes that "consumer switching costs (whether real or perceived) are widespread, and our analysis suggests that the resulting welfare losses may be substantial: switching costs generally raise prices and create deadweight losses…in a closed oligopoly."[75] The significance of the potential impact of these factors has lead Waterson and Klemperer to conclude that there is a positive role for policies that reduce these costs:

> Competition authorities need to embrace the idea that consumers may need substantial assistance in challenging established players. Thus, the role of competition authorities might usefully be extended to encompass actions designed to spur consumers into forcing industries to operate more effectively.[76]

and

> …public policy should discourage activities that increase consumer switching costs (such as airlines' frequent-flyer programmes), and encourage activities that reduce them (such as standardisation that enhances compatibility and reduces learning costs of switching, and quality regulation and information sources that reduce consumer uncertainty about untested brands).[77]

There are already many tools that aim to promote demand-side responses. These include tools directed at simplifying the task of comparing products and prices. In energy markets we see on-line comparison tools provided by regulators[78] and energy brokerage services. In mortgage markets disclosure of comparison rates is mandatory.[79] Another example that has often been discussed but not widely implemented in Australia is the use of unit pricing, for groceries in particular. Such pricing allows consumers to compare prices for a range of relevant goods, more easily.[80] This is already in use for supermarket meat, fruit and vegetable pricing but generally not packed goods.[81] Industry-based alternative dispute resolution is a further example – providing recognition and redress for wrongs suffered by

---

[74] Klemperer, as above, pp.517-518.
[75] Klemperer, as above, p.536.
[76] Waterson, as above, p.20.
[77] Klemperer, as above, p.536.
[78] For example, see the Essential Services Commission's price comparator at: www.esc.vic.gov.au/public/For+Consumers/Energy/Choosing+a+retailer/Energy+Comparator.htm
[79] *Consumer Credit Code* Part 9A.
[80] For an explanation of unit pricing see the Consumer Federation of Australia's discussion at: http://www.consumersfederation.com/unitpricing.htm and the article by Choice at: www.choice.com.au/viewArticle.aspx?id=105675&catId=100476&tid=100008&p=1&title=Truth+in+pricing.
[81] See, for example, in Victoria: *Trade Measurement (Interim) Regulations 2006* (Vic) Reg 80; in NSW: *Trade Measurement Regulation 2007*(NSW) - Reg 78; similar provisions apply in other states and territories under uniform trade measurement regulation arrangements.

consumers, and, importantly, an easier and more cost-effective way for consumers to ensure their rights are upheld.

International markets provide several interesting examples of rules or principles that directly consider consumers' ability to act in the market place. For example, a rule in the UK energy market allows consumer switching between energy providers every 28 days – thus avoiding the effects of long-term 'lock-in' contracts. The UK Financial Services Authority, which has recently moved to a more principles-based regulatory approach, includes several outcomes directly addressing consumers in markets including:

- Products and services marketed and sold in the retail market are designed to meet the needs of identified consumer groups and are targeted accordingly; and
- Consumers do not face unreasonable post-sale barriers imposed by firms to change product, switch provider, submit a claim or make a complaint.[82]

These examples include two key common features – they focus on consumers' experience in markets (including the ability and commitment to monitoring) and they permit response where problems are identified (including tools with which to respond).

As Australia is increasingly compelled to compete internationally, Australian consumers should expect consumer protection laws that reflect international best practice. This will also benefit Australian markets and our international competitiveness. International best practice reforms help consumers to feel and act more confidently within markets and make it easier to address problem supplier conduct. The importance of this from a competition perspective appears to be better understood.

As Timothy Muris, (then) Chairman of the Federal Trade Commission in the United States, has pointed out, 'well-conceived competition policy and consumer protection policy take complementary paths to the destination of promotion of consumer welfare.'[83] Ultimately, reforming the consumer protection provisions of the Act will help to empower consumers to actively engage in the marketplace, as well as ensuring that they benefit from high levels of protection.

3.2.3 Consumers' behaviour in markets

As mentioned, behavioural economics examines actual consumer behaviour and identifies systematic biases and departures from the perfectly rational consumer that is assumed by classical economics.

This has significant implications for policy, allowing these systematic biases or departures to be considered in determining whether intervention is necessary and in judging the efficacy of proposed responses. Importantly, contrary to suggestions by some commentators, behavioural economics' power does not lie in trying to change consumers to make them behave more like the model – rather its potential lies in changing the model so it is more like consumers.

[82] See for example FSA, *Treating customers fairly – towards fair outcomes for consumers*, July 2006.
[83] Muris, T. J. 2002. *The Interface of Competition and Consumer Protection*. Paper presented at The Fordham Corporate Law Institute's 29th Annual Conference on International Antitrust Law and Policy, New York, 7 November 2002, p.3.

Nor, as others have suggested, are the insights offered by behavioural economics necessarily in conflict with traditional economics. As noted by Louise Sylvan in the Maureen Brunt Lecture in 2006:

> It seems to me that the powerful combination of conventional economics and behavioural economics – I don't see these as in conflict as some do, but as complementary – makes ultimately for better implementation of policy decisions in consumer protection. If one is intervening in the market, either for the purposes of reform and improvements in competition or in relation to consumer empowerment and protection, one wants to be sure to have the desired effect and to get the results intended. That needs rigour and research about consumers just as much as it does about firms.[84]

Sylvan went on to outline a number of key examples of behavioural economics' findings and their implications for policy. Some key examples are worth repeating here:

Framing – This proposes that consumers are affected by the way a choice is framed.[85] Thus a product that is described as 93% fat-free is viewed more favourably than a product described as containing 7% fat, even though there is no mathematical difference. A good example of this bias in practice is the CHOICE test of low-fat yoghurts, mentioned earlier in section 2.2, in which this claim could lead consumers to choose a less healthy option.

Hyperbolic discounting - Consumers tend to choose short-term gratification over long-term reward (leading to problems in achieving adequate levels of saving for retirement for example) and have inconsistent preferences over time. Consumers are also poor at understanding the importance or relevance of something that may happen in the future.

Loss aversion – Consumers will seek to avoid a loss with greater vigour than they will exert to make a gain of the same magnitude.[86]

Fairness matters – Punishing unfair behaviour is important to consumers – such that they may drive out of their way to avoid shopping at an over-priced trader, even though the cost of avoidance exceeds the level of overcharging. Other studies have shown that even if a consumer will gain from a transaction, if the consumer believes the transaction is unfair, he or she may not go ahead with the transaction at all. This leads to a dead-weight loss (similar to the situation with choice overload, described above in section 2.2).[87] Similarly, consumers are motivated to 'do the right thing'. Therefore introducing a reward for activities viewed as altruistic may in fact reduce motivation (as has been found in relation to volunteering and blood donation).[88]

---

[84] Sylvan, Louise. 2006. *The Interface between Consumer Policy and Competition Policy*. 2006 Consumer Affairs Victoria Lecture, in honour of Dr Maureen Brunt AO. p.13.

[85] See for example Tversky, A., & Kahneman, D. 1981. The framing of decisions and the psychology of choice. *Science*. 211: 453-458.

[86] See for example Tversky, A. & Kahneman, D. 1991. Loss Aversion in Riskless Choice: A Reference Dependent Model. *Quarterly Journal of Economics*. 106: 1039-1061.

[87] For example, Manfred Holler describes tests of the so-called 'ultimatum game' in which two players are invited to share $100 as long as they can agree on how to split this amount. He shows that the predicted equilibrium outcome does not occur when the players incorporate notions of fairness into the game. See Holler, M.J., *Classical, modern and new Game Theory*, available at: http://www.law.yale.edu/documents/pdf/holler.pdf.

[88] See for example Cooper, M.H. & Culyer, A.J.2001. *The Price of Blood*. Institute of

Endowment effect – This has been described as 'the fact that people often demand much more to give up an object than they would be willing to pay to acquire it.'[89] Even before completing a purchase, a consumer may assign value to the product or service involved, making them less likely to withdraw from the purchase. This can be exacerbated in lengthy negotiations or by sales techniques. Thus a consumer may assign value to a vehicle following a test drive as they imagine the positive affect of the car on their lives.[90]

Bounded rationality – Consumers do not approach each decision or choice with perfect rationality (assessing all available options and prices) but rather use 'rules of thumb' or act out of habit.[91] This is due to limitations of knowledge, cognitive capacity and computational resources. This means that people are unable to process and compute all the alternatives available to them. Indeed, bounded rationality as a concept encompasses several other biases, which may act as rules of thumb or heuristics to simplify decision making.

Too much choice can cut sales – As discussed in section 2.2 above, in the well-known 'jam' experiment, Iyengar & Lepper produced results that indicate consumers find too much choice demotivating or confusing.[92]

Habits are important - "people do many things without consciously thinking about them. These habits are hard to change – even though people might want to change their behaviour, it is not easy for them".[93] Neoclassical economic theory, on the other hand, assumes that people act rationally to maximise their utility (given their particular preferences). Therefore, according to neoclassical economics, a person would not do something out of habit, such as ordering the same type and size cup of tea from the same cafe on their way to work each morning. Rather, they would undertake a full analysis of all the available cups of tea, including the types and sizes available and all the price options offered in the market.

Behavioural economics is still a developing field, and significant opportunities remain in how it can be applied to policy development and implementation. Nevertheless if it promises to better match policy initiatives to consumer behaviour, making them more likely to succeed, then it deserves to be considered and fostered. Further, examples of how this may help in policy design are now are emerging. Notable examples include *Behavioural analysis for policy – new lessons from economics, philosophy, psychology, cognitive science and sociology* by the New Zealand Ministry for Economic Development, and *Behavioural economics: seven principles for policy-makers* by the UK's new economics foundation.[94]

Economic Affairs, Hobart Paper 41; and Fray, B.S. & Goette, L. 1999. *Does Pay Motivate Volunteers?* Working Paper No.7, Institute for Empirical Research in Economics, Universität Zurich.

89 Kahneman, D., Knetsch, J.L. & Thaler, R.H. 1991. "Anomalies: The Endowment Effect, Loss Aversion, and Status Quo Bias." The Journal of Economic Perspectives 5(1):193-206 at 193.

90 See for example Thaler, R. 1980. Towards a positive theory of consumer choice. *Journal of Economic Behavior and Organization*. 1: 39-60.

91 See for example, Khaneman, D. 2002. *Maps of bounded rationality: A perspective on intuitive judgement and choice.* Nobel Prize Lecture.

92 Iyengar, S., & Lepper, M., *When too much choice is demotivating: Can one desire too much of a good thing?* Journal of Personality and Social Psychology (2000) 79, pp995-1006.

93 New Economics Foundation, as above.

94 New Economics Foundation. 2005. *Behavioural economics: seven principles for policy makers*. NEF: London.

In fact, suppliers already regularly apply consumer behavioural principles, in product design, advertising and marketing. For example, credit cards can be designed so that the lender profits from consumers' tendency to discount future costs, preferring short-term benefit. Retailers consistently use framing and anchoring[95] techniques to encourage consumers to buy their products, with most consumers being familiar with the "93% fat-free" technique (as discussed earlier as an example of framing) or the "was $200, now only $100" anchoring technique.

The effects of failing to consider behavioural principles can be seen in the use of disclosure regimes in the financial services market. Not only are consumers highly unlikely to actually read complex and detailed disclosure documentation, other forms of disclosure, such as disclosure of conflict of interest, can have the opposite effect to that intended. For example, one study (discussed in further detail later in this submission) found that rather than making consumers more cautious, disclosure of a conflict of interest raised their trust regarding the adviser.[96]

The emerging body of work in behavioural economics is already providing insights about why products or policies succeed or fail. Policy makers and regulators should actively explore opportunities to consider these in current policy design. They should also develop an effective framework to do this. This is discussed further in Section 4 below.

Recommendation 4:

Commonwealth Treasury should review the examples of efforts to help apply behavioural economics principles in policy design in the United Kingdom and New Zealand. These should be used to develop similar applications in Australia.

[95] Tversky, A. & Kahneman, D. 1974. Judgment under uncertainty: Heuristics and biases. *Science* 185L 1124-1130.
[96] See Cain, D.M., Loewenstein, G. & Moore, D.A. 2005. *The Dirt on Coming Clean: Perverse Effects of Disclosing Conflicts of Interest*. Journal of Legal Studies. 34: 1 - 25. This issue is discussed further in Section 2.3 of this submission.

4.0 The policy response

Key points

- Australia's consumer policy framework is out of date and does not adequately deal with the increasingly complex issues that are faced by consumers today.
- There are gaps and shortcomings in the consumer protection provisions in the *Trade Practices Act*.
- While Australia was once a world leader in consumer policy, it now lags behind international best practice.
- Consumer policy framework updates should have a dual goal: to empower consumers and protect them.

4.1 The role of consumer policy

Our understanding of the potential for consumer policy to improve economic and social outcomes for the community has greatly progressed over the past few decades, as the previous discussion about real consumer behaviour shows.

Consumer policy in its modern form emerged in the 1960s, particularly following US President Kennedy's declaration of four basic consumer rights – the right to safety; the right to be informed; the right to choose and the right to be heard. Other influences include the book *Unsafe at Any Speed*, by the renowned US activist Ralph Nader,[97] published in 1965. The growth in consumer movements in western countries such as Australia also spurred government interest in the area. For example the Australian Consumers' Association (now CHOICE) was founded in 1959 and Consumers International (then the International Organisation of Consumers Unions) was founded in 1960.

Given its beginnings, the primary focus of consumer policy always been social justice, especially the fair treatment of consumers generally. The recognition that low-income and disadvantaged consumers faced particular problems in consumer markets came later, and is reflected in the expansion of recognised consumer rights to include the right to satisfaction of basic needs, and in the modern focus of work by consumer organisations, including Consumer Action, and government consumer agencies.

However, growing understandings from competition, consumer and behavioural economics provide scope for a more sophisticated approach to consumer policy that recognises its impact on markets and its potential to improve market outcomes, as well as achieving socially just outcomes. Consumer policy has therefore increasingly attracted a more overtly economic focus, analysing not only its role in protecting consumers from practices considered unfair or inappropriate, but also how it may affect the overall operation of a market or markets

This increasing sophistication has raised new challenges for consumer policy in continuing to pursue both social and economic goals with one set of policies. Whereas once legislators and policy-makers were reasonably eager to intervene in markets to address fairness concerns, now they are more circumspect and may

[97] See Nader, R. 1965. *Unsafe At Any Speed: The Designed-in Dangers of the American Automobile*.

prefer to rely on policies that aim to improve overall market efficiency as a way of improving outcomes for both suppliers and consumers. This is because, as the Commission identifies, intervention in markets is itself not cost-free and poorly designed intervention can be bad for consumers in the long term.

The Commission's Issues Paper demonstrates the increasing sophistication in the consumer policy approach. It identifies several different potential rationales for consumer policy and government intervention in consumer markets. These include economic rationales, particularly using consumer policy as a companion to competition policy to ensure effective demand-side participation in markets, and social rationales, particularly using consumer policy to promote social justice by ensuring disadvantaged and vulnerable consumers participate effectively in markets and are not exploited by sharp practices.

Consumer Action strongly agrees with this assessment that modern consumer policy should play a variety of roles and has both an economic and social character. We would add that one of the other generally accepted aims of consumer policy, namely promoting general fair trading, also carries this dual character of ensuring efficient yet socially fair outcomes. Fairness in the treatment of consumers has always been a social justice objective, but we now understand that it also affects markets, given that fairness matters to consumers. In fact research shows that consumers who perceive themselves to have been treated unfairly by a supplier may adopt inefficient practices rather than continue to be treated unfairly, or may choose not to participate in markets at all, as discussed above under section 3.2.

4.2 Principles for updating the framework

The consumer protection framework needs to promote competition and reflect broader social goals such as equity and fairness, access to essential services and protection of disadvantaged and vulnerable members of the community. On the one hand, the framework should empower consumers; on the other, it should protect them. Within these dual goals of consumer policy, we can identify several broad aims for the consumer policy framework and define a set of principles that should guide the redevelopment of the framework. These principles are set out below (and are extrapolated on in other parts of the submission).

Principle 1: Support the demand side of the market

Support and allow the demand side of the market to function effectively, by basing policy on a comprehensive understanding of the issues consumers face in the marketplace and which limit their ability to actively participate in markets. This includes:

- Ensuring that barriers to consumers effectively activating competition are minimised – particularly in transaction and switching costs.
- Examining the effect of product bundling on competition, including the potential for bundling to cause market distortions on the supply side (e.g. the possibility of an incumbent bundling supplier discouraging potential competitors from entering a market).
- Examining the effect of bundling on consumers, especially for vulnerable and disadvantaged consumers, including the potential for misuses of market power (e.g. whether bundling limits choice in the marketplace or forces consumers to purchase products they do not need), especially in relation to long-term contracts

- Protecting consumers from fraudulent activities and other problems arising from the use of the internet to conduct commercial transactions.
- Ensuring that consumers have the ability to obtain redress across national borders. Develop tools that promote demand-side responses, especially those that simplify the task of comparing products and prices.
- Basing the consumer policy framework on consumers' actual behaviour, rather than on ungrounded theoretical assumptions about their supposed "rational" behaviour. The framework should use research from behavioural economics and cognitive psychology.
- Ensuring that consumers are adequately protected in new and emerging market arrangements, particularly in sectors where services were previously provided by a single government supplier (such as utilities and telecommunications). This includes ensuring that consumers understand their options for switching between suppliers, and service standards and obligations in these new markets.
- Recognising that increasing debt levels among Australian consumers are preventing many consumers from actively participate in markets. This includes addressing the implications of debt being used to fund market transactions and examining the potential impact of large numbers of foreclosures on "debt solution" loans after initial discount rates expire.

The policy framework should:

- Recognise that increasing limits on consumers' time, coupled with an increasing volume and complexity of product choices and the emergence of new markets, has implications for the ways that consumers make choices in the marketplace.
- Recognise that research has shown that too much choice can actually be demotivating for consumers. This results in the use of simple heuristics or "rules of thumb" when faced with more complex choices.
- Understand that consumers are not in a position to analyse all the information relating to every transaction. Provide a baseline of protection to allow consumers to act with confidence in new markets. This may require some regulation in recently deregulated markets (e.g. for utilities and telecommunications services) to enable the benefits of competition to be realised.
- Develop and support frameworks that allow consumers to enter markets and act with confidence.

Principle 2: Ensure there is supply side competition and fair trading

Ensure genuine competition on the supply side of the market. This includes:

- Ensuring that incumbent suppliers cannot distort markets to discourage other potential suppliers from entering.
- Ensuring clarity and transparency on the supply side of the market so that consumers can seek redress where necessary (for example, where intermediaries are used in markets for credit and financial products).
- Eliminating the ubiquitous use of unfair terms in standard form contracts, which represents a market distortion arising because consumers cannot

shop around for better contract terms (due to complexity and lack of competition in this area) and exposes consumers to significant detriment.

- Ensuring that regulators actively enforce existing regulations once the substantive rules have been established.

Principle 3: Protect vulnerable and disadvantaged consumers

- Recognise that microeconomic reforms such as financial deregulation and national competition policy have exposed or exacerbated the position of low-income and disadvantaged consumers (e.g. competition has had a detrimental effect on low-income and disadvantaged consumers in the form of higher banking fees, higher energy prices and exposure to predatory lending practices such as pay day lending).
- Use emerging sophisticated approaches to addressing disadvantage to address concerns about practices affecting disadvantaged and vulnerable consumers, without hindering welfare or efficiency outcomes more generally.
- Incorporate the following three points into the response to issues of disadvantage in the marketplace:
  a) Recognise that a market problem that appears to affect disadvantaged or vulnerable consumers may, in fact, be a market-wide failure. It is originally assumed to affect only disadvantaged consumers because problems can be more readily observed in those cases (e.g. financial intermediaries, reckless lending and equity stripping).
  b) Understand that in-market solutions do not always have to be universal or inefficient. Consumer policy tools can also be designed to be targeted rather than applied generally (e.g. financial hardship policies in utilities markets).
  c) Be flexible in approach and recognise that social justice considerations and the fact that problems are unlikely to be addressed by the broader tax and social welfare systems, mean that targeted policies can be used – despite a net cost on the wider community, particularly if that cost is only marginal.
- Protect vulnerable and disadvantaged consumers from unfair practices by suppliers. Specific issues that the consumer policy framework must address include:
  - Situations where consumer choice is limited through practices such as product bundling, especially for essential services, or where consumers who cannot afford to purchase a bundle of products are excluded from accessing discounts that are available to other consumers.
  - Situations where vulnerable and disadvantaged consumers are exposed to threats such as “double disconnection” from essential services resulting from new market arrangements and products.
  - The increasing proportion of consumers who are vulnerable to predatory lending practices such as pay-day lending and unsolicited increases in credit card limits.
  - The policy framework should take account of the impact of the “digital divide” on vulnerable and disadvantaged consumers.

Principle 4: Ensure access to essential services

Ensure that all consumers have fair and reasonable access to services, especially essential services. This includes:

- Ensuring equitable access to services such as utilities and telecommunications, both in terms of pricing for these services, and in terms of market and product configurations.
- Ensuring that disadvantaged and low-income consumers are not further disadvantaged (or miss out on benefits in the marketplace) through their lack of internet access.

Principle 5: Have regard to international developments

While Australia's competition policy framework has been systematically reviewed and significantly changed since the introduction of the TPA, Australia has not generally kept pace with international developments in consumer policy and protection. Our consumer policy framework should be constantly reviewed and updated in line with international best practice.

Principle 6: Approaches should be evidence based

This principle carries with it the need to ensure that:

- There is a strong and independent consumer voice.
- Consumers or their representatives are included with policy discussions that impact on the consumer interest.
- There is a commitment to ensuring that research is undertaken to provide relevant evidence in formulating consumer policy.

Principal 7: Ensure efficient national coordination[98]

For an effective review of consumer policy framework it is essential that there are optimal support structures and systems to make the framework "work". This includes flexibility so that framework can be updated in response to any new problems by:

- Reviewing the current arrangements for national coordination of consumer issues to ensure that consumers are adequately protected.
- Establishing an adequately resourced and funded national consumer research and advocacy organisation.
- Considering other issues related to the coordination of consumer protection, such as the need to re-instate a Commonwealth Minister for Consumer Affairs.

Principal 8: Flexibility

The policy framework and regulatory responses must be flexible in approach and application. This means in particular:

- No one approach or tool should be automatically preferred over others.
- Application should not necessarily be linear.
- Complex problems will generally require a range of tools and approaches.

[98] Coordination and structural issues are discussed further in Sections 3.5 and 3.6 below.

- The overriding objective should be to select the right tool for the right job.

4.3 Criteria for assessing regulatory impact

Key points

- The methods used to measure regulatory burden need to be broadened. Arbitrary approaches that measure the number of pages of regulations, or which promulgate a "one in, one out" approach, are useless in assessing the effectiveness of regulation.
- We should focus on whether regulations do the job that they were designed for, including whether they are structured to enable consumers to fully participate in the market and to feel confident that a baseline of protection is in place.
- Assessments of regulatory regimes should measure the benefits of regulation, not just the costs. They should incorporate and support qualitative measures. They should also assess the benefits and costs of regulation or deregulation for consumers as well as for business.
- Measurement of regulatory burden should include assessments of consumer benefit and detriment. Borrowing techniques from other regulatory or policy processes should be considered (e.g. victim impact statements and environmental impact statements). Consumer Impact Statements could be developed as an extra tool to evaluate the costs and benefits of regulatory change.
- The OECD Consumer Policy Committee has a template for assessing regulatory change that focuses on how consumers are affected by regulation and thus attempts to measure whether regulation is effective.

4.3.1 The role of regulation in consumer policy

Consumer policy necessarily entails "regulation" of some sort, as recognised by the Commission in its Issues Paper, as regulation is a key tool to implement consumer policy.

Which regulations are necessary (or even whether they are necessary) is strongly debated in Australia within both the business and consumer sectors. Consumer Action is particularly concerned that while assessment frameworks claim to consider both costs and benefit to both business and consumers, in reality cost to business appears to be the central focus.[99] This message is reinforced by comments that refer solely to regulation as a 'burden' or as unnecessary 'red tape'.

For example, in April 2007 the Victorian Competition and Efficiency Commission, which advises the Victorian government on business regulation reform, released its annual stocktake of regulation in Victoria, *The Victorian Regulatory System 2007*. Media reporting about the Report, and ensuing debates, focussed on VCEC's attempt to quantitatively assess the level of regulation in Victoria, summarised in its statement that "the 72 business regulators in Victoria administer 420 Acts and Regulations, comprising more than 32,000 pages, as well as nearly 1.9 million

[99] For example the Office of Best Practice Regulation provides tools to assess costs to businesses but no tools to assess benefits arising from regulation nor costs to consumers from the absence of regulation.

licences."[100] Consumer Action believes that such a quantitative focus on regulation is pejorative and is of little use in assessing its effectiveness or impact. Similarly, a “one in, one out” approach to new regulation, which has been suggested, is another arbitrary measure which avoids any real assessment of costs and benefits.

Before regulations are implemented in Australia, there is a lot of emphasis on the need to analyse the costs and benefits, particularly to business.[101] However, there is seldom enough focus on whether the regulation is structured to achieve the best outcomes for consumers and the community as a whole. As costs to consumers can be harder to quantify, they are often discounted or forgotten in regulatory gate-keeping processes (even though the reason for the proposed regulation may be to prevent harm to consumers). This problem is exacerbated by the paucity of consumer data available in Australia and the need for a consumer voice strong enough to raise relevant issues in the many and varied processes that affect their interests. This is discussed further in Section 3.5 below.

The regime used to address conflict of interest in financial services is a good example of the importance of focussing strongly on consumers in undertaking cost-benefit analysis. A disclosure regime might be assessed as costing less than stronger and more restrictive regulation as it does not limit the types of products offered, or commission structures and relationships, so does not affect the market too much. But if it does not actually stop the harm to consumers which it is intended to address, it is still imposing costs on business – passed on to consumers – and the result is net costs. Stronger regulation prohibiting certain conflict arrangements or providing that intermediaries are agents of suppliers, might have led to real benefits for consumers and to a more efficient market as a whole. In short, the benefits of the regulation might outweigh the costs.

There is a balance between ensuring that regulation is not overly burdensome, but is sufficient to meet its aims.

4.3.2 Current approaches

Currently, the potential impact of new legislation is assessed using a Regulatory Impact Statement or Business Impact Assessment. For example, the VCEC requires Victorian Government departments to develop a RIS for any regulation or statutory rule that imposes “appreciable burden”, and a BIA for any legislation that has potentially “significant effects for business or competition”.[102] These statements emphasise the costs of regulation, and as such stipulate that “where possible, quantitative measures – such as financial and economic costs and benefits – should be identified and compared. In other words, a dollar figure should be assigned to costs and benefits, where feasible.”[103]

Changes in administrative burden in Victoria require that any new regulation is met by an “offsetting” simplification in the same or related area. A SCM must be used to

---

[100] Victorian Competition & Efficiency Commission. *Victorian Regulatory System 2007: New report released today*. Media release, 19 April 2007.

[101] For example, see Office of Best Practice Regulation. 2006. *Best Practice Regulation Handbook*. Canberra: Productivity Commission. pp.1-1 – 1-3; and Victorian Competition & Efficiency Commission. 2007. *Victorian Guide to Regulation*. Melbourne: VCEC. pp.4-2 – 4-11.

[102] Victorian Competition & Efficiency Commission. *Hints and Tips on writing a Regulatory Impact Statement or Business Impact Assessment*.

[103] Victorian Competition & Efficiency Commission. *Victorian Guide to Regulation*, as above.

assess changes in the administrative burden. This measures the cost of compliance to business or the cost of government regulation. The SCM is an activity-based methodology that estimates the costs of completing administrative activities associated with new or revised regulation. Other financial and compliance costs are required to be measured separately. There is an overemphasis on the burden of regulation for business. For example, VCEC states that:

> The burden of regulation is a major issue of concern for the business sector, particularly small business. In addition to the economic impact of regulation (e.g. investment distortions, disincentives), businesses are faced with the burden of administrative and compliance costs, including items such as the cost of new equipment, inspection charges, training, additional record keeping requirements, and the time required to complete the paperwork.[104]

The Australian OBPR also focuses on the compliance costs to business, rather than on the overall effectiveness of proposed regulation. The OBPR requires a preliminary assessment of the impacts of the regulatory option on business and individuals or the economy. If the regulatory option has no or low impact, then no further analysis is required. If the preliminary assessment shows there is an impact then, after consultation with the OBPR, compliance costs must be analysed. This involves assessing the competition impacts (no/low or significant) and compliance costs (no/low, medium or significant) of the regulation that is being considered. Depending on the result, there may be no further action; preparation of a RIS; preparation of a BCC report; or both a RIS and BCC report. This system focuses heavily on business compliance costs. The fact that a BCC report is the only consideration in determining whether a regulation that has high compliance costs or affects competition will go forward bear obvious risks that consumer benefits will not be considered or given sufficient weight. Considering that the OBPR framework allows regulation to be stopped if it does not pass its processes, this is unacceptable.

In contrast, the OECD Consumer Policy Committee has developed a comprehensive checklist and toolkit which begins with questions assessing *both* the supply side and the demand side of the market. The demand-side questions reflect modern understandings of consumer experience and behaviour, including: “Is the market sound?”, “Are consumers enjoying the benefits of a competitive market?”, “Is there information failure?” and “Are there behavioural biases affecting consumer decision-making and outcomes?”. The next step in the checklist involves analysing whether informational instruments, behavioural instruments or other instruments are required. Importantly, the decision tree recognises that more than one type of tool can be used to address demand-side issues. If the analysis finds that the benefits of intervention (to empower or protect consumers) would outweigh the costs then a policy response for improving the market for consumers is recommended. If the analysis finds that the costs of intervention would outweigh the benefits, then a further analysis is still required – to assess whether costs are falling on vulnerable or disadvantaged groups. If so, then policies to compensate or protect these consumers are recommended. Copies of the OECD materials are in **Appendix B**.[105]

The approach recommended by the OECD Consumer Policy Committee clearly expands the ambit of analysis on the effects of regulatory change. Unlike the approaches required by the OBPR and the VCEC, the OECD method explicitly

---

[104] As above.
[105] Appendix B also includes a copy of the OECD’s Draft Checklist and Toolkit for analysing markets from the perspective of both competition (supply-side) and consumers (demand-side).

considers the potential impact of regulation on consumers, including vulnerable and disadvantaged consumers.

4.3.3 Some alternative approaches

Consumer detriment surveys

CAV has undertaken research that assesses the various costs that can be incurred by consumers in the marketplace. CAV's report, *Consumer detriment in Victoria: A survey of its nature, costs and implications*, sets out some approaches to measuring consumer detriment that are useful for developing a broader methodology for assessing the impact of regulatory change.

CAV defines "consumer detriment" with reference to the range of effects on consumers when goods and services do not meet their expectations. A broad range of effects, both financial and emotional, tangible and less tangible are considered.[106] CAV used the following definition:

> Consumer detriment (to the individual consumer and/or society as a whole) can constitute: satisfaction (utility) less than was reasonably expected when a purchase was made, whether revealed or not; and dissatisfaction due to the inability to make desired purchases, because of missing markets, non-credible claims and/ or physical disadvantage.[107]

A survey was done to measure the level of consumer detriment in the preceding 12 months. The survey estimated that the total cost of consumer detriment in Victoria in the 12 months to March 2006 was $3.15 billion, corresponding to approximately 1.5 per cent of gross state product. Estimates were based on the costs of repairing and replacing items; the costs of following up problems and resolving them;

and the costs of personal time in resolving problems.

CAV also assessed how problems in markets can affect consumers emotionally by causing annoyance, frustration, stress and disappointment.[108] The research found that these kinds of costs contribute to consumer detriment. As these are more difficult to measure using traditional empirical models than costs which can be measured in terms of financial indicators, they have traditionally been excluded from analyses of market intervention. However, their potential magnitude means that they must not be excluded from analyses that assess the effects of market changes.

We also note that the ASIC Consumer Advisory Panel has recently commissioned a project to examine ways of assessing consumer detriment to help improve regulatory impact assessment. The results should help determine how Australia's regulatory gate-keeping processes can be further improved.

Consumer Impact Statements

We see victim-impact statements in the criminal law and environmental impact-statements in the environment protection context. Similarly, consumer-impact statements could be developed as an extra tool to measure the costs and benefits of

---

[106] Consumer Affairs Victoria. 2006. *Consumer detriment in Victoria: A survey of its nature, costs and implications*. Research paper no. 10, p.iii.
[107] As above, p.iv.
[108] As above, p.1.

regulations. The contents of these would need to be explored more fully; however the following list indicates the types of issues that they would need to cover to assess the costs and benefits to consumers of regulatory change:

- How will the regulation affect the prices of goods and services in the market?
- How will access to services, and the choices available to consumers, be affected?
- Will the regulation impose any additional switching costs on consumer?
- How will the regulation affect disadvantaged and vulnerable consumers? What structures are proposed to protect these consumers?
- How will the legislation affect consumers' ability to follow up problems and resolve them?

4.3.4 Conclusions

We submit that current regulatory assessment approaches and their application in practice urgently need to be "re-focussed" in order to deliver on the objective of evidence-based regulation. For example:

- Rather than focusing on the "burden" of regulation, they should focus on whether regulations are effective.
- Unnecessary or ineffective regulation is undesirable. However 'unnecessary' must be viewed from a range of perspectives. For example, what is defined as burdensome for business can actually be necessary and effective regulation for the broader community.
- We need to effectively identify and give weight to qualitative benefits of regulation. For example, regulation can help consumers feel more confident to enter markets if they know a baseline of protection is available.
- Assessments need to incorporate both the effects of regulatory change, and importantly, the effects of no change.
- We need to acknowledge that there are costs of deregulation, or policies such as "one in, one out", which affect business, consumers and markets more broadly. However, since costs to consumers are difficult to quantify, the effects on consumers are often discounted.
- Assessments of effectiveness of a proposed regulation must include assessment of the effectiveness of the compliance, enforcement and redress regime that applies to it.

Examples of inquiries that will assist to answer these questions from a consumer perspective include:

- Are the penalties, and risks of being caught, enough to outweigh the benefits of non-compliance?
- Does the regulator have the resources to enforce the regulation?
- Are there loop holes? It may be necessary to run through a range of possible scenarios against the legislation to identify them – in other words, proposed regulation should be road-tested.
- Do provisions need to be interpreted (in legislation or guidelines) for particular

industries/products?

- Are there gaps in the regime? An otherwise effective regime can fail due to one weakness, such as lack of accessible dispute resolution, lack of an active regulator, lack of processes to identify systemic issues, or lack of processes to address systemic issues (as opposed to relying on individual consumers to enforce provisions by court or ADR complaints).

In summary Consumer Action recommends that Australian regulatory gate-keeping processes be reformed so that both costs and benefits are assessed more rigorously. This includes reform to the OBPR's assessment model. This should fully consider both supply and demand-side issues, including those affecting disadvantaged and vulnerable consumers, as a separate question.

The approach developed by the OECD Consumer Policy Committee provides a methodology that can be used in the Australian consumer policy framework. This goes beyond simply considering the "burden" of regulation on business to one which actually considers regulation outcomes. This approach focuses on problems in the market and how best to intervene, and how intervention will benefit consumers, including disadvantaged and vulnerable consumers, while considering the costs of intervention. Moreover, it provides a methodology to analyse whether regulations are likely to achieve their goals.

Recommendation 5:

Undertake an urgent renew of the Office of Best Practice Regulation (and relevant State and Territory agencies and processes) with the objective of:

- Broadening the approaches that are used to measure regulatory impact with a focus on the effectiveness of the regulation as well as costs and benefits;
- Developing tools to assist in assessing costs and benefits to consumers;
- Including consumer benefit or detriment in measures of regulatory burden;
- Incorporating qualitative measures and considering Consumer Impact Statements; and
- Incorporating best practice models such as that developed by the OECD Consumer Policy Committee.

4.4 Evidence base for updating the framework

Key points

- Updates of the consumer policy framework need to incorporate the latest evidence and knowledge about consumers' experience and behaviour in markets. This approach will mean our policies are more likely to achieve their aims and are able to meet the new challenges and complex issues that consumers face in the modern marketplace.
- Evidence-based approaches to consumer policy are now international best practice, as reflected in the consumer policy work being undertaken in the OECD, United Kingdom and New Zealand.

Critically related to improving our regulatory assessment processes is the need to improve the evidence available on which to base assessments. This needs to occur on two levels:

- The updating our theoretical frameworks to utilise new evidence emerging regarding the impact of actual consumer behaviour;

- Evidence of actual consumer experiences in markets.

A brief summary of some international examples is outlined in Section 3.2.

Unfortunately, however, Australia's consumer policy framework has fallen behind international best practice. For example, as noted, the New Zealand Ministry for Economic Development has produced fact sheets and guidelines that present lessons from behavioural economics and cognitive psychology that can be used to develop policies which are more likely to achieve their goals. The introduction to the New Zealand guidelines notes that:

> Assumptions about behaviour are an important part of the policy process. A policy analyst's assumptions can colour the way problems are defined, objectives set and options designed and implemented. It is important to ensure that the assumptions relied on reflect the way people actually behave. The neoclassical economic theory approach to policy tends to assume that people will behave by making rational decisions, acting in self-interest and making decisions with complete information. Other disciplines, including behavioural economics, psychology and sociology, can help provide a broader understanding of the range of factors that influence people's behaviour. Understanding our assumptions about the way people behave is important in designing effective policy.[109]

This quote neatly summarises the importance of incorporating the latest knowledge and developments into policy – without it we dramatically and knowingly reduce the chance of policies working to achieve their aims. This is because:

> Most decisions in the world are made under uncertainty (including policy decisions). Making decisions under uncertainty means they are not made with perfect information, and so things irrelevant to decision-making in traditional economics (because they are not needed once you assume perfect information and perfect rationality) become important: beliefs, the actual information people possess, culture, peers, learning, and the many other things studied within behavioural economics, psychology and other relevant fields.[110]

Work and discussion is occurring within the OECD that further shows that Australian policy is falling behind international best practice. These new understandings are already reflected in legislative and regulatory frameworks in the UK.[111]

In short, important research, discussion and policy development is occurring around the world which uses the latest knowledge and methodologies to develop consumer policies which are likely to be more effective than those that rely solely on assumptions from neo-classical economics. Unfortunately, this work is occurring in jurisdictions other than Australia. In our view, the Productivity Commission should

---

[109] New Zealand Ministry for Economic Development. 2006. *Behavioural analysis for policy – new lessons from economics, philosophy, psychology, cognitive science and sociology*.
[110] New Zealand Ministry for Economic Development, as above.
[111] See Section 3.2.

review the work being undertaken in jurisdictions such as the OECD, the UK and New Zealand and recommend that these approaches be incorporated into the Australian consumer policy framework as a matter of urgency. The ability to effectively wield these tools can avoid unnecessary harm to Australian consumers, businesses and overall market efficiency in Australia.

As well as considering data from behavioural economics in policy development, we also need to acknowledge the implications of consumers' active role in markets. Consumer Action supports the active role of consumers in markets and encourages initiatives that will enhance the demand side of the market. In its Issues Paper, the Commission also acknowledges the need for a well functioning 'demand side'. Thus policy settings that encourage consumers to take part effectively in markets are an integral complement to competition among suppliers".[112] Therefore, other things being equal, the policy response also needs to:

1. Minimise transaction and switching costs for consumers across all products and markets. (For example, this can be done by minimising the scope for lock-in contracts, eliminating complex switching arrangements that apply in many areas, and simplifying the choices available to consumers).

2. Effectively punish "bad" behaviour (this is discussed further later in this submission when we address issues related to enforcement of regulation).

The following three examples clearly show how current consumer policies can result in a misdirection of policy effort because they are based on neoclassical economic assumptions.

Box 1

Example 1 – The disclosure regime for financial services

Disclosure regimes are designed to provide consumers with all the information that they need to make informed decisions. This is based on the assumption that consumers who are fully informed will make rational decisions. However, this assumes that consumers are able and willing to use all of the relevant information in making their choices. This contrasts with what we know about behavioural biases such as bounded rationality and limits on consumers' time and ability to make choices. The assumption is likely to be particularly untrue of consumers who experience disadvantage that affects their understanding.[113] There is also evidence that disclosure can actually have the opposite effect and further distort the market. US behavioural economics research has found that disclosure of conflicts of interest actually increased the level of trust between the consumer and the adviser.[114] Moreover, it was found that "people generally do not discount advice from biased advisors as much as they should, even when advisors' conflicts of interest are disclosed [and] disclosure can increase the bias in advice because it leads advisors to feel morally licensed and strategically encouraged to exaggerate their advice even further."[115] This research clearly shows that disclosure regimes are based on

[112] Productivity Commission. 2007. *Consumer Policy Framework: Productivity Commission Issues Paper*. p.7
[113] For example consumers with limited English or consumers with a disability that affects cognition.
[114] See Cain, D.M., Loewenstein, G. & Moore, D.A. 2005. *The Dirt on Coming Clean: Perverse Effects of Disclosing Conflicts of Interest*. Journal of Legal Studies. 34: 1 - 25.
[115] Cain *et. al.*, as above, p.1.

erroneous assumptions about people's "rationality". While disclosure regimes are intended to help consumers make more informed decisions, they do not necessarily have this effect. Prohibiting certain types of conflicts, or making it clear that an intermediary was an agent of the seller rather than the consumer, might be a more effective way of addressing this issue. As the authors of the study suggest, "When possible, the more lasting solution to these problems is to eliminate the conflicts of interest."[116]

Box 2

Example 2 – Penalty fees

Behavioural economics, rather than neoclassical economics alone, may also be useful in analysing penalty fees charged by financial institutions.[117] Under neoclassical economic theory, it is assumed that consumers will switch suppliers if penalty fees are too high – "this theoretical ability of consumers to switch banks is supposed to place competitive pressure on banks to lower their fees in order to retain and compete with other financial institutions for customers."[118] However, various studies have shown that consumers are unlikely to change banks in response to penalty fees. For example, a United Kingdom Co-operative Council study found a very high reluctance on the part of small and medium business customers to switch banks, as it appeared too complex. An Australian Consumers Association study found that while only 13 per cent of Australian customers were satisfied with the larger banks, only 22 per cent had changed institutions in the past five years.[119] Consumers' reluctance to change banks is in part due to the (actual and perceived) switching costs of changing banks. However, it can also be the result of "bounded rationality" and "hyperbolic discounting". Being boundedly rational, consumers will have only a limited ability to consider various features of banking products and are unlikely to look at the detailed terms and conditions beyond up-front price and charges and important service features. Being hyperbolic discounters, consumers are unlikely to properly calculate and consider the risk of incurring penalty fees in the future in any significant manner.[120] This has clear policy implications in terms of assessing whether penalty fees are being set at an efficient rate or whether consumers are in fact unable to exercise any effective restraint on excessive charging. Combined with the high switching costs of changing financial institutions, other forms of market intervention may be required to address the issue of penalty fees and ensure they are being priced fairly and efficiently. Policies that assume consumers will behave rationally regarding penalty fees will fail to make any inroads

[116] Cain *et. al.*, as above, p.22.
[117] Penalty fees include periodic payment and direct debit dishonour fees; cheque dishonour fees; overdrawn account honour fees; credit card late payment fees; and credit card over-the-limit fees.
[118] Rich, Nicole. 2004. *Unfair fees: A report into penalty fees charged by Australian banks*. Melbourne: Consumer Law Centre Victoria. p.33.
[119] As quoted in Rich, as above, pp.35-36.
[120] This has also been shown to be the case in terms of credit card interest rates, with consumers with a high level of unrealistic optimism underestimating their future borrowing. This means they are less sensitive to credit card interest rates and more sensitive to up-front costs such as fees: Sha Yanga, Livia Markoczyb, Min Qic, (2006), "Unrealistic optimism in consumer credit card adoption", *Journal of Economic Psychology*,Volume 28, Issue 2, April 2007, pp.170-185. The authors of this study find that it is not likely that market competition will cause banks to lower their credit card interest rates as doing so would simply lead to less profit while making little difference in the ability to attract consumers with a higher level of unrealistic optimism, thus alternative approaches are needed to protect consumers.

into the problem.

Box 3

Example 3 – Standard form contracts

Consumers exhibit bounded rationality, meaning that they are simply not going to be able to consider every contract term in mass contracts they are presented with. They are more likely to consider key terms such as price and services, initiating effective demand-side competitive pressures on these terms only, and not the remainder of the contract terms. The current framework's reliance on consumers to be informed and to demand changes to contract terms simply does not take into account the evidence of consumer behaviour under bounded rationality, and cannot ensure that contract terms are efficient or fair.[121]

Recommendation 6:

MCCA members should commit to:

- Incorporating the latest evidence and knowledge about consumers' experience and behaviour in markets into consumer policy. The consumer policy work in the OECD, United Kingdom and New Zealand should be reviewed as part of this process; and
- Providing resources to compile available evidence regarding consumer experiences in markets encourage the development of additional research and commission work.

4.5 Strengthening the consumer voice

Key points:

- An independent national consumer research body should be established to lead and coordinate consumer policy and research, and provide an evidence-base to develop and implement consumer policy. The National Consumer Council in the United Kingdom provides a well-established model for this.
- A key missing link in Australian consumer policy is the inability for governments and other decision-makers to meaningfully consult consumer representatives.
- A well-funded and resourced peak body that represents consumer organisations from around Australia is needed to strengthen the consumer voice and represent consumer interests in policy development.
- A peak body with appropriate funding could undertake vital work across four key areas: policy advocacy; networking and information sharing; coordinating consumer representation; and development of best practice models.

Strong and effective consumer representation and advocacy is a very important element of the overall functioning of the consumer policy framework (and indeed of a

[121] See Russell Korobkin, *Bounded Rationality, Standard Form Contracts, and Unconscionability*, University of California, Los Angeles, School of Law, Law and Economics Research Paper No. 03-02.

functioning democracy). We refer to and endorse the comprehensive submission by the Consumers' Federation of Australia on this issue. Despite this fact many organisations have been de-funded at the same time as more and more importance is placed on research and data about consumers. Consumers themselves are also increasingly exposed to more market-based interaction and complexity. Consumer Action notes the recent report on behalf of the Consumer Advisory Panel of the Australian Securities and Investment Commission. This report, *A Strong Consumer Voice*, addresses some of the key elements necessary to ensure that Australia's consumers have a strong and effective voice in relation to the issues that concern them. The report is based on interviews with nearly forty key stakeholders in consumer advocacy across Australia and thus reflects the consensus of leaders in the sector. Consumer Action adopts and endorses the report's findings. We focus on two particular elements below.

Research Capacity

As discussed in Section 4.4, there is a critical need for research and data regarding consumers experience in markets. A key component in addressing this gap is a national, independent consumer research body. The national body would not focus on one area of consumer interest, such as the financial services sector, but could examine relevant issues for consumers across all markets. It would maintain independence from political, commercial or other vested interests and have a mandate to seek to ensure that consumer interests are represented in policy and decision-making. It would need recurrent government funding and should be overseen by an independent board made up of relevant consumer and community stakeholder groups. The group would have a dedicated research capacity to focus on the experience of consumers in the marketplace, where there is now a significant gap. It should have a focus, though not an exclusive focus, on issues affecting disadvantaged and vulnerable consumers.

A model for operating an independent consumer research body is provided by the well-established and successful consumer council in the United Kingdom.[122] The UK Council focuses on making a practical difference to the lives of UK consumers within an environment similar to Australia. The council researches and investigates key consumer issues in the context of market changes and deregulation. The Council is able to proactively undertake research. This allows consumer research to make a significant contribution to policy development (for example, through the conduct of policy forums with public service providers, business and regulators) rather than consumer interests and research knowledge being considered only in response to government initiatives.

A peak consumer body

A key area in which consumer advocacy needs to be strengthened is increasing the capacity for meaningful and comprehensive consultation with consumer representatives. This can be achieved by resourcing an independent and appropriately-funded consumer voice.

Consumer Action notes that there was overwhelming and unequivocal support for funding a peak body to represent the consumer organisations from around Australia. We believe there is a significant need for a funded representative organisation to ensure that consumers are represented in policy debates and through mechanisms that review and update policies and regulations that affect them. A peak body with

[122] Information about the UK National Consumer Council is located at www.ncc.org.uk

appropriate funding would be in a position to work across four key areas: policy advocacy; networking and information sharing; coordinating consumer representation; and developing best practice models.

Recommendation 7:

The Federal Government should establish an independent national consumer body to undertake research on issues affecting consumers, including research on consumers' behaviour and experience in markets.

Recommendation 8:

Provide appropriate funding and resources for a peak body that represents consumer organisations from around Australia. This will strengthen the consumer voice and provide much-needed consultation addressing consumer interests in policy development. A peak body with appropriate funding could undertake vital work across four key areas: policy advocacy; networking and information sharing; coordinating consumer representation; and development of best practice models.

4.6 National administration and coordination

Key points

- The current arrangements for coordinating consumer issues and policy through the Ministerial Council on Consumer Affairs do not allow consumer issues to be dealt with in a timely and comprehensive manner.
- The position of Federal Minister for Consumer Affairs needs to be re-instated to strengthen the government's commitment to and focus on consumer issues.

Consumer Action believes that the current arrangements for national coordination of consumer issues and policy are inadequate and ineffective. Mechanisms developed to coordinate competition policy and other issues of priority not only provide a notable contrast, they show that the problems in the consumer policy framework can be fixed.

As the Commission is aware, it is the MCCA's responsibility to consider issues that are of national significance and to develop consistent approaches to those issues. The council is supported by the SCOCA and four advisory committees that focus on particular aspects of consumer protection.

Consumer Action is concerned that the MCCA is not adequately resourced and structured to deal with consumer issues in a timely and comprehensive manner. Delays are often attributed to the complexities in obtaining agreement between participating governments. This challenge should not to be understated. However, problems persist even when agreement is obtained. For example, government, industry and consumer stakeholders have agreed for many years on the need for national finance and mortgage broker regulation. However, despite publishing its report recommending this regulation in November 2004,[123] MCCA has seemingly made little progress since, with a consultation bill now due to be released "later this year".[124] In fact, most MCCA initiatives follow a similar trajectory, with proposals

[123] See Office of Fair Trading, *National Finance Broking Regulation: Regulatory Impact Assessment Discussion Paper*, November 2004.
[124] Ministerial Council on Consumer Affairs, *Meeting Communiqué* meeting held 18 May 2007, available at: www.consumer.gov.au/html/download/Final_Communique_May_2007.pdf

taking several years to progress and many simply disappearing from the public agenda with little or no explanation. For example, it is not clear what occurred in MCCA's car hire industry review.

We note the MCCA's September 2005 Strategic Agenda included a commitment to review MCCA, including 'the structure, operations, performance and achievements of MCCA to ensure that MCCA remains focused and effective in ensuring consumers are adequately protected in Australia'. According to the September 2005 Agenda, the review was due to be completed in 2006; however no report of the review is available.

These examples illustrate critical problems in resourcing, effective coordination and accountability. We suggest the following measures be recommended to address these concerns as a matter of priority:

- A commitment by MCCA members to provide adequate resourcing to SCOCA processes. In defining 'adequate' it should refer to the staffing and administrative requirements required to conclude SCOCA's current work program within 12 months; and
- A commitment by MCCA members to public reporting of meeting agendas and outcomes, a published work plan and monthly reporting of progress against the work plan.

Consumer Action also believes to strengthen the consumer voice and ensure efficient coordination of consumer issues it is vital that the position of Federal Minister for Consumer Affairs is re-established. Australia has not had a federal Minister for Consumer Affairs since 1988 and this has led to a failure to ensure government accountability nationally for consumer policy development, implementation and review. This review has highlighted the importance of understanding consumer issues and representing consumer interests. Issues such as market deregulation, new complex and sophisticated products and increasing debt levels among Australian consumers show that consumer interests need to be represented at the highest level of policy development and decision making, particularly for those who are vulnerable and disadvantaged. This challenge is exacerbated by the fragmented status of consumer policies between the state, territory and federal governments, and across multiple government portfolios. It is essential that Australian consumers are represented by a focussed voice at the Ministerial table within the Commonwealth government.

A national minister would be able to oversee and implement the recommendations of this review and strengthen Australia's consumer policy framework. Re-establishing a national Minister for Consumer Affairs would be an important first step in re-establishing Australia as a world leader in consumer policy.

Recommendation 9: MCCA members should commit to providing adequate resourcing to SCOCA processes. In defining 'adequate' it should refer to the staffing and administrative requirements required to conclude SCOCA's current work program within 12 months.

Recommendation 10: MCCA members should commit to public reporting of meeting agendas and outcomes, a published work plan and monthly reporting of progress against the work plan.

Recommendation 11: The Federal Government should re-instate the position of

National Minister for Consumer Affairs.

5.0 The policy toolkit

5.1 Choosing the right tool for the job

Key points

- A range of policy responses are needed to deal with the issues experienced by Australian consumers.
- This should include tools that improve overall market efficiency; those that ensure fair trading; those that target vulnerable and disadvantaged consumers; and those that are specific to certain industries.
- The tool kit should be flexible and the focus should be on choosing the right tools for the job, rather than preferring certain tools over others or a linear approach to regulation.
- Self-regulatory regimes that have been used in Australia have proved ineffectual and in fact have often led to market distortions. Therefore these approaches are not recommended. Models such as that provided by the SER in the Netherlands offer co-regulatory regimes that may be more effective.
- There has been some support for a principles-based approach to regulation in Australia. However, this approach poses various risks and challenges that would need to be explored in detail first.

This section discusses the range of responses to address the consumer policy issues that are raised throughout this submission.

Broadly speaking, we accept that a balanced approach is needed to protect the interests of vulnerable and disadvantaged consumers at the same time as promoting overall market efficiency and fair trading. However, while improving the efficiency of the market overall can benefit consumers generally, we need to be aware that there is evidence that some vulnerable and disadvantaged consumers miss out on these benefits. To promote both overall market efficiency and to protect disadvantaged consumers, Consumer Action believes that a range of approaches and responses are needed in the consumer policy framework.

The overall goal, however, should be to find the "right tools for the job". When it falls to policy-makers, legislators and regulators to address a problem, the aim of any action taken, regulation or otherwise, is to target that problem and deal with it. Consumer Action believes that this can best be done with a flexible policy tool kit and a commitment to using the most effective tools in any given situation. It cannot be done if there is an inappropriate focus on a linear approach that always favours some tools above others, regardless of whether they will be effective.

These tools can be grouped into three broad categories:

1. *General responses* that "grow the pie" so that the benefits of improvements in market efficiency can be distributed to all consumers in the marketplace.

2. *Targeted responses* that are designed to specifically protect the needs of vulnerable and disadvantaged consumers.

3. *Industry-specific responses* that address issues within particular industries (note, however, that industry-specific responses may either aim to improve overall

efficiency in that industry's markets or target issues for vulnerable and disadvantaged consumers within a specific industry).

We need to find a balance between generic, targeted and industry-specific approaches through a policy toolkit that meets the multiple aims of consumer policy. These aims include promoting overall market efficiency, ensuring fair trading, protecting vulnerable and disadvantaged consumers, and addressing market distortions within particular industries. A tool kit of responses ensures a flexible framework that can use various approaches to maximise outcomes for Australian consumers.

In the discussion below, we show how different tools can be used for the most effective response to consumer issues. We also show where regulators, within existing regulatory frameworks, can better enforce existing laws and regulations. By identifying the benefits of the three regulatory approaches in particular market situations, and areas in which existing law enforcement can be improved, we offer a broad tool kit of responses that, used together, can improve outcomes for Australian consumers.

The Inquiry's Terms of Reference require the Commission to examine whether there is over-reliance on industry-specific regulation, when issues could be dealt with under general regulation or non-regulatory approaches. It has also been asked to examine how self-regulatory and principles-based approaches could be used more effectively.

It is important for the Commission to examine whether different policy and regulatory tools have been over or under used, as this can help ensure that the best tools for the job are used, rather than simply the tools we are most familiar with. However, we believe these parts of the terms of reference clearly imply that the Commission should report on how self-regulatory and principles-based tools should be *preferred*.

This is an unhelpful approach that would ensure that the more things changed in Australian policy and regulatory implementation, the more they stayed the same. This is because it continues to rely on a linear approach that automatically requires some tools to be used first. A better approach is one that assesses the most useful responses and then chooses the best tools for the job.

In this context it is important to comment specifically on self-regulation as a tool to address consumer issues. It has been suggested that self-regulation avoids the compliance costs associated with more prescriptive regulatory regimes and thus should be preferred over other forms of regulation. However, Consumer Action is not aware of any successful self-regulatory models in consumer markets in Australia.[125]

In our view, self-regulation by industry has been shown to require a regulatory hook, whereby it actually becomes co-regulation, before it demonstrates any effectiveness in addressing problems. One example is membership requirements pursuant to legislation or license conditions that are required by industry regulators to ensure they have the capacity to enforce standards against recalcitrant industry members. A good example is the standards development process. Australian Standards represents an important aspect of industry and broader participant contribution and self-regulation in product definition, performance and safety. Standards are benchmarks in themselves, however, they often rely on supportive legislation for

[125] Successful models such as the Code of Banking Practice are effectively co-regulatory in that they have mechanisms that render them enforceable by consumers and include independent compliance monitoring and review.

strength and enforceability. This can be achieved either through mandatory codes, for instance the Building Code of Australia, or as accepted community standards, for instance in misrepresentation or negligence claims. Thus they might more accurately be classed as part of a co-regulatory system.

Self-regulation is unlikely to be successful because it can actually lead to market distortions, as without monitoring or enforcement some industry members will comply and some will not. In fact, it is usually the industry participants that are already trading reasonably fairly that comply with self-regulatory measures, while the poorer industry players do not. This means that the better suppliers bear higher costs. Graeme Samuel, Chairman of the ACCC, made this point recently at the 2007 National Consumer Congress.[126] Self-regulation may also, by its presence, slow the development of more effective responses. Thus, we do not support self-regulatory measures that lack monitoring and enforcement mechanisms. There is, in our view, no evidence or industry examples to suggest that pure self-regulation offers sufficient benefit and protection to customers to be a credible alternative to government regulation. Similarly, the United Kingdom experience suggests that self-regulation has not always worked in the best interests of consumers.[127]

The Commission should also note that there are some co-regulatory models being developed in Europe that are far more rigorous than the self-regulatory models suggested for use in Australia (which commonly involve only signing up to a code of practice). For example, the Dutch Sociaal-Economisch Raad (SER) (Social and Economic Council) coordinates self-regulatory processes for major consumer contracts that result in agreed changes to consumer contract terms. Under the SER model, the content and structure for self-regulation of a particular industry is the result of agreement by industry and consumer groups, and is underpinned by law, making it more of a co-regulatory model. As the SER explains:

> One of the SER's statutory tasks is to promote desirable trends in business and industry. To achieve this, the SER encourages business and consumer organisations to consult each other about mutually satisfactory general terms and conditions (General Terms and Conditions make up the 'fine print' that applies when consumers purchase goods or services from businesses). This type of self-regulation ideally leads to the establishment of Consumer Complaints Boards made up of members representing both business and consumers.[128]

Consumer Action also notes that there has been some support for a principles-based approach to regulation. In broad terms, "principles-based regulation means moving away from reliance on detailed, prescriptive rules and relying more on high-level, broadly stated rules or principles to set the standards by which regulated forms must conduct business."[129] The benefits of this include flexibility, potential to encourage innovative approaches and an improvement in the conduct of firms "as they focus more on improving substantive compliance and less on box-ticking or on 'creative compliance'".[130]

On the other hand this may not provide enough certainty; could lead to retrospective

[126] See Samuel, G. "A regulator's reflections on future frameworks". Paper presented at the national Consumer Congress, Melbourne, 15 March 2007.
[127] See National Consumer Council. 2003. *Self-regulation: the National Consumer Council's Position*. London: National Consumer Council.
[128] See www.ser.nl.
[129] Black, Julia. 2007. *Principles based Regulation: Risks, Challenges and Opportunities*. Paper presented at the Banco Court, Sydney, 27 March 2007. p.3.
[130] As above, p.1.

decision-making by regulators and could allow firms to maintain minimum levels of conduct. As Professor Julia Black has noted, in relation to the UK Financial Service Authority's recent move to a more 'principles-based' approach to regulation:

> The standard criticism of principles-based regulation is lack of certainty. Principles do not give the industry the comfort of knowing where it stands because the meaning of the Principles is not sufficiently certain. The FSA has recognised that it must be possible to predict, at the time of the action concerned, whether or not it would be a breach of a Principle. There is a distinction, however, between predictability and certainty. Certainty with respect to rules means that there is a shared understanding between those applying the rule as to its meaning and application in particular instances.[131]

Issues of uncertainty are also relevant in the Australian context. For example, in some respects the main consumer protection provisions in the *Trade Practices Act* prohibiting misleading and deceptive conduct and unconscionable conduct are principles-based, with their exact application in different industry contexts being considered on a case-by-case basis. This has meant consumer protection regulators have had to provide guidance on how these principles apply in different industry situations, including the debt collection industry, jewellery industry, motor vehicle industry and toy industry.[132]

In fact, it is often industry groups, not consumers, who call for more specific guidance on what conduct they should and should not engage in under general consumer protection provisions. This means there are various risks and challenges involved with a move to a more principles-based approach to regulation, and these need to be explored in much more detail and on a case-by-case basis before moving down this path. This does not mean that there may not be significant benefits in the right context. Again it is a question of viewing principles-based approaches as one of a range on options to address problems, rather than one that should be preferred over others.

In many instances direct legislative regulation will be necessary. More prescriptive regulation is required, for example, where an industry is unable to show enough commitment to achieving just outcomes for consumers; where an industry services an area of market failure or provides an essential service; or where the consumers of a service are not sufficiently informed or empowered.

---

[131] Black, Julia, as above, p.14.

[132] See for example: ACCC-ASIC, *Debt collection guideline: for collectors and creditors*, October 2005; ACCC, *Guidelines for Advertising and Promotion in the Jewellery Industry - A Guide to the Trade Practices Act*, August 2005; ACCC, *Guidelines for Pricing in the Motor Vehicle Industry*, November 2004; and ACCC, *Country of Origin Guidelines for the Toy Industry*, August 2004.

5.2 Industry-specific and general regulation

Key points

- Industry-specific regulation, appropriately directed, should be seen as a complement of general regulation.
- It has been suggested that reducing reliance on industry-specific regulation will reduce duplication and inconsistency. However, there are examples where industry-specific regulation has been essential for improving market efficiency (with benefits for consumers and business) and improving consistency across jurisdictions within particular markets.
- There are very real needs for industry-specific regulations, and we are able to identify situations in which industry-specific regulations are required. These include markets for essential services; new markets; markets for credence goods; and markets for high risk products.

5.2.1 Introduction

The manner in which the Issues Paper is framed seems to suggest a competition between industry-specific and general regulation. Consumer Action suggests that there is a role for both and they should be seen as complementary. A further theme running through the Issues Paper suggests that industry-specific regulation drives inconsistency and duplication. Whilst this may be the case in some areas, in others, industry-specific regulation can drive down compliance costs and improve certainty.

Debt collection is an example of how general regulations may be unable to address specific industry problems. The laws that apply to debt collection are very broad, and poor practices in debt collection generally fall under the prohibitions on undue harassment and coercion, misleading and deceptive conduct and unconscionable conduct that apply under the *Trade Practices Act, Australian Securities and Investments Commission Act* and state and territory fair trading acts. Consumer complaints and detriment from various debt collection practices led to the ACCC and ASIC to produce a guideline for debt collectors, explaining how the general provisions might apply in debt collection situations. The guideline itself is not enforceable, although it is based on a range of regulatory provisions that could apply to debt collection.

While we continue to believe that a guideline cannot address problems adequately, it has allowed some flexibility. For example, it was recently updated to take into account practices that emerged since the first edition. It has also been used broadly by industry to train and guide staff. There have also been several court decisions under the relevant provisions. Nevertheless, these have not necessarily eliminated the relevant practices in the marketplace.

For example, a recent Supreme Court case that found that a debt collector had engaged in unconscionable conduct should have had a more significant impact on industry practices. However, research by ASIC found that “the effect of *Collection House v Taylor*[133] on collection practices is poorly recognised within the debt

[133] The decision in this case can be viewed at: www.austlii.edu.au/au/cases/vic/VSC/2004/49.html

collection industry."[134] To ensure that legal precedent really changes industry practices the regulator may need to explain what the case means to the industry and be prepared to use enforcement where necessary. The experience with debt collection issues illustrates the problem with broad regulation, where legal precedents are few. Industry and consumers need some guidance – but guidelines are just that. If industry merely needs a small amount of assistance they may be effective, but they will not bring about changes in industry conduct alone.

Industry specific regulation is not always driven by consumers and their representatives. As shown, it is often industry that calls for specific guidance on how a general principal may apply and industry itself may prefer industry-specific regulation. Equally, governments may see virtue in a targeted and visible response to a problem, as this may draw attention to it and provide a warning to industry participants that the conduct is not acceptable.

The Commission should also note that industry-specific regulations can in fact encourage market efficiency, with associated benefits for consumers and businesses. For example, energy-specific consumer protections in Victoria have added to the efficient operation of a competitive market, even though they were originally developed to ensure that consumers have continued access to energy supply, an essential service, and are not disconnected. This is outlined further in Box 4 below.

Box 4

Victorian energy specific consumer protection regulation

In Victoria, energy-specific legislation is largely contained in Codes and Guidelines issued by the Essential Services Commission under energy legislation. The primary regulatory instrument, the Energy Retail Code, provides certainty in providing an essential service, by including terms relating to regular billing cycles, informative statements of account and the mandating of a range of payment options (by person, mail or direct debit). The Energy Retail Code also includes provisions relating to payment difficulties, instalment plans and disconnection. These clauses provide an effective and respectful framework for energy retailers to deal with energy consumers experiencing financial hardship. It would be inappropriate to have such regulation applied broadly in general legislation. It would be inefficient and distort the marketplace, as such requirements are not necessary for luxury goods.

Following full retail contestability in the energy market, the ESC also established the Code of Conduct for Marketing Retail Energy. Importantly, the Marketing Code supplements consumer protections in the general legislation, rather than duplicating them. The treatment of consent under the energy framework provides a useful example.[135] It is acknowledged that some vulnerable members of the community may be unable to provide requisite consent to entering into a market energy contract, particularly in a telephone sales or door-to-door sales context (e.g. the elderly or consumers from non-English speaking backgrounds). While general contract law

[134] See ASIC, "ASIC calls for debt collectors to improve practices on old debts", 22 September 2005, at: http://www.asic.gov.au/asic/asic.nsf/byheadline/0589+ASIC+calls+for+debt+collectors+to+improve+practices+on+old+debts?openDocument.

[135] In Victorian energy regulation, consent is regulated through *Guideline No 10 – Confidentiality and Explicit Informed Consent* of the Marketing Code and the Energy Retail Code.

allows for consent to be implied from particular circumstances, in the context of essential services for which contractual relations have not been historically required, explicit informed consent is required to enter into a market contract, and is integral to the operation of a fair and effective market.

Informed consent consists of five principle components: information disclosure; capacity of the consumer to understand the information; genuine understanding by the consumer; that the transaction be completely voluntary; and that the decision to enter the arrangement/contract is made by the consumer. Explicit consent ensures that the consent is verifiable and auditable (in writing signed by the customer or recorded by electronic communication). Energy-specific marketing regulation explains how the concept of explicit informed consent is implemented. For example, the Marketing Code details the types of information that consumers must receive before entering into a contract. While Victorian fair trading legislation provides, for telephone marketing agreements (and not for door-to-door sales), that the consumer must be informed of ‘all matters relevant to the consent of the purchaser’, energy-specific regulation clearly identifies what those matters are. Further, energy-specific marketing regulation requires that the relevant consent is that of the account-holder, which is not a requirement under general fair trading laws.

In the context of a national energy market, energy-specific marketing regulation will also allow for a harmonised regulatory framework across Australia. This will benefit both industry and consumers. In contrast, there are significant differences in substance and scope between fair trading legislation between different jurisdictions.

It is possible to identify circumstances where industry-specific regulation is appropriate. These include essential services, new markets, credence goods and high risk products. The reasons why industry-specific regulations are required for these areas are outlined below.

5.2.2 Essential services

Consumers require access to essential services to maintain a minimum acceptable standard of living. It is therefore critical that attention is directed to ensuring access is maintained, particularly for vulnerable and disadvantaged consumers. Industry-specific regulation fulfils this role where the market under a general regulatory framework may rationally exclude certain customer types based on cost to serve. Maintaining supply is not simply a question of mandating an obligation to supply, as illustrated by the case study above, it requires detailed attention to many aspects of the consumer/supplier relationship.

To ensure access to these services, it is important that low-income consumers have a range of payment options for essential services such as utilities and basic telecommunications services. However mandating that a number of payment options must be made available in general regulations (such as in fair trading legislation) would be inefficient.

An example of industry-specific regulation being targeted to protect disadvantaged consumers is the financial hardship provisions for energy consumers in Victoria (these are discussed further in section 5.3.1). The Victorian energy market is also subject to industry-specific pricing regulation that has promoted general market outcomes, as described in the box below. These include promoting effective competition as well as ensuring access to an essential service for consumers.

Box 5

Pricing regulation in the Victorian energy industry

In the energy industry, price regulation that was designed to protect consumers actually contributes to market outcomes rather than diminishes them. In Victoria, pricing regulation is currently achieved through the price path negotiated between licensed retailers and the State Government. This negotiated agreement is enforced by energy retailers which have a license condition requiring them to offer consumers living in particular geographic areas (i.e. the energy retailers' host area) the "standing contract" on regulated terms and conditions, including at prices that accord with the negotiated agreement. This is known as the "consumer safety net". Energy retailers are free to offer "market contracts" to all customers at prices above or below those regulated through the price path.

This form of pricing regulation contributes to competition by providing non-host retailers with a "price to beat". The addition of "retail headroom" in the regulated tariff enables host retailers, as well as competitive "second-tier" retailers, to competitively offer products at discount. While the regulated price path should be monitored to ensure it does not allow retailers to over-recover, it also encourages competition. If pricing regulation is removed, there is a real danger that once-effective competition may be diminished, delivering poorer results for consumers. Without pricing regulation consumers will bear the risks associated with price spikes in the volatile wholesale energy market. This may result in inefficient outcomes as consumers are not well placed to manage risks associated with wholesale energy prices. Pricing regulation also addresses particular market failures. Many consumers, who are not targeted for competitive market offers, perhaps because of their location or consumption profile, continue to benefit from pricing regulation, which ensures that they have access to energy services and are not "redlined" from the market.[136]

5.2.3 New markets

Consumers will be unfamiliar with the choices available in new markets and may require extra confidence to enter the marketplace. Consumer protection through industry-specific regulations may therefore be required for effective and efficient competition to occur.

The energy market again provides a relevant example. New technologies are driving market development in this market. Advanced metering technologies that use remote communications, are being implemented as they can cut costs in metering as well as provide more information for demand-based tariffs.

The rollout of advanced meters, however, may significantly shift risk from industry to consumers. For example, if the rollout depends on the deregulation of retail energy tariffs (as some advocate, to encourage time-of-use pricing), risks associated with volatile wholesale energy prices will be borne by consumers. Retailers will try to pass these costs on, to maintain profit margins. This will not necessarily be economically efficient, as industry is better placed to manage such risks, and may be able to keep costs down by taking out hedge contracts. Consumers are unable to do this, and will be forced to deal with price spikes. While advanced metering may help consumers understand and manage their demand for peak power, without concomitant regulatory supervision to ensure they are not unfairly disadvantaged, efficient

[136] See section 5.3.1 for further discussion of "redlining".

outcomes may be thwarted. This is clearly an example where general consumer regulation would be insufficient to protect consumers.

Consumer protection regulation should not stifle technological developments, and regulators should be empowered to ensure regulations keep pace with market developments. Again, this is something which can be achieved through the use of industry-specific regulation.

5.2.4 Credence goods

Credence goods are those goods that have a direct, rather than inverse, relationship between price and demand. Consumers find it very difficult or impossible to assess the utility of these goods. Examples of credence goods are vitamins, education, medical care and car repairs. Because consumers find it difficult to assess these goods by using any method other than price, it is possible that the least expensive products might be avoided in an attempt to avoid goods which consumers' perceive to be of poor quality. Credence goods clearly require specific regulation to regulate the terms under which they are supplied. Since consumers are unable to assess the qualities of credence goods themselves, regulations are required to specify standards that protect consumers. There are many other examples of credence goods that also demonstrate the need for industry-specific regulation, such as standards for professions such as medicine and law.

These principles also apply to goods and services that consumers do not buy very often, and so are unable to build up experience and expertise in such transactions, relying on credence in their decisions. Often these are also higher value transactions, such as a house purchase, a move into a retirement village or aged care, or superannuation or financial investment advice, increasing the possible detriment to the consumer if something goes wrong. While it may be all very well for consumers to learn from their mistakes in non-credence and high-use products, this is unlikely to work in non-credence markets, which means more specific consumer protection may instead be required.

5.2.5 High risk products

The need for industry-specific regulation is also demonstrated by high risk products. Where an industry trades in products that are potentially harmful or dangerous to consumers, there is clearly a need to have specific regulations that reduce these risks. For example, regulations that specify minimum requirements for the quality and safety of food and food-related products for sale in the marketplace are required. Such regulations would need to address issues that are very specific to food and which were not covered adequately under more general regulations. For example, the risk of human contamination with Bovine Spongiform Encephalitis ("mad cow disease") can only be addressed through very specific regulations. Other examples of high-risk products that need industry-specific regulation include those that may affect public health, such as drugs and medicines.

5.2.6 The role of the regulator

There is a difference between industry-specific regulation and an industry-specific regulator. While there is some debate about whether industry specific regulation can ultimately impose onerous and duplicative burdens on business, or whether it effectively protects consumers, Consumer Action suggests there is not enough focus on the role and effectiveness of the regulator. In our view poor outcomes are more likely to occur among industry-specific regulators.

The reasons for this are:

- They do not have the benefit of experience across a range of different industries, and are thus are less likely to be able to draw on this to improve regulation and practices;
- They are more likely to rely on more and more industry-specific regulation, due to a lack of expertise and familiarity with more general provisions;
- They are less efficient as they cannot apply resources and expertise across a range of industry functions; and
- They can become "captured" by the industry they regulate due to ongoing contact and familiarity with the businesses and their personnel.

At a national level, we see this play out in, for example, a comparison between the ACCC and the former Australian Communications Authority, where the former has taken a range of enforcement actions against business, using general provisions and applying them to specific industry circumstances, whereas ACA has engaged in little consumer protection action. At a state level, in Victoria the Business Licensing Authority is responsible for licensing and CAV for enforcement, for several licensed industries. While various improvements can be made to both the schemes and their implementation, in general they are regulated appropriately and consumer protection actions are taken where necessary. This contrasts starkly with the domestic building registration scheme, where the Building Commission takes only a small number of disciplinary actions against builders each year despite widespread problems in the industry. Further, such actions are heard before a panel that comprises mainly industry representatives, and there is very little consumer representation on any of the relevant boards or panels that work with the regulator.

5.3 Targeted responses addressing disadvantage

Key points:

- Modern consumer policy plays a variety of roles and has both an economic and social policy character.
- This raises new challenges for consumer policy in pursuing both social and economic goals with one set of policies, as intervention in markets is not cost-free, and poorly designed intervention can be bad for consumers in the long term.
- This can be particularly problematic when grappling with policy responses to problems that affect the disadvantaged or otherwise vulnerable consumers, particularly as modern consumer markets do not necessarily distribute benefits equally nor equitably.
- Consumer policy has traditionally been one of the principal tools used to address problems affecting low-income, disadvantaged or otherwise vulnerable consumers but some argue this is less efficient than using the "tax and transfer" system to redistribute the benefits of efficient markets.
- There is still an important role for consumer policy in addressing the needs of disadvantaged and vulnerable consumers because:
  1) In many cases, a problem that appears to affect disadvantaged or vulnerable consumers may, in fact, be a market-wide failure;
  2) In-market solutions do not always have to be universal or inefficient.

Consumer policy tools can also be designed to be targeted rather than general; and

3) Despite a net cost to the wider community, a consumer policy may be justified to ensure social justice and because the problem is unlikely to be addressed by the broader tax and social welfare systems. This is particularly so if any theoretical net cost imposed by the policy is only marginal.

The challenges involved in balancing competition and fair trading objectives (discussed in Section 4.1) can be particularly problematic when grappling with policy responses to problems that affect harshly on disadvantaged or otherwise vulnerable consumers.

In discussing some of the significant changes in consumer markets under sections 2.1-2.3 above, we showed how particular market developments may be particularly bad for low-income, disadvantaged or otherwise vulnerable consumers. For example, product bundling can lock some consumers out of the best deals; the increasing use of the internet as an efficient tool to participate effectively in consumer markets may divide the average consumer and consumers without computer and internet access; and some consumers are finding it disproportionately difficult to manage the burden of rising debt levels.

In our modern consumer markets in Australia, shaped by microeconomic reform such as financial deregulation and national competition policy, low-income, disadvantaged and vulnerable consumers generally have been exposed or their problems exacerbated. Our 2005 research report (as Consumer Law Centre Victoria), *Do the Poor Pay More?*,[137] specifically studied the effect of this microeconomic reform in Australia's modern consumer markets on low-income consumers. While the report reflected our belief that microeconomic reform has undoubtedly brought overall benefits for consumers, it also identified that the distribution of these benefits was not equal, nor equitable.

The *Do the Poor Pay More?* study found that low-income consumers tend not to receive a fair share of the benefits of a strong and growing economy with competitive consumer markets. This included banking and other financial services such as credit, telecommunications, energy and water and even essential household goods and services such as household appliances, furniture, motor vehicles, education and health care. It drew on the landmark 1967 US report by David Caplovitz that showed that it was almost inevitable that modern markets would provide more expensive, and often exploitative, options for the poor, given that they require access to goods and services like everyone else, yet cannot afford to pay for them and cannot access mainstream credit to fund purchases due to being perceived as a poor credit risk.[138]

In Australia, we see this play out in a range of consumer markets and a variety of forms. The Reserve Bank of Australia has provided a neat summary of how this occurred after the deregulation of Australia's banking market:

> One question that has been of interest over recent years is whether the increase in [banking] fees has offset the benefits to bank customers from the reductions in banks' interest margins that have occurred over the past decade. The Reserve

[137] Stewart, A. (ed.). 2005. *Do the Poor Pay More? – A research report*. Melbourne: Consumer Law Centre Victoria.

[138] Caplovitz, D. 1967. *The Poor Pay More: Consumer Practices of Low Income Families*. New York: Free Press.

> Bank's analysis of this in past years has concluded that the increase in fees has offset only a small part of the effect of the reduction in margins. The latest data do not change this conclusion…As noted earlier, bank customers have not been affected uniformly by these trends in fees and interest margins. Arguably, those who have benefited most are those with a loan secured by a residential mortgage, who use electronic payments channels and who avoid late payment and other similar charges. Such customers have benefited from lower interest rate margins and can avoid many of the banking fees introduced over the past decade. In contrast, those customers without a loan, who have low balances and have a high volume of transactions would not have benefited from the fall in interest margins and would be paying higher fees.[139]

This trend was confirmed in subsequent Reserve Bank of Australia bulletins, including this statement in its May 2005 bulletin:

> In previous years' analysis of the bank fees survey, it was shown that, in aggregate, the increase in bank fees since the mid 1990s had not offset the benefit that banks' customers had received from the reduction in banks' interest margins. It was also noted that not all customers have necessarily benefited from declines in interest margins on loans. For example, customers with only deposit accounts have faced a significant rise in fees over this period without any offsetting benefits in the form of lower interest margins. The results from the 2004 survey do not change these conclusions.[140]

It is typically low-income and disadvantaged consumers who do not obtain home loans, have less access to the internet to use electronic banking channels, and are more likely to maintain low bank balances with deposits roughly matching withdrawals, leaving them at greater risk of penalty fees for dishonoured payments or overdrawn accounts. They are the consumers who are losing out in the scenario described by the Reserve Bank of Australia.

This does not mean the market is not operating efficiently; in fact it is operating as it would be expected to. The Commission would no doubt be aware of how this occurred, but to clarify it, a summary is provided in Box 6 below.

Box 6

Why low-income and disadvantaged consumers are the losers in banking sector deregulation

Consumers have benefited from a more competitive banking sector, with competition in lending substantially reducing inefficiently high interest-rate margins.

However, this has reduced the revenue available to the banks to subsidise the costs of servicing low-value customers. Given that hidden and inefficient subsidisation is no longer viable due to this competition in lending, more and higher up-front fees have been implemented for banking products and services to consumers.

There is still a net benefit for consumers as a whole, as banking fees remain lower than the savings realised from declining interest rate margins. However, consumers who access only basic banking services are at a big disadvantage as they pay higher fees but do not have access to lending.

Further, as competition leads financial institutions to compete for profitable

[139] Reserve Bank of Australia. 'Banking Fees in Australia', *Reserve Bank of Australia Bulletin*, April 2003, pp.4-6.
[140] Reserve Bank of Australia. 'Banking Fees in Australia', *Reserve Bank of Australia Bulletin*, May 2005, p.69.

customers, they offer incentives to attract such customers including fee waivers on banking services. The cost of servicing such customers remains, but is subsidised elsewhere, including from the fees charged to less profitable customers.

In this way, the banking market has shifted dramatically from cross-subsidisation of low-income consumers by wealthier consumers, to reverse cross-subsidisation, in which wealthier customers are offered cheaper servicing while low-income consumers pay more for their basic products.

When such practices occur consciously and deliberately, they have been referred to as “redlining”. The term “redlining” comes from the practice of literally marking out on a map the areas in which disadvantaged communities live and which are considered too risky or unprofitable to service. This was common practice by both government agencies and businesses in the US from the 1930s, and still occurs to some degree.

While such overt redlining has, to our knowledge, been less common in Australia, the natural tendency of our deregulated consumer markets has undoubtedly has excluded low-income and disadvantaged consumers or communities from the benefits of competitive markets. It is entirely rational that business will seek out the most attractive customers and avoid the less profitable, or only service them at a higher price to recover the higher cost of doing so, but the result is that disadvantaged consumers are excluded from accessing the benefits of competition (such as lower prices).

For example, in the privatised and deregulated Victorian energy retail market, profitability often depends upon a particular household’s consumption patterns. This is because higher retail margins can be made where consumption is high. Households with low electricity loads (who perhaps use cheaper gas for space and water heating) are seen as relatively “low-margin” consumers.[141] Research of consumption patterns also suggests that low-income consumers generally consume less energy than high income consumers.[142] This means that the market necessarily tends towards higher prices for consumers who have low incomes and low consumption.

In the financial services market, payday lending – small amount, short-term lending at a high cost – is another clear example of this phenomenon. Much has been written on this topic; however, in essence, low-income and disadvantaged consumers are excluded from the mainstream market for consumer credit due to their inability to repay higher amount, and thus more profitable, higher margin loans, together with their (perceived or actual) higher risk of default. Consumers in this situation seeking credit are given two options – don’t take out credit and suffer the consequences (be it defaulting on other debts or expenses, or simply going without) or take out credit on usurious terms. In fact, this scenario is the subject of Caplovitz’s report.[143] It is also elucidated in the most comprehensive report on the topic in an Australia context, our 2002 report (as Consumer Law Centre Victoria), *Payday Lending in Victoria*.[144]

---

[141] Consumer Law Centre Victoria and Centre for the Study of Privatisation & Public Accountability. *Electricity Reform in Victoria: Outcomes for Consumers*. February 2006, p.19, citing, for example, Energy Australia, *Submission on Review of effectiveness of retail competition*, 2004.

[142] For example, see Roy Morgan Research, *Victorian Utility Consumption Survey 2001*, Final report, Department of Human Services, June 2002 at 41.

[143] Caplovitz, as above.

[144] Dean Wilson, *Payday Lending in Victoria – A research report*, Consumer Law Centre Victoria, 2002.

As a fundamental social policy goal, it is generally accepted that we do not want to see entrenched disadvantage such as this in our consumer markets. Consumer Action therefore considers that there is little debate over whether overall policy goals for our community should include the protection of the interests of low-income and disadvantaged consumers from unfair, expensive or exploitative market practices.

The debate occurs over how best to tackle these problems. This is why the Commission, in its Issues Paper, asks relevant questions about how to best to meet the needs of such consumers and whether policies attempting to do so may impose net costs on the wider community.

5.3.1 Consumer policy as a tool to address consumer disadvantage

Consumer policy has traditionally been one of the principal tools used to provide protections and to address problems affecting low-income, disadvantaged or otherwise vulnerable consumers who have been the victims of misleading and deceptive sales practices or exploitative products. The risk in this approach is that universal consumer policy regulation may be imposed to protect the interests of a small group of disadvantaged consumers. These policies may increase costs in the market overall and stifle business innovation without necessarily protecting consumers.

Using consumer policy (for example, consumer protection regulation) to protect disadvantaged or vulnerable consumers' interests might be termed an “in-market” approach to addressing consumer disadvantage. In-market solutions might include limits on price increases for all consumers or a price cap on the total cost of credit, or banning the offering of certain products or services or conduct considered predatory or exploitative, such as door-to-door hawking of credit.

The main alternative to an in-market approach is using consumer policy tools to improve the efficiency of the market, while relying on the “tax and transfer” system to redistribute the benefits of efficient markets in ways considered desirable by the community.

Most people would agree that policy goals should protect the interests of low-income and disadvantaged consumers. However, we consider that one of the most difficult issues that the Commission must grapple with in its inquiry is how far this should go. Should the role of consumer policy be limited to improving market outcomes more generally, while relying on the more general tax and social welfare policies to address consumer disadvantage, instead?

More sophisticated approaches to this question are emerging. In particular, there is increased understanding of three matters:

1. In many cases, an identified market problem that appears to be affecting disadvantaged or vulnerable consumers may, in fact, be a market-wide failure. It was previously assumed to affect only disadvantaged consumers because the detrimental effects are more readily observed in those cases.
2. In-market solutions do not always have to be universal or inefficient. Consumer policy tools can also be designed to be targeted. The use of targeted consumer policies can improve efficiency outcomes for suppliers as well as consumers.

3. Despite the cost to the wider community, consumer policy intervention may be justified on social justice grounds and because it is unlikely that the problem will be addressed by the broader tax and social welfare systems, particularly if any theoretical net cost imposed by the policy is only marginal.

Consumer Action believes that these emerging considerations may greatly help policy-makers formulate consumer policy that addresses concerns about practices affecting disadvantaged and vulnerable consumers, without hindering market efficiency and welfare outcomes more generally.

1. Using disadvantage to identify broader market failures

Elsewhere in this submission we discuss the problems with current regulatory gate-keeping processes, including an incomplete assessment of costs and benefits of regulatory change. As the Commission itself notes in its Issues Paper, some of the challenges in this area include the difficulty of quantifying benefits and costs of government intervention, which may be widely spread or hidden.

Australian regulatory processes are certainly ineffective at assessing the benefits of applying interventions to address problems affecting consumers. For example, the Victorian Competition and Efficiency Commission's *Annual Report 2005-06* noted that the quality of regulation could be improved by quantifying the extent of problems that regulation is addressing and the costs and benefits of solutions.[145] In detailing its work in these areas, it highlighted that quantification of the problem to be addressed in Victorian regulatory impact statements improved in 2005-06, as did cost quantification.[146] However, in contrast, quantification of the benefits of proposed regulation in Victorian regulatory impact statements actually declined in 2005-06. It reported that "improvement in quantifying benefits, however, has not progressed from 2004-05 where 64 per cent of RISs contained some type of quantification."[147]

In measuring the benefits of regulation, the Victorian Competition and Efficiency Commission noted that '[i]t is widely recognised that it can be more difficult to estimate the value of benefits…Some regulatory proposals impose benefits that are not amenable to quantification or that can be difficult to quantify…'[148]

There is a tendency to assume that market problems that affect disadvantaged consumers harshly, are limited to those consumers, because it is difficult to assess their wider impact. However, once a market problem is identified, a more sophisticated approach asks whether further investigation is needed to determine if the problem points to a broader market failure. In a sense, low-income and disadvantaged consumers are often the canary in the coalmine, less able to carry the

[145] Victorian Competition and Efficiency Commission, *Annual Report 2005-06*, September 2006 at 63.
[146] As above, pp.87-90. Regarding problem quantification, it reports: "In 2005-06, 73 per cent of RISs assessed had some quantification of the extent of the problem requiring regulatory action, unchanged from 2004-05. The proportion of RISs that comprehensively quantified and monetised the problems however, increased from none in 2004-05 to 17 per cent in 2005-06." Regarding cost quantification, it reports: "The proportion of RISs that contain some quantification of the predicted costs of the proposal has increased from 88 per cent in 2004-05 to 93 per cent in 2005-06…Further, half the RISs included a comprehensive quantification of direct costs, and 3 per cent included a rigorous quantification of all direct and indirect costs, a significant improvement on last year when only 27 per cent of RISs quantified direct costs and none quantified indirect costs."
[147] As above, p.67.
[148] As above.

burden of consumer detriment and thus the first and/or most obvious group to suffer loss.

Different tools are required to assess broader market failure than those traditionally relied upon. For example, in October 2006, CAV released a paper outlining the results of a consumer detriment survey undertaken in March of that year,[149] discussed in section 4.3.3 above. This was the first research of its kind in Australia, and indicated that consumer detriment in Victoria translates to substantial costs. The report analysed both revealed detriment, that is, problems that consumers were aware of and for which the costs can be measured, and unrevealed detriment – namely harm that a consumer might not even be aware they have suffered, concentring on some limited examples. In explaining the rationale for the survey, the paper states:

> Consumer affairs organisations have traditionally made extensive use of complaints data to trigger investigations and to allocate resources to policy analysis of problem markets. The implied assumption, often, is that complaints are representative of consumer detriment. While this may have been a valid assumption in the past, many things have changed since consumer protection frameworks were set up in Australia in the 1960s and 70s.[150]

Further studies of this type could greatly assist in identifying the extent of consumer harm where disadvantaged consumers are presenting with problems. For example, Consumer Action's legal casework practice sees with many cases where consumers have been extended credit (such as a refinanced home loan or an unsolicited credit card limit increase) when proper assessment would have shown that the consumer did not have the means to service the debt (without recourse to assets held by the consumer) or, at least, not without substantial hardship. Most of our casework in this area tries to help low-income and disadvantaged consumers with these problems, as they tend to default on these debts because they cannot afford the repayments.

However, Consumer Action believes that this sort of lending – where lenders inappropriately extend credit based on an assessment of whether they are able to recover their loan (including via an asset sale or via continual minimum repayments on a credit card), rather than whether the consumer has the capacity to service the debt without financial hardship – does not just affect disadvantaged groups. For instance, a consumer may be managing to support the minimum repayments on their credit card account having spent up to the newly increased limit offered by their lender, even though they are finding this difficult. As long as they are managing, however, it is unlikely that they would seek help (or obtain advice about whether they could challenge the lender's decision to increase the limit). Meanwhile, their increased spending on debt servicing diverts these funds from other uses in the economy, without us ever knowing or recording these facts.

The Commission is aware of the distinction between "disadvantaged" consumers and "vulnerable" consumers. Disadvantage refers to persistent or ongoing characteristics that lead to ongoing susceptibility to harm. Vulnerability refers more to being at risk of being easily harmed.[151] As vulnerability depends on the circumstances that a consumer finds themselves in within a market, including individual and market characteristics, it is possible for a wide range of consumers to become vulnerable

---

[149] Consumer Affairs Victoria, *Consumer Detriment in Victoria: a survey of its nature, costs and implications*, Research Paper No. 10, October 2006.
[150] As above, p.iii.
[151] See, for example, Consumer Affairs Victoria, *Discussion Paper: What do we mean by 'vulnerable' and 'disadvantaged' consumers?*, March 2004.

consumers at any given point.

For example, consumers who cannot afford their loan repayments may enter in refinancing arrangements that ultimately strip equity out of their homes. Despite such transactions being economically irrational, consumers enter into them because of their strong emotional attachment to their home.[152] These consumers are not necessarily disadvantaged; rather they become vulnerable to unfair practices through being in particular circumstances at a particular time. This means that consumer policies targeting problems affecting disadvantaged and vulnerable consumers may in fact benefit most consumers, even if it is not possible to identify these consumers in advance.

The ultimate lesson is that caution should be exercised before consumer policies are dismissed based on a cost-benefit analysis that only takes into account benefits to low-income and disadvantaged consumers. Many market practices that harm low-income, disadvantaged or otherwise vulnerable consumers may, in fact, indicate a wider market-failure. As such, identifying systemic problems that detrimentally affect disadvantaged consumers may enable us to identify areas of market failure more broadly. In these instances, tools aimed at addressing problems for vulnerable and disadvantaged consumers can then be rightfully seen as tools to improve the overall functioning of markets.

2. Making use of targeted consumer policies within markets

The Issues Paper reflects an understanding that consumer policies do not have to be universal, but may be targeted to disadvantaged or vulnerable consumers, although this can sometimes be difficult to achieve. Where market problems truly do affect particular consumer groups rather than reflecting a wider market failure, targeted responses can ensure that these problems are addressed while avoiding unnecessary wider costs. These responses may improve efficiency on the supply side of markets as well as the demand side (see Box 7 below).

Policies can be “targeted” in different ways. The most common targeted policy applies certain rules and regulations only in defined circumstances or only for the benefit of consumers who fall into a defined category. For example, a policy might provide for a price cap, but only if the consumer fits into a defined category of person, such as receiving social welfare payments. However, a targeted approach may also involve one set of general market rules, with targeted programs to ensure certain groups of disadvantaged consumers find it easier to use, and if necessary seek redress, under the same rules that work for consumers generally. A good example of this sort of targeted approach is Consumer Affairs Victoria’s Indigenous Consumers Unit.

One of the reasons why designing and implementing targeted policies has been regarded as problematic is due to conflict between the need for certainty and the need for flexibility. Policies need to be flexible enough not to exclude consumers based on fixed and arbitrary definitions. While certainty is helpful, sometimes government agencies can become obsessed about rigidly defining in advance which consumers should be considered “disadvantaged” in determining whether they are eligible for targeted programs.

---

[152] This is at least partly due to the endowment effect, as discussed in section 3.3.3: see Kahneman, D., Knetsch, J.L. & Thaler, R.H. 1991. “Anomalies: The Endowment Effect, Loss Aversion, and Status Quo Bias”. *Journal of Economic Perspectives*. 5(1): 193–206.

Targeted policies do not need to be difficult to formulate or design, as long as it is understood and accepted that it is not possible to define definitively in advance which consumers should be targeted. This does not mean that such policies will be too broad and impose significant costs on the wider market. Rather they will be flexible enough to address issues of disadvantage *without* imposing inefficient regimes on market operations. This is particularly important given that many consumers are susceptible to being vulnerable in particular circumstances, within particular markets or at particular times. Therefore, policies addressing consumer vulnerability and disadvantage need to be flexible enough to capture the broad range of circumstances that can lead to consumers becoming disadvantaged.

Financial hardship policies in the Victorian energy and water sectors are good examples of targeted policies that help low-income and disadvantaged consumers on the basis of their circumstances and need, rather than fixed traits, while benefiting suppliers and leading to better market outcomes (see Box 7 below). We also note that while financial hardship policies are targeted at consumers with financial difficulties, they are based upon universal consumer protection measures that provide basic consumer protection for all consumers, including the requirement to develop more targeted policies for those who require extra help.

Box 7

Financial hardship policies in the Victorian energy and water markets

Community concerns about the financial hardship of energy consumers led the Victorian Government to establish an Independent Committee of Inquiry (the Committee) into the issue in 2005. Despite Victoria's strong 'consumer safety net' (a standing contract on regulated terms and conditions, including price), providing energy as a market commodity contributed to higher costs and made energy unaffordable for some consumers. The Government, recognising that energy is an essential service integral for health and wellbeing, asked the Committee to provide recommendations about how it should respond to the issue of energy hardship. Following the Committee's recommendation, the Government enacted the *Energy Legislation Amendment (Hardship, Metering and other matters) Act 2006* (Vic) which required energy retailers to establish financial hardship policies.

Under the law, consumers cannot be disconnected if they are participating in a retailer's financial hardship program. Hardship policies must also include certain minimum standards, including flexible options for payment of bills, provisions for auditing of customer's usage, flexible options for replacing energy appliances, and processes for early response to payment difficulties. Hardship policies must be approved by the energy regulator, the Essential Services Commission, which also has a role in monitoring their effectiveness. While some energy retailers had hardship policies before the legislation, many newer entrants did not. Also, voluntary hardship policies without mandated minimum standards in some cases allowed for arbitrariness and inappropriately low standards. The legislation ensured that, in the context of the competitive retail energy market, consumers were not disadvantaged by switching retailers should they experience financial hardship.

The legislation aimed to promote the use of 'best-practice hardship policies'. In the utilities sector, Yarra Valley Water's hardship policy is widely regarded as 'best practice'. Importantly, Yarra Valley Water has identified the 'business case' for having a successful financial hardship policy (in addition to other benefits), pointing to improved cash flow from consistent payment and more effective debtor management through better customer segmentation. Making such benefits more widely known and acknowledged among the industry is difficult, and targeted legislation will encourage industry to develop and improve financial hardship policies.

In a related area, Victorian energy consumers also benefit from targeted protections against inappropriate disconnection from electricity and gas. Following the establishment of full retail contestability in the Victorian energy market, disconnection levels for both electricity and gas increased significantly. This occurred despite the Energy Retail Code supposedly providing robust regulation of disconnection. In response, the Victorian Government amended the *Electricity Industry Act 2000* (Vic) and the *Gas Industry Act 2001* (Vic) to impose a new license condition on retailers, obliging them to make "wrongful disconnection payments" to customers in certain circumstances. This obligation requires a retailer to makes a payment to a disconnected customer if the retailer "wrongly" disconnects the supply of electricity or gas to the premises of a "relevant customer" after failing to comply with the terms and conditions of the contract. The terms and conditions of energy retailer contracts are regulated by the Energy Retail Code, which specifies the circumstances in which the supply of electricity or gas may be disconnected.

The amount of the payment is $250 for each whole day that supply is disconnected (with a pro rata amount payable for any part of a day disconnected) and must be paid as soon as practicable after reconnection of supply, either directly to the customer or by way of a rebate on the customer's bill. "Relevant customers" are customers consuming less than a specified, fairly large, amount of electricity or gas, which includes most domestic customers. The provisions also make clear that the payment does not affect any other rights that customers may have, such as the right to seek compensation for loss suffered as a result of being wrongfully disconnected. This suggests that the payments are intended not only to compensate consumers who have been wrongfully disconnected but are also designed to encourage retailer compliance with their obligations.

This targeted response had a positive effect. The Energy and Water Ombudsman Victoria's disconnection case numbers reduced significantly following the legislation. In the second half of 2005, electricity cases about actual disconnection were down 77 per cent for electricity and 73 per cent for gas, compared to the second half of 2004 (the legislation came into effect on 8 December 2004). Moreover, the targeted legislation seems to have been successful in improving retailer's systems and compliance with the disconnection provisions of the Energy Retail Code.

3. Implementing polices on justified grounds despite marginal cost

We understand that reservations may still exist about using consumer policy responses to address problems affecting disadvantaged consumers, given concerns over imposing a net cost more generally, which is ultimately borne by consumers. Despite these concerns, it is generally recognised that problems facing disadvantaged and vulnerable consumers exist and are undesirable, and that solutions are needed. Rather, reservations about policies addressing address consumer disadvantage tend to be based on the belief that it would more efficient to let the market operate efficiently for the benefit of all, and instead use the tax and social welfare systems to redistribute these benefits to meet social goals.

However, Consumer Action strongly cautions against relying on general welfare policies to deal with consumer policy issues. The reality is that our tax and transfer system is far-removed from individual consumer markets and any problems manifesting within them. The overall tax and transfer system is also expected to deal with a range of social inequalities, not just consumer market failures, and in truth it will never fully deal with all of them. Trying to use this broader system to address individual market issues could also prove a blunt and imperfect tool.

For example, the general tax and social welfare system is not appropriate for dealing with misleading advertising, unfair contract terms or sharp trading practices – issues that harshly affect vulnerable and disadvantaged consumers. In fact, even where the tax and transfer system is used to provide a minimum level of income through unemployment or disability benefits, the people receiving these benefits will still be exposed to the practices identified above where they occur, with poor outcomes for themselves individually and for the general functioning of the market.

By contrast, it will often be easier in practice to identify and implement market-based solutions to problems in a market, even if these problems leverage off the effects of poverty or income disparity. Targeted consumer policy has the potential to address problems where they occur, and without imposing limits on the overall functioning of the economy. Thus, in many cases, while theory might tell us that it is inefficient to favour a consumer policy approach over a tax and transfer approach, the reality is that a consumer policy approach will be more efficient and effective in practice. This does not mean that an in-market or consumer policy specific approach should always be preferred. However, it does mean that consumer policy approaches to addressing consumer disadvantage should not be automatically dismissed based on a theoretical net cost, particularly if that theoretical cost is not significant.

Sometimes market practices need to be addressed in the overall interests of fairness and social justice, regardless of marginal inefficiencies. However, it is easy to lose sight of this if the problem is regarded solely from an economic point of view. The beginnings of consumer policy lie in social justice considerations and this remains a valid ongoing role for consumer policy.

Consumer Action believes that consumer policy may be justified on the grounds of fairness and social justice, despite a theoretical net cost on the wider community. Indeed, the "public benefit test" incorporated into the *Trade Practices Act* recognises this principle. We recently completed a report "Defining the 'public benefit' - Social and Environmental Considerations in Part VII of the *Trade Practices Act 1974*" which discussed these issues. A copy of the report is attached at **Appendix C**.

This point may be illustrated by a striking current example. The Council of Australian Governments has identified tackling the health problems associated with growing rates of diabetes in our community as a priority. In February 2006 COAG adopted a new wave of micro-economic reform, termed the National Reform Agenda. These reforms encompassed three streams – human capital, competition and regulatory reform.[153] At its next meeting, in July 2006, COAG agreed to concentrate on four initial priority areas for human capital reforms, including improving health outcomes in relation to diabetes.[154]

The initial reaction of many Australians to COAG's decision to elevate diabetes to a priority issue might be to support it strongly, based on the serious health impacts of diabetes and its link to other health problems such as obesity and heart disease. However, COAG has made diabetes a priority reform issue because of its economic

[153] Council of Australian Governments, *Council of Australian Governments Meeting – 10 February 2006 – Communiqué*.
[154] Council of Australian Governments, *Council of Australian Governments Meeting – 14 July 2006 – Communiqué*, p.6.

consequences in terms of impact on the nation's productivity, not just because of health or social welfare concerns.

In its motivations for adopting the National Reform Agenda with its human capital reforms, COAG agreed that 'the new national reform agenda should be based on an overarching theme of enhancing productivity and participation, with human capital as a key component'.[155] At its July 2006 meeting, COAG stated:

> COAG reaffirmed its February 2006 commitment to progress the National Reform Agenda, encompassing human capital, competition and regulatory reforms, to help underpin Australia's future prosperity. This is a long-term and integrated agenda across governments and portfolios to increase the nation's productivity and workforce participation. COAG recognised the benefits to the economy and community of concerted actions to progress the three streams of the NRA, and the potential costs of failing to do so.[156]

Consumer Action agrees with COAG that diabetes and other health and human capital concerns have serious economic effects and we do not dispute the priority given to these issues on economic grounds. However, their economic impacts surely do not detract from their importance on health and social equity grounds. It would seem absurd for someone to argue that they should not be addressed on health and social policy grounds, but only if the economic case linking them with productivity growth can be made.

In a similar vein, consumer policy should never be divorced from social policy, even when its economic impacts are taken into account. As the *Do the Poor Pay More?* report asserts, the poor can never be an inconvenience to the greater good.[157]

We submit the matters discussed above underpin and support Principle 3 outlined in Section 4.2.

Recommendation 12:

Incorporate a formal requirement to analyse whether policies are required to address market problems affecting disadvantaged or vulnerable groups into formal policy making and regulatory impact assessment processes.

[155] Council of Australian Governments, *Council of Australian Governments Meeting – 10 February 2006 – Communiqué – Attachment A*, p.1.
[156] As above, p.5.
[157] *Do the Poor Pay More? – A research report,* Anna Stewart (ed), 2005, p.3.

5.4 Enforcement and redress

Key points

- Much greater enforcement of existing law is required.
- In some markets consumers need better access to redress.
- There are examples of enforcement and redress approaches that have had some impact.
- There are several areas where the current enforcement and/or redress arrangements are weak and provide inadequate protection for consumers. These include credit-reporting arrangements; regulations addressing cartel behaviour and telecommunications issues; problems with the Uniform Consumer Credit Code and guidelines for debt collection; the inability of the ACCC to obtain refunds for consumers under the TPA; and regulator ineffectiveness in tackling “difficult cases”.
- A range of responses including legislative amendment, extension of external dispute resolution, re-framing of guidelines and cultural change are required to address these issues.

5.4.1 Introduction

While regulation may be well-designed and targeted, it will not be effective unless compliance is properly monitored and enforced and effective and accessible redress is available for consumers when breaches occur.

This section provides a brief discussion of the strengths and weaknesses of existing law in this regard. While there are some examples where existing frameworks have successfully protected consumers, in many others areas frameworks have been weak and ineffective.

A range of factors contribute to an ineffective framework, including:

- Regulators have insufficient resources or powers to enforce existing laws;
- Regulators have been ineffective in exercising their powers;
- Regulators may lack incentives to pursue enforcement of hard cases, given the higher risks of losing such cases and the inappropriate pressure placed on them by governments, media and the public to achieve only successful outcomes in regulatory actions;
- Regulators may fail to effectively publicise outcomes;
- Consumer-redress mechanisms may be ineffective or inaccessible; and
- Standing to take action to enforce laws may be unnecessarily limited.

While existing law enforcement can be improved generally, weaknesses in enforcement may require legislative amendment. For example, a regulatory scheme with well-designed rules will nevertheless be ineffective in addressing industry or market-wide problems if it can only be enforced by individual consumers taking legal action against individual breaches of the rule (as is the case with the unjust contract regime under the UCCC).

Below we discuss strengths and weakness of current consumer protection arrangements, and discuss some of the options available to strengthen our consumer protection framework.

5.4.2 Some examples of successful approaches

Enforcement of Victorian Unfair Contract Terms Regulation

We strongly support the Victorian unfair contract terms regulation and the enforcement options it provides. A scheme such as this could have provided only private-action rights to consumers to challenge unfair contract terms. However, it provides both individual rights and regulator powers to address unfair terms on a systemic basis. This is a significant measure, given that unfair contract terms relate to increased use of standard-form contracts, which are used industry-wide

CAV has used this regulatory scheme strategically, examining terms in a range of identified “problem” areas as a first step. It has also relied on its powers to support its negotiations with industry participants, rather than simply jumping to legal action. As a result, a range of standard-form contracts have been changed, with the most egregious terms amended, including in the hire car, fitness, mobile phone, pay TV and carpets and curtains industries. CAV has also initiated (successful) legal action against AAPT (with whom negotiations were unsuccessful), which ultimately led to significant changes to AAPT’s mobile phone contracts. Where national suppliers have been involved, consumers outside Victoria have benefited in some cases.

Code of Banking Practice

This has been reasonably successful in changing industry conduct in relation to several issues raised by consumer groups. Sign-up is voluntary, but few banks have not signed up. Attention to the mechanisms to ensure monitoring and enforcement has made this code more effective than other codes, including telecommunications consumer codes, discussed below. The code is enforceable because of a simple provision that makes it a condition of the contracts between signatory banks and their customers. It is properly monitored by a code Monitoring Committee, which receives and examines complaints. Banks are reluctant to accept interpretations of their credit assessment obligations under the code, but there are effective forums where these issues can be debated. The code is also actively interpreted by the industry dispute resolution scheme regarding general individual complaints.

Insurance

Some years ago, insurers routinely denied 10 per cent or so of the quantum of car accident claims on the basis that the claimant was 10 per cent at fault. These amounts were generally too small for a consumer to fight through the courts or tribunals. However, caseworkers saw this practice virtually stop overnight when the Insurance Ombudsman Scheme was established. This is an example of a change in practices that can occur simply by improving access to dispute resolution.

Victorian licensed motor car traders

Victorian motor car traders are licensed by the Business Licensing Authority, where a portion of licensing fees are paid into a fund to compensate consumers who suffer certain types of loss as a result of dealings with a licensed trader. Where a claim is admitted by the fund against a trader, the trader is required to compensate the fund or show cause why their license should not be suspended. If conduct is the subject of a claim, it can also be referred to CAV for investigation. This regime protects consumers and provides redress when certain types of losses occur, and provides information to licensing and enforcement bodies to help maintain standards of industry conduct.

5.4.3 Current arrangements requiring attention

Credit Reporting

Consumer advocates have identified a number of serious shortcomings and problems related to credit reporting. These include complaints handling, enforcement and identification, and addressing of systemic issues. While the legislation is complex, and the regulator's powers could be increased, the general consumer view is that the Federal Privacy Commissioner has not taken a leading role in dealing with these problems. In some cases, the Commissioner has added to the problems.

For example, while expanding the definition of "credit provider" to include a range of businesses such as utilities, very little was done by the regulator to address the related problems – such as listing small defaults, listing defaults while a bill was in dispute, or the wide scale listing of defaults by debt collectors based on unreliable data. The Privacy Commissioner's complaints handling processes have also been criticised by consumer advocates. These relate in particular to processes that often exhaust consumers before a complaint can be made, and the commissioner's use of Section 41(2) of the *Privacy Act 1988* to stop an investigation in some cases where we believe a formal Determination should be made. We have recently been advised that since late 2006, the Federal Privacy Commissioner has begun prioritising complaints in the queue, combining similar complaints and giving priority to complaints that may affect many consumers. While this is commendable, we are surprised that this system was not started years ago.

Consumer Action has waited for 12 months for the OPC to respond to two representative complaints about credit reporting that are thought to affect at least half a million Australians.[158] The two complaints were made on behalf of individuals who had an alleged unpaid Telstra debt listed on their credit information file. Old Telstra debts were sold to debt collection firm Alliance Factoring between 2002 and 2003. Alliance Factoring listed large numbers of these debts with the credit reporting bureau Veda Advantage shortly after buying them from Telstra. Alliance Factoring listed large numbers of false and inaccurate debts on consumers' credit files without properly notifying the consumers or making sure it had proof that the debts were correct.

While a number of concerns about the current system have been raised in the Australian Law Reform Commission's current review of credit reporting regulation, we believe that some of these problems could have been addressed under current regulation by a more responsive and effective regulator.

Recommendation 13:

The Federal Government should initiate a review of the Office of the Privacy Commissioner, examining the culture, operating policies and financial resourcing of the OPC.

[158] See Consumer Action Law Centre, "Appalling delays in handling privacy complaints are no secret", press release issued 17 April 2007.

Cartel behaviour

There is legislation to prohibit the behaviour, and a regulator that is prepared to act in this area. But it is generally agreed that pecuniary penalties do little to deter wrong does due to the significant profits involved. Introducing criminal sanctions should improve this.

Telecommunications

A poorly designed regulatory regime for consumer protection in telecommunications, together with an inactive regulator, has led to continued poor consumer practices by telecommunications companies and to consumer detriment.

The *Telecommunications Act 1997* explicitly establishes a scheme whereby self-regulation by industry bodies is preferred to regulator action. It allows industry bodies to develop voluntary codes, which can then be registered with the regulator, ACMA (previously the Australian Communications Authority). If an industry participant fails to comply with the code, the regulator may direct them to comply. If problems continue to persist in the industry, the regulator can act by mandating an industry standard but only if certain conditions are met.

This process has been an abject failure in achieving any positive change on industry-wide problems such as the widespread use of unfair terms in consumer contracts and failure to establish procedures to deal with customers with genuine payment difficulties. While the industry has developed codes related to both these areas,[159] sign-up to the Codes is not compulsory and many industry players, including major businesses, have not signed up. Even where there is sign-up, the codes remain voluntary with no direct mechanism for enforcement by customers. The industry ADR scheme does apply the codes in handling general consumer complaints, however, this has not led to widespread compliance and monitoring of the codes' effectiveness. In fact, the telecommunications Unfair Contact Terms Code and subsequent improvements to contract terms are generally attributed to the Victorian unfair contract terms regulation. This can be contrasted with the experience of the Code of Banking Practice, discussed above, which has been widely agreed to, is enforceable by consumers and is subject to an independent review process.

Compounding this unhelpful regulatory regime, the regulator has historically been entirely ineffective in monitoring and enforcing consumer protection standards where the option was available. While this may be more difficult than in other industries, it is nevertheless possible for the regulator to act, including by mandating a standard, where necessary. However, we are unaware of any industry standards being mandated, no matter how long a problem has persisted. Poor credit management practices, especially for customers in financial hardship, and manifest failures in complaint handling is an example of this. Given a relatively small number of consumers who access the Telecommunications Industry Ombudsman for redress, the inaction of the regulator has left the industry with little incentive to improve its performance regarding code development, application and compliance.

[159] See Australian Communications Industry Forum (now Communications Alliance), *Industry Code ACIF C541:2006 - Credit Management*, January 2006; and Australian Communications Industry Forum, *Industry Code ACIF C620:2005 - Consumer Contracts*, March 2005.

Recommendation 14:

The Federal Government should initiate a review of the telecommunications consumer protection regime, examining:

- Elimination of the statutory preference for self-regulation under the *Telecommunications Act*;
- the need for mandated financial hardship obligations for telecommunications service providers; and
- Possible means to improve the consumer protection performance of the regulator.

Credit Regulation

While we strongly support consumer credit regulatory protection, the weaknesses in this legislation have been well documented and it has not kept up with changes in the lending industry.

For example, no mention is made of intermediaries or brokers in the legislation. Lenders have also used various loopholes to avoid the UCCC, for example, with business-purpose declarations or wording loans as consumer leases.[160] The development of industry ADR schemes for many financial services, but not for all credit providers, has left those consumers who are most vulnerable, such as those who borrow from finance companies and pay-day lenders, with regulation that lacks teeth and accessible means of redress.

A particular example of UCCC failure relates to repossession provisions. Consumers must receive appropriate notice before repossession, and failure to do so is an offence. However, to our knowledge there have been no prosecutions under the UCCC for this or any other breach. It is not clear whether failure gives the consumers any rights, so the goods are sold, and the company is not prosecuted. This provides little incentive for a lender to comply.

Comparison rates were introduced to provide consumers with a useful tool for comparing the cost of credit products, however in practice this has not been useful to consumers. However, we believe this relates to the implementation of the regulation, rather than the regulation itself. First, industry has generally not helped consumers to understand or use comparison rates. In one example, a bank advertisement showed two balloons – one with the interest rate, and the other with the (slightly higher) comparison rate. The message appeared to suggest that the interest rate was low, compared to another rate (the comparison rate). There was also little, if any, publicity when the comparison rate regime was introduced. We believe that Government assumed that industry would use comparison rates to help consumers understand products, and that it would encourage price competition. However, as we have stated earlier, many industry players benefit from pricing complexity, and some finance brokers in particular are averse to emphasising price when recommending credit products.

---

[160] For examples of other loopholes used by consumer credit providers, see, for example: Carolyn Bond, *How to succeed in business without really complying*, presentation to the Credit, Debt & The Consumer Conference, March 2003, available on the CAV website at www.consumer.vic.gov.au.

Rather than repeal comparison rate regulation in the UCCC because its benefits have been less than expected, the Government should consider how tools such as this can be implemented so that they are useful for consumers and cannot be easily subverted by industry. For example, tighter rules about the use of comparison rates by industry and a targeted education campaign for consumers on how to read them would give this regulation a proper chance to demonstrate its potential.

There are several other possible changes that could improve the operation of consumer credit regulation. First, loopholes are allowed and enforcement is irregular partly because consumer credit is a national market but is regulated by individual states and territories (albeit under a (largely) uniform scheme). Consumer Action therefore supports national legislation for consumer credit. This would allow for more efficient and timely action to address concerns with the regulatory framework as they arose. This would particularly benefit low-income and disadvantaged consumers who tend to be most affected by credit providers who engage in sharp practices.[161]

We also recommend that all consumer credit providers be required to join an industry dispute resolution scheme, as with other financial services providers. This would ensure that all consumers, especially disadvantaged consumers who borrow from fringe credit providers, have access to appropriate complaints-handling processes.

Other credit and debt issues, such as ‘equity stripping’ and pay-day lending, discussed earlier, also occur because of weaknesses in the current regulation and we therefore support changes to address them, especially as they affect disadvantaged consumers harshly (some relevant case studies are in **Appendix A**).

For example, when providing a loan, lenders have a financial incentive to protect their own interests in having a loan repaid. However, this is not the same as ensuring that the consumer will be able to make the regular loan repayments without financial hardship. For example, a lender could protect its interests in other ways, such as by taking security over the consumer’s assets. We see this market dynamic play out in practices such as asset lending and equity stripping.[162]

The UCCC allows a court to reopen a consumer credit contract if it is satisfied it was unjust. In determining whether a contract is unjust, the court may consider:

> Whether at the time the contract, mortgage or guarantee was entered into or changed, the credit provider knew, or could have ascertained by reasonable inquiry of the debtor at the time, that the debtor could not pay in accordance with its terms or not without substantial hardship.[163]

This provision aimed to stop loans being made without ensuring the consumer could repay them. However, this has not worked because it is not an up-front obligation, and it relies on the consumer to take individual action in a court or tribunal. Regulators cannot enforce this obligation, which means it cannot be tackled as an industry-wide problem.

A relatively simple change to the regulation should provide an up-front obligation on

---

[161] We do think that there could be a continuing role for state and territory regulators under a national scheme, as they could be enabled to take enforcement action in local cases.

[162] See, eg, the case of *Permanent Mortgages Pty Ltd v Michael Robert Cook and Karen Cook* [2006] NSWSC 1104 (24 October 2006), in which asset lending was described as: ‘to lend money without regard to the ability of the borrower to repay by instalment under the contract, in the knowledge that adequate security is available in the event of default’.

[163] *Consumer Credit Code* section 70(2)(l).

lenders to ensure that a consumer has capacity to repay a loan without substantial hardship. This would ensure that the protection was unambiguous and would allow regulators to act on systemic problems. This would not need to be prescriptive about how lenders should determine a consumer's capacity to repay a loan. We believe the obligation alone could greatly improve protection, as the market would develop appropriate standards in making these assessments and lenders that did not meet such standards would be pressured to improve due to comparisons with competitors.

Demand for pay-day lending and other high-cost, short-term lending is created by poverty and disadvantage,[164] and is a predictable development in modern consumer markets as discussed in section 5.3.1. This does not mean that this is desirable. The harm in these loan products is their high costs. Funds used for debt servicing under these loans are diverted from other purposes and they entrench consumer disadvantage, trapping consumers in a high-cost debt cycle. For example, the *Payday Lending in Victoria* report found that 65% of payday loan customers had taken out more than one payday loan, with on average six repeat loans taken out by consumers over 12-months. Many of the consumers surveyed used them continuously, with 37% of consumers having used five or more loans within the previous 12 months. Within this group, a sub-group of consumers were in a cycle of back-to-back loans, with 15% of consumers having taken out 10 or more loans in the previous 12 months.[165]

These market problems are both a phenomenon in the lending market and the result of broader poverty and disadvantage. However, we submit that alleviating poverty (which would probably address these market problems) is unlikely in the foreseeable future. Thus, relying on the general tax and social welfare system to address the fringe-lending problem would, we believe, be disingenuous or perhaps negligent at best, and recklessly indifferent to substantial and harsh injustice at worst.

The UCCC has been amended and some jurisdictions have amended their specific consumer credit legislation, to try to address this problem, recognising the need for in-market solutions. However, the pay-day and fringe-lending market continues to grow. This is largely because none of the regulation tackles the central issue – high cost – effectively. Several jurisdictions have capped the interest rate that lenders can charge on consumer credit,[166] but with no cap on fees and charges this simply allowed for another loophole. Fringe lenders simply increased fees on their loan products to compensate. **Case study 10 in Appendix A** contains some examples demonstrating the high fees on some of these loan products.

Until the *total* cost of consumer credit that can be extended to consumers is regulated, Consumer Action does not believe that this problem can be addressed. We note that NSW recently amended its consumer credit legislation so that fees and charges must be included in its 48% interest rate cap.[167] This type of provision is

[164] For example, the *Payday Lending in Victoria* report found that 79% of payday loans were used to maintain existing living standards and compensate for shortfalls in income: 32% to cover bills; a further 26% to cover day-to-day living expenses; 10% to pay for car repairs or registration; 7% to pay rent or mortgage; and 4% to repay existing debts: Dean Wilson, *Payday Lending in Victoria – A research report*, Consumer Law Centre Victoria, 2002 at 66-67.
[165] Dean Wilson, *Payday Lending in Victoria – A research report*, Consumer Law Centre Victoria, 2002, p.65.
[166] In Victoria, 48% for unsecured loans and 30% for secured loans; In NSW and the ACT, 48% on all loans; Qld, SA and WA can prescribe a maximum annual percentage rate but have not done so.
[167] *Consumer Credit (New South Wales) Special Provisions Regulation 2002* regs 7-8.

ultimately the only type that will be effective. For example, ANZ Bank, in its submission to the Report of the Victorian Consumer Credit Review, stated:

> A more appropriate legislative response to the immediate issue of predatory pricing of short term credit may be an effective interest rate cap, similar to the legislative 48% p.a. cap introduced in New South Wales, which factors in both interest charges and fees and which would therefore close the loopholes in the Victorian interest rate cap currently being exploited by some 'fringe' lenders. Such a cap would regulate clearly egregious lending practices, providing a legislative 'safety net' while the short term small amount credit market is developing. This is the more appropriate role for regulation.[168]

The argument generally raised against such a cap is that it would shut down fringe-lending businesses altogether. While we are not convinced that this would occur, we do not think this would be a bad result, given the substantial harm it causes to individual consumers and the fact that it diverts funds from more efficient uses in our economy. There are also helpful and more positive measures that could be used to help consumers in financial hardship, including financial hardship policies by essential service suppliers, and expanding affordable finance and housing initiatives. These sorts of measures do not impose the same inefficient and usurious high costs on consumers as fringe-lending products, simply to allow consumers to meet ordinary expenses (which is what generally generates demand for payday and fringe lending products).[169]

Ultimately, we believe that regulating the high cost of pay-day and fringe lending is the only acceptable path in social justice terms, even if there were proved to be a marginal cost to the lending market overall in doing so.

Importantly, any protections against high-cost credit, and other protections under general consumer credit regulation must also include empowering regulators to enforce them both in an individual case and industry-wide. Now, consumers can individually challenge establishment, early termination and prepayment fees as unconscionably high under the UCCC, but this protection has not addressed the problem because consumers in this market – the low-income and disadvantaged – are unlikely to complain, and even if they do (and win) it is only an individual decision and does not apply more broadly.[170]

---

[168] ANZ, *The Report of the Consumer Credit Review - ANZ Submission*, May 2006, pp.26.
[169] See above, n 164.
[170] The Victorian Government recently supported changes to give its regulator the power to take action in consumer credit matters where currently only individuals have rights of action: Consumer Affairs Victoria, *Government Response to the Report of the Consumer Credit Review,* 2006, options 14.2 and 14.3.

Recommendation 15:

Urgently amend consumer credit regulation in the following ways:

- Fast-track current MCCA proposals to amend the UCCC to close loopholes relating to fringe lending and to regulate finance and mortgage brokers;
- State governments should refer their powers to regulate consumer credit to the Commonwealth so that it may be nationally regulated;
- Provide that intermediaries are the agents of the lender where they are paid by the lender;
- Tighten the rules around the use of comparison rates and undertake a targeted education campaign for consumers on using them;
- Require all consumer credit providers to join an approved ADR scheme;
- Provide for an up-front obligation on lenders to ensure a consumer has the capacity to repay a loan without substantial hardship before extending credit;
- Mandate financial hardship obligations on consumer credit providers;
- Cap the total cost of credit, including interest, fees and charges as has been done in NSW; and
- Empower Federal and State regulators to enforce consumer protections.

Refunds

There are significant shortcomings in the ACCC's ability to help consumers affected by conduct that breaches the TPA to obtain redress – especially in the case of refunds.

Refunds may be appropriate in cases involving a large number of consumers with relatively small individual losses. For example, in 2003, the Federal Court declared that a range of claims made by Danoz Direct Pty Ltd about the benefits of its "Abtronic Fitness System" were deceptive or misleading. The company itself also admitted that some claims in its Abtronic advertising were misleading or deceptive and in breach of the Act. Despite this and the court's finding, the court held it did not have the power to order Danoz Direct to provide consumer refunds, as it did not have the power under the TPA to order compensation in favour of non-parties to the ACCC's legal action. While Danoz Direct told the court that it would withdraw the Abtronic from sale; would not sell the Abtronic in the future; that all existing stock of the Abtronic would be destroyed; and that it would not in the future sell a similar electronic muscle stimulation device, it was not required to refund affected consumers. Taking action on behalf of this many consumers just once is fraught with prohibitive logistical and administrative problems, let alone taking such action regularly. This one instance not only leaves the affected consumers without effective redress, it places profits from the 15.5 million in sales in the hands of the admitted wrongdoer.

Urgent amendments to the TPA are needed to address the ACCC's (and ASIC's) ability to obtain refunds on behalf of consumers.

> ***Recommendation 16:***
>
> Amend the TPA and *Australian Securities and Investments Commission Act* as a matter of urgency to allow the regulators to seek orders for the compensation of consumers.

'Difficult' cases

Taking on "difficult cases" helps establish the boundaries and applications of the law. It also sends a message to businesses that they should comply with the spirit of the law – avoiding blatant breaches is not enough. There is little doubt that media and government messages affect regulators' willingness to take on these "difficult cases". For example, during his speech at the opening of ASIC's Melbourne office on 23 April 2001, Parliamentary Secretary to the Treasurer, the Hon Chris Pearce, noted that "Last financial year alone — ASIC prosecuted over 350 companies or company officers for over 900 contraventions of the Corporations Act. During the same period, ASIC had a 94 per cent success rate in litigation — a remarkable record."[171] Consider also the recent media frenzy following the ACCC's loss in the Geelong Petrol case. Regulators should strive for success, and failure due to poor or inadequate preparation should be examined. However it must also be accepted that cases that seek to find the boundaries are more likely to fail. Nevertheless, well defined boundaries are critical to the success of our regulatory system. Therefore the signals sent to regulators in selecting enforcement cases must be carefully examined.

Other 'difficult' cases are those where jurisdiction may be unclear or strong action to prevent detriment may be required.

The recent collapse of the ACR property investment scheme illustrates the need for regulators to act with greater resolve (and the consequences of failing to do so). In this case, ASIC focussed on improving disclosure in the prospectuses issues by ACR, which included information about the nature of the investment and the risks involved.[172] However, ASIC's approach seems to have had little effect on the decisions made by investors, who appear to have been far more heavily swayed by ACR's advertising (this was discussed in Section 2.2 above). ASIC has since indicated that it would use a market research company to profile retail investors and develop targeted consumer education programs.[173]

Clearly regulators need to take a more active role in investigating high-risk property investment schemes. The newly appointed AISC chairman, Tony D'Aloisio, has acknowledged that the regulator needs to investigate these schemes. He told a Senate estimates hearing on 30 May 2007 that "with the benefit of hindsight … maybe we have got to do more and accept we haven't done enough in the past in these areas".[174]

We note that ASIC will set up a team to examine risks for retail investors and retirees (the main group of consumers that property schemes target) to develop strategies.

---

[171] See transcript at www.treasurer.gov.au/cjp/content/speeches/2007/007.asp.

[172] See: D'Aloiso, T. *Statement on Australian Capital Reserve*. Australian Securities & Investments Commission, 30 May 2007.

[173] Drummond, M. "ASIC profilers target retail investors". *Australian Financial Review*. 8 June 2007.

[174] Khadem, N., "ASIC chief vows to look at schemes". *The Age*, 31 May 2007.

These include providing advice and investor education, such as the importance of diversifying risk and understanding risk; better disclosure that is simple and easily understood by retail investors, especially in regards to prospectuses; blitzes on advertising complex products targeted at retail investors; and early detection and elimination of illegal operators.[175] However, these proposals largely place the onus on investors rather than addressing the conduct of these companies and the failure of regulators to intervene to protect small investors' funds.

5.4.4 Additional tools required

Civil pecuniary penalties

The principal pieces of consumer protection legislation should be amended to include the ability to seek civil pecuniary penalties in consumer cases. Now, penalties can only be obtained via criminal proceedings, which limits regulators' ability to seek redress. See the SCOCA Discussion Paper on Civil Pecuniary Penalties for discussion on this and related issues.

In short, while it is important to have access to the criminal justice system, particularly for individual cases, access to civil pecuniary penalties would allow enforcement agencies to seek a disgorgement of profits made through unlawful conduct. It is not suggested that pecuniary penalties should replace criminal prosecutions, as these will still be necessary, especially in cases where consumers have suffered significant losses. Rather, civil penalties would strengthen the current regime by providing another, flexible avenue for redress that would give much-needed extra protection for consumers.

Recommendation 17:

Amend the TPA and *Australian Securities and Investments Commission Act* to provide for civil pecuniary penalties.

General consumer compensation

The principal pieces of consumer protection legislation should be amended to allow regulators to seek compensation for consumers generally by way of cy pres settlements. These are a sensible addition to existing powers relating to community service orders.[176]

When consumers have lost as a result of market conduct, regulators cannot necessarily secure refunds for them, even if the court agrees that the relevant business acted in breach of the law. Even with effective powers to seek refunds, consumers who have suffered loss may be difficult to identify in some case, or the losses to each individual may be too small to justify the administrative cost in delivering the refund. It is nevertheless undesirable that the wrongdoers should profit from its misconduct or that there should be a loss to consumer welfare in these circumstances. Rectifying this obvious flaw in the regulatory scheme is relatively simple.

Cy pres is a legal doctrine meaning "as near as possible" and in effect it enables compensation to be aggregated and refunded to a cause that relates to the needs of

---

[175] Khadem, as above.
[176] See for example TPA Section 86C.

the affected consumers generally. In this way, compensation is achieved without requiring inefficient processes to identify and refund every affected consumer.

We have direct experience of this mechanism being used in Australia. In the late 1980s, the Consumer Credit Legal Service in Victoria objected to the licensing of a large finance company on the ground that the company was engaging in dishonest and unfair selling practices in relation to consumer credit insurance. The circumstances of the case made it impossible to identify (for the purpose of compensation) every single consumer who may have been wronged by the finance company. The solution was to compensate consumers at large under the doctrine of cy pres. The cy pres solution resulted in the finance company paying $2.25 million into a fund to establish a centre that would advocate for, and work in the interests of, Victorian consumers. Accordingly, the Consumer Law Centre Victoria (CLCV), was established in 1992. The CLCV (which merged with CCLS to form Consumer Action in 2006) became a highly respected and influential voice in the consumer policy arena, both at a governmental level, and throughout the community generally. In 2001 it started a successful consumer litigation practice to further help it seek redress for disadvantaged consumers. This clearly demonstrates the benefits of being able to seek compensation for consumers under a cy pres mechanism.

Some businesses already use this mechanism voluntarily. For example, the National Australia Bank recently identified that it had mischarged a large number of customers for foreign currency conversion. However, in many cases the refunds due to consumers were small, often less than $2. As a result, the bank wrote to affected customers to inform them of the error and suggested that for those customers entitled to a refund of less that $2, that it instead donated the refunds to a cancer research charity. This is a responsible approach that ensured the business did not retain consumer refunds. They were applied efficiently and effectively rather than paying more to give the refunds than the refunds themselves were worth. Unfortunately, cy pres measures are only used in isolated voluntary cases. This means that businesses engaging in good practice effect cy pres refunds, while businesses engaging in wrongful conduct are not required to do so.

Recommendation 18:

Amend the TPA and *Australian Securities and Investments Commission Act* to allow the regulators to seek orders for cy pres compensation by wrongdoers and for disgorgement of profits obtained as a result of wrongful conduct.

Tackling unfairness

As we noted in section 3, Australia’s consumer policy framework has fallen behind international best practice and does not adequately deal with the increasingly complex issues that are faced by consumers today. We recommend updating our general consumer policy framework in line with international best practice, by introducing:

1) National unfair contract terms laws, based on the European, UK and Victorian models.

2) A general obligation not to trade unfairly, based on the European and UK model, and drawing on lessons from the US.

3) Provision for super-complaints to regulators by designated groups, to ensure

accountable regulator action on systemic consumer problems, based on the UK model.

4) Powers for regulators to issue stop-now orders where a supplier breaches consumer protection rules and this breach is causing substantial harm, based on the European and UK model.

5) Powers for regulators to pro-actively investigate the effectiveness of competition in particular markets.

Recommendation 19:

MCCA members, including the Commonwealth, should commit to updating our general consumer policy framework in line with international best practice, by introducing:

5. National unfair contract terms laws, based on the European, UK and Victorian models.
6. A general obligation not to trade unfairly, based on the European and UK model, and drawing on lessons from the US.
7. Provision for super-complaints to regulators by designated groups, to ensure accountable regulator action on systemic consumer problems, based on the UK model.
8. Powers for regulators to issue stop-now orders where a supplier is in breach of consumer protection rules and this breach is causing substantial harm, based on the European and UK model.

Recommendation 20:

Amend the TPA to provide powers for the ACCC to pro-actively investigate the effectiveness of competition in particular markets.

Appendix A: Case studies of consumer issues

Unless otherwise indicated, case studies are of Consumer Action Law Centre clients.

Intermediaries

Case study 1 - Intermediary obtains inappropriate loan for consumers and receives high payments

A recent decision by the Credit Ombudsman Service Ltd (**COSL**) highlights how a broker may secure an inappropriate financial product for a consumer.[177]

The borrowers responded to an advertisement by the broker and applied to refinance their home (their current lender was seeking possession of the home). The borrowers were both unemployed and in receipt of Centrelink income. The broker offered to provide $139,000 to refinance the mortgage, $26,000 for use as the borrowers wished and six months of prepaid interest (that is, no repayments were required for the first six months of the loan).

The borrowers signed the letter of offer, but the terms were later changed by the lender to $110,000 as a first mortgage and $72,750 as a second mortgage. The term of the first mortgage was only 12 months and payments were interest only. Therefore, the borrowers would have to refinance the loan within 12 months. The loans were stated to be for business purposes, despite the fact that the borrowers being in receipt of Centrelink incomes was disclosed to the lender.

The loans were short term, more expensive than was originally presented to the borrowers by the broker, and inappropriate in the borrowers' circumstances. The consumers also claimed that the broker discouraged them from seeking independent legal advice.

Of about $182,000 advanced, $30,000 was paid in fees, including $13,225 commission to the broker.

COSL resolved the matter by requiring the broker to refund its $13,225 fee as well compensating the borrowers for approximately $7,000 in legal and other fees.

Case study 2 - Broker knowledge not relevant to lender

The case of *Neuendorf v Rengay Nominees Pty Ltd*[178] provides a case study of how a lender can avoid liability for procuring an inappropriate loan for a consumer where a broker's involvement in the transaction ensures the lender does not have knowledge of the purpose of the loan.[179]

Mrs Neuendorf, an elderly retired woman, contacted Fishley Financial Services Pty

---

[177] Credit Ombudsman Service Ltd, *Determination 003*, 28 May 2007, see: www.creditombudsman.com.au/5737,01,1-0-Determinations.php.
[178] *Neuendorf v Rengay Nominees Pty Ltd* [2003] VCAT 1732 (3 September 2002).
[179] The UCCC only applies where the credit is provided or intended to be provided wholly or predominantly for personal, domestic or household purposes; s.6(1)(b). Under s.11(2), credit is presumed conclusively not to be provided wholly or predominantly for personal, domestic or household purposes if the debtor declares, before entering into the credit contract, that the credit is to be applied wholly or predominantly for business or investment purposes (or for both purposes).

Ltd (**FFS**) about refinancing a loan secured over her home that she had written with Bailey O'Neill & Associates Pty Ltd (**Bailey O'Neill**), which had in turn been taken out to pay out a previous loan she had used to pay debts incurred by her husband prior to their divorce.

FFS were finance intermediaries and mortgage consultants. Mrs Neuendorf met with Mr Fishley of FFS three or four times over a period of a month. FFS arranged for Mrs Neuendorf to obtain a loan secured by mortgage over her home from Rengay Nominees Pty Ltd (**Rengay**).

In the course of obtaining finance for Mrs Neuendorf, a firm associated with FFS, McDuff Thompson & Associates (**McDuff Thompson**), wrote to Rennick & Gaynor, Solicitors (of which Rengay was a subsidiary) requesting "residential finance". That letter stated that Mrs Neuendorf's current mortgage was with Bailey O'Neill and that she wished to refinance the current loan to effect repairs to her home and to cover costs.

Despite this letter, Mr Rush, a director of Rengay, gave evidence that he drew no conclusion about the purpose of the loan from this letter as he understood (mistakenly, as it later transpired) that Bailey O'Neill only made loans not subject to the Code, that is, not for personal, domestic or household purposes. VCAT accepted this evidence.

Rengay approved the loan application and forwarded the loan offer through McDuff Thompson to be completed by Mrs Neuendorf. One of the conditions of the loan offer was that the loan must be wholly or predominantly for business or investment purposes and not subject to the UCCC, and a statutory declaration to this effect was required.

Mrs Neuendorf had signed the loan offer letter setting out this condition and had also signed a declaration that the loan was wholly or predominantly for business or investment purposes.

During the course of arranging the loan, Mrs Neuendorf was asked to drive with Mr Fishley to the offices of C A Italia & Associates, solicitors, so that she could sign the loan documentation, including the offer letter and declaration. She did not recall being given an explanation before signing any documentation connected with the loan. She thought the declaration was a formality and signed where instructed. The process of signing the declaration and security documentation took about ten minutes.

The loan was used predominantly to pay out the Bailey O'Neill loan and the remainder was used to pay rates on her home property and pay costs incidental to the loan. However, VCAT found that no matter what the knowledge of FFS or Mr Fishley, it was satisfied that Mr Rush and Rengay neither knew nor had any reason to believe that the loan was for other than business or investment purposes.

The UCCC was therefore held not to apply to the loan.

Case study 3 – Intermediaries' involvement adds complexity

Zaparenkov v Perpetual Trustees Ltd & State Securities Pty Ltd.

Our clients, Mr and Mrs Zaparenkov, were in their seventies and had a limited education and very limited knowledge of English. They were retired factory workers and had been in receipt of Centrelink aged pensions since the mid-1990s. Prior to the dealings outlined below, they had very limited experience in financial matters and no plans to start a business. Furthermore, they owned their home (valued at approximately $300,000) outright. They have two adult children (a daughter and son). Their daughter disappeared after living with them for approximately five years (during which the events below took place). Upon her disappearance, she left her two youngest children in our clients' care.

Our clients entered into three loan contracts with Perpetual Trustees Ltd totalling $260,000. All of the loans were secured by our clients' only asset, their home. The case primarily involved issues of unconscionable lending (including over-commitment and asset based lending) by Perpetual Trustees. The case also involved problems associated with business purpose declarations and 'low doc' loans; and issues involving family transmitted debt.

Relevant Parties

The involvement of so many parties, especially intermediaries, made this case complex and difficult for the Zaparenkovs. The following parties were involved:

- Perpetual Trustees Victoria Ltd (ACN 004 027 258) – The Lender and Mortgagee (one document in Perpetual Trustees' discovered documents refers to them as the 'Trustee for the Interstar MBS Program').
- Interstar Securities Australia Pty Ltd (ABN 72 087 271 109) – Referred to as the 'Funds Manager' and the 'Lender's Manager of the Loan' (the Loans are referred to as being 'Interstar Facilities' in the 'Interstar Loan Terms & Conditions Booklet' attached to the Loan Contracts).
- State Securities Pty Ltd (ACN 079 829 495) – Variously described as the 'Broker', the 'Originator', the 'Mortgage Manager' and the 'Account Manager'. Also referred to as both the 'Broker' and the 'Lender' in the Privacy Consent form under the heading 'Authority of Broker Appointment' (They receive commission for 'referred credit business' from Interstar (Australia) Pty Ltd. They also receive an 'Establishment Fee', an 'Application Fee' and a 'Brokerage Fee' (from at least one of the loans) out of the disbursement of the loan.).
- Superior Finance (ABN 171 831 262 35) – Receives a broker fee out of the disbursement of the loan. Also within the file is a 'Letter of Broker Appointment', appointing Superior Finance as broker and ostensibly executed by our clients (our clients' instructions and information provided by other parties left it unclear what the role played by this company was. However, it appears from our clients' instructions that they may not have dealt with this company directly).
- First Title City West – It appears from the documents that this company is an agent of either Perpetual Trustees and/or Interstar. It appears to attend to settlement of the loans on behalf of one or both of these companies and receives a fee for doing so out of the disbursement of the loans.

The Loan Contracts

Between June 2002 and October 2004, our clients entered into three loan contracts with Perpetual Trustees, each of which were secured by our clients' home. Our clients entered into the contracts at the behest of their daughter who is not liable under the loan contracts despite organising the loans and obtaining the entire benefit of them (except for approximately $2,000 used by our clients to erect a gravestone for Mr Zaparenkov's father).

Together, the principal borrowed under the loans totalled $260,000.00. Fees and charges totalled approximately $13,201 and interest was charged at a rate of between approx 7.5% and 8.15% on each of the loans. The monthly repayments were made by our clients by way of direct debit.

A business purposes declaration was executed in relation to each of the loans.

As a result of our clients' entry into the third loan, their total indebtedness exceeded the income they received from Centrelink. Accordingly, they fell into default under the loan contracts and Perpetual Trustees sought to enforce the mortgage by issuing a Writ for possession of our clients' home in the Supreme Court of Victoria.

Circumstances surrounding our clients' entry into the loans

At no stage did our clients deal directly with Perpetual Trustees. Rather, it appears from the documents in this case and the information provided by our clients, Perpetual Trustees and State Securities that the loans were organised through State Securities, one of the intermediaries involved in the transactions. Employees of State Securities also appear to have witnessed at least two of the loans.

a) The first loan

Our client's daughter drove our clients to an office located somewhere in a northern Melbourne suburb and saw a man by the name of 'Tom'. Our clients' daughter did all of the talking with Tom. Our clients instruct that the loan contracts were not explained to them and nor could they read them due to their inability to read English. Our clients also instruct that they advised Tom that they were pensioners and showed him their pension cards to prove this. A copy of Mrs Zaparenkov's pension card was on the discovered file of State Securities.

The loan application refers to the loan purpose as providing a line of credit for the borrower's business.

b) The second and third loans

As with the first loan, the loan contracts were not explained to our clients. On one occasion, our clients signed these documents at home in front of their daughter; on the other occasion, our clients attended an office in the city with their daughter and spoke to a man by the name of 'Dominic'.

The loan application for the second loan refers to the purpose of the loan as being 'investment'. The loan application for the third loan is referred to as being for 'unspecified business and investment use'. Furthermore, this last application refers to our clients earning $35,000 pa each and to having a Mercedes Benz and shares and other assets worth $1,385,000.

c) All three loans

All three loan applications appear to have been forwarded to Perpetual Trustees by State Securities. State Securities advised the Tribunal that their entire file was simply faxed through to Perpetual Trustees.

All of the loan applications refer to our client's occupation as being 'investor/self-employed'. Business Purpose Declarations were unknowingly signed by our clients in relation to each of the loans. However, no checks appear to have been done to see if there was any business in existence, nor to reconcile the contradictory evidence of 'self employed/investors' (the description on their loan application forms) with the fact that our clients were in receipt of Centrelink income only.

Final Outcome

We lodged a Defence on behalf of our clients and subsequently issued proceedings in the Victorian Civil and Administrative against Perpetual Trustees and against State Securities to have the loan contracts re-opened as unjust under the Consumer Credit Code.

The matter was settled at mediation to the satisfaction of our clients and the terms are confidential. However, the involvement of so many parties made the initial running of the case difficult and prolonged the time before court action could be taken and a satisfactory settlement obtained.

Unfair contract terms

Case study 4 – unfair car hire contract term

Ms B, a pensioner, flew interstate on a holiday package deal, which included car hire from a major national car hire company. At the end of her trip interstate, she returned the hire car to the airport. The company did not inspect the car upon it being returned but four weeks later, it claimed that there was damage to the car and debited $370 via direct debit to Ms B's credit card. The damage was to the driver's door and would have been apparent at the time she returned the car, but Ms B claimed that she had not caused any damage to the car.

Ms B sent a letter to the company but its reply was that the matter had been investigated and that under the terms and conditions of the contract, they had the right to automatically deduct an amount from her credit card for the repairs. They stated that there was "nothing more we can do". Ms B paid the amount for the repairs because she could not afford to pursue the matter further.

Case study 5 – unfair education contract term

Ms C enrolled in a fashion school, agreeing to pay $23,900 in monthly instalments over 3 years for an advanced diploma course. After attending the course for the first semester, Ms C was forced to move interstate urgently to care for her parents who were unwell. The contract included a 'declaration' as follows:

> I acknowledge that by signing the [school] Enrolment Agreement I undertake to pay the prescribed fees by the specified dates as set out in the table of fees on pages 25,26 and 27 of the [school] folder, whether I finish the course or not. I understand that no deferrals are possible and that no refunds will be made for any reason whatsoever.

Although the school agreed to allow Ms C to defer her course temporarily and to study by correspondence, it would not allow her to cancel the contract, despite her urgent need to move interstate. The school referred the matter to debt collectors and Ms C was pursued for the outstanding sum of $19,594.70.

Case study 6 – unfair mobile phone contract term

Sam and Susie, a married couple, saw a brochure from a telecommunications company advertising unlimited free five-minute telephone calls between phones on the company's network. Sam and Susie thought this sounded like a good deal - Sam telephoned the company and, on the basis of the offer in the brochure, Sam and Susie agreed to a two-year contract for two phones (one in each name) on a plan that allowed for unlimited free five-minute calls. The company then sent Sam and Susie their new phones, together with several documents including another copy of the same brochure, a welcome letter and a copy of the terms and conditions.

Six months later, someone from the company telephoned Sam and informed him that it would be placing a limit of 300 minutes per month on the free five-minute calls. Sam said he was not happy as he and Susie had switched to the company specifically because of the offer of *unlimited* free five minute calls. Sam asked why they were allowed to change the deal. The company informed Sam that they could do so under the terms and conditions. The company also told Sam that, based on his and Susie's past patterns of usage, it would "only" cost them $130 more per month.

Equity stripping / asset lending

Case study 7 - Equity stripping via refinancing (1)

Mr S is a self-employed masseur who has not earned more than $1,000 per month from his business for the past 4 years. He cares for his ex-wife who has schizophrenia and their young child who is twelve years old.

Mr S was served with a Writ for possession of his house by his mortgagee, an individual who had lent our client money as a result of a solicitor loan through a law firm.

The loan contract the subject of the Writ was entered into in order to refinance a previous loan contract which was also a refinance in itself of a loan that was obtained some four years earlier.

a) The First Loan

Four years ago Mr S had a loan secured by his house with NAB, the balance of which was $39,000. However, he was falling into financial difficulty as he also had some other debts that needed to be paid, and he needed to purchase a motor vehicle. During this time, he received a letter in the post apparently addressed to him from a company called "Mortgage Masters". The letter had words to the effect: "Having money problems? We'll say yes, when the banks say 'no'". Mr S contacted this company and arranged an appointment with them. This company signed our client up to a loan for one year on interest only terms with a non-bank lender, with assurances from the broker that “this year we will just get you a loan for the year because you are in a hurry for the money but next year you will get a loan that you can work with”. For Mr S, this meant a normal principal and interest loan. The total of the credit provided under the first loan was $70,000. $39,000 went to paying out the loan to NAB and the Mr S received approximately $16,000 after fees and charges were deducted. Mr S thought that he could cope with the repayments but soon discovered he was struggling to make the required payments and he ultimately fell into default.

b) The Second Loan

Mr S sought a further refinance through Mortgage Masters to pay out the previous loan. This loan was also for a year and was also interest only. He thought that he only had to pay $2,500 for procuring the loan, but he discovered that he was also charged with fees for going through another broker, being the law firm. He was required to pay the law firm approximately $4,500 in fees. The second loan was through the law firm and the creditor was an individual. The loan was for $90,000.

c) The Third Loan

When the year was up for the second loan, Mr S could not repay the principal and had to obtain a further refinance. He obtained another interest only loan through the law firm, this time for $120,000. All but $6,000 of this loan went towards paying out the second refinance, despite Mr S believing that he would get at least $13,000 out of these loan proceeds. The repayments for the third loan were $900 per month which constitutes most of Mr S’s monthly income. He quickly fell into default.

Mr S lost his house, which was worth approximately $250,000. At the time he originally fell into financial difficulties, the loan amount outstanding against his home was $39,000.

Case study 8 – Equity stripping via refinancing (2)

Permanent Mortgages Pty Ltd v Michael Robert Cook and Karen Cook[180]

In late 2000 the Cooks fell into arrears under their mortgage with the Commonwealth Bank of Australia due to Mr Cook's ill health and lack of employment.

With the assistance of Wizard Home Loans in Campbelltown, the Cooks borrowed $120,000 from a lender to pay out the loan and remedy the arrears. In March 2003, after refinancing twice to prevent repossession of their home with short-term interest-only loans, obtaining a personal loan of $22,000 at high interest to remedy arrears, and having $15,000 of superannuation benefits released through APRA, the Cooks fell into default again.

In order to payout their current mortgage with Liberty Financial and personal loan with Cash King Pty Ltd, they were required to pay $191,166.30 and $38,778.01 respectively. Again the Cooks refinanced. With fees and legal costs, the two mortgages advanced to them by Permanent Mortgages Pty Ltd totalled $245,000.00.

In roughly three years, through high interest loans, brokerage fees, enforcement costs and incapacity of the Cooks to repay these loans, roughly $130,000 in equity and $15,000 in superannuation was siphoned off to non-conforming lenders and brokers.

The Cooks defaulted again and a writ of possession was sought by Permanent Mortgages.

Patten AJ found that the loan was unjust, because, broadly, it is contrary to public policy to engage in asset-based lending, where the asset is the borrower's sole residence and the borrower has demonstrated an inability to protect their own interests.

Case study 9 – Equity stripping via credit card limit increases

Ms W owns a small home in a rural area. She suffers from a number of illnesses which have prevented her from working. She has only ever received a Centrelink pension or a minimal part-time income.

In 1992 she had a credit card with a bank under which the credit limit was $1,100.00. Over the ensuing years, she was sent a number of offers by her bank to increase her credit limit by $1000 or $3000. Experiencing financial hardship and believing her financial position would inevitably change, she accepted a number of the offers to increase her available credit.

By 2006 her credit limit was $21,000. As a Centrelink recipient, earning approximately $1000 per month, she was unable to make the minimum payments on her credit card account of approximately $500 per month. The bank initiated enforcement action against her to recover the debt and she risks losing her home.

[180] *Permanent Mortgages Pty Ltd v Michael Robert Cook and Karen Cook* [2006] NSWSC 1104 (24 October 2006).

High cost, small amount loans

Case study 10 – Small amount loans with excessive fees and charges

Mr L

Mr L is 65 years old. For at least 6 years, and possibly for many years before that, he has suffered from cognitive impairment. It is readily apparent to the ordinary observer. He manifests as unintelligent and naïve. Mr L's sole income is a disability support pension. He does not own any substantial assets.

In 2006, Mr L entered into a contract for a loan of $750. The contract provided for a 'Loan Advance and Administration Fee' of $750, as well as other fees of $105.16, in addition to interest of 45.5% per annum. The Loan Advance and Administration Fee is said to accrue at the date of signing of the contract.

Ms M

Ms M is 28 years old. In 2007, Ms M entered into a loan contract. She borrowed the sum of $3000, and took that money subject to a 'Loan Advance and Administration Fee' of $4618.45, a loan application fee of $30, and interest of 7.0% per annum.

Ms B

Ms B is 35 years old. She was born overseas and has a limited grasp of English. Her sole income is a parenting payment from Centrelink. Her husband receives a disability support pension. She does not own any substantial assets.

In 2007, Ms B entered into a contract for a loan of $1500. There was a 'Loan Advance and Administration Fee' of $2269.70, a loan application fee of $30, and interest of 7.0% per annum.

Ms S

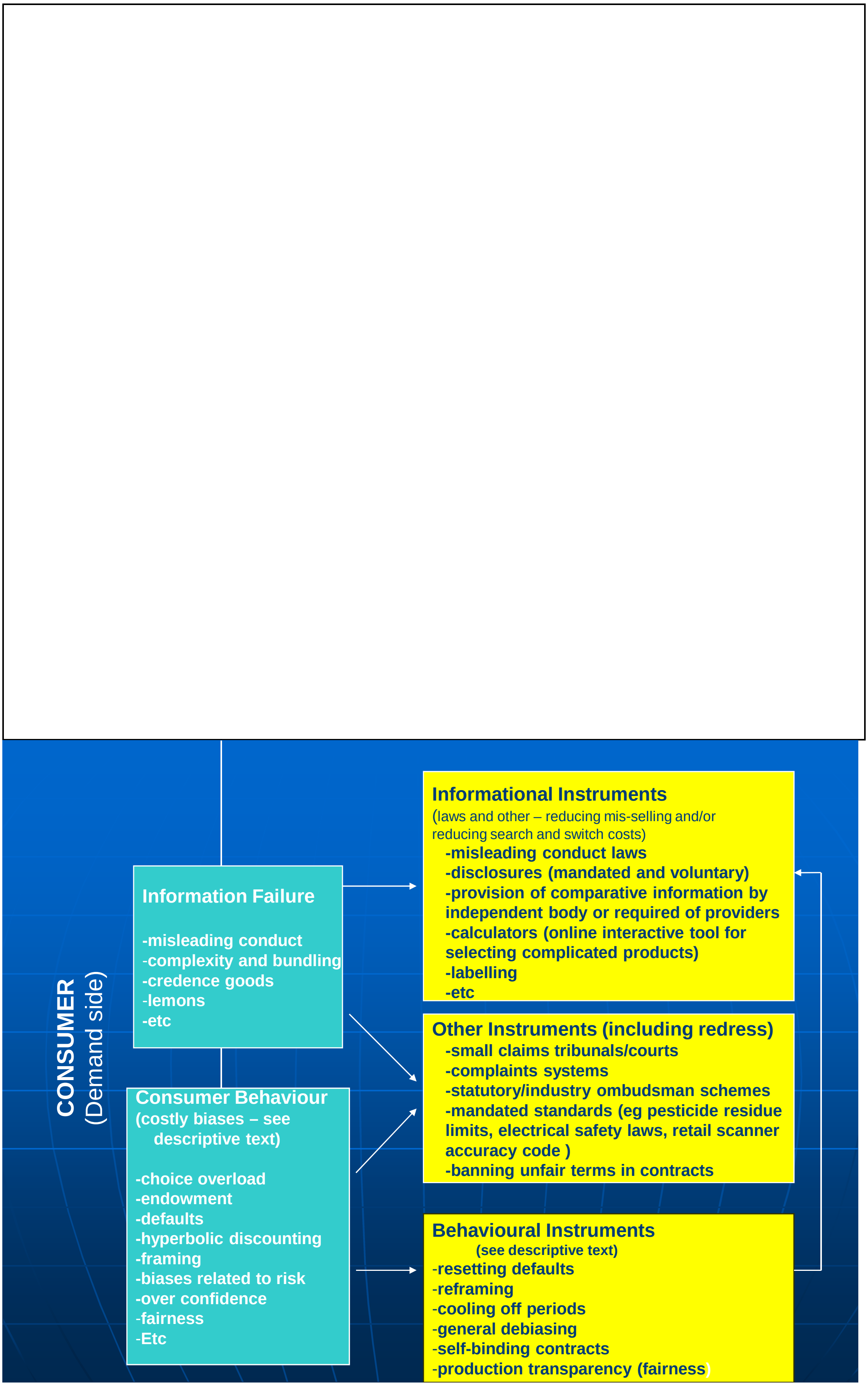
Ms S entered into a Loan Contract at the beginning of 2007.

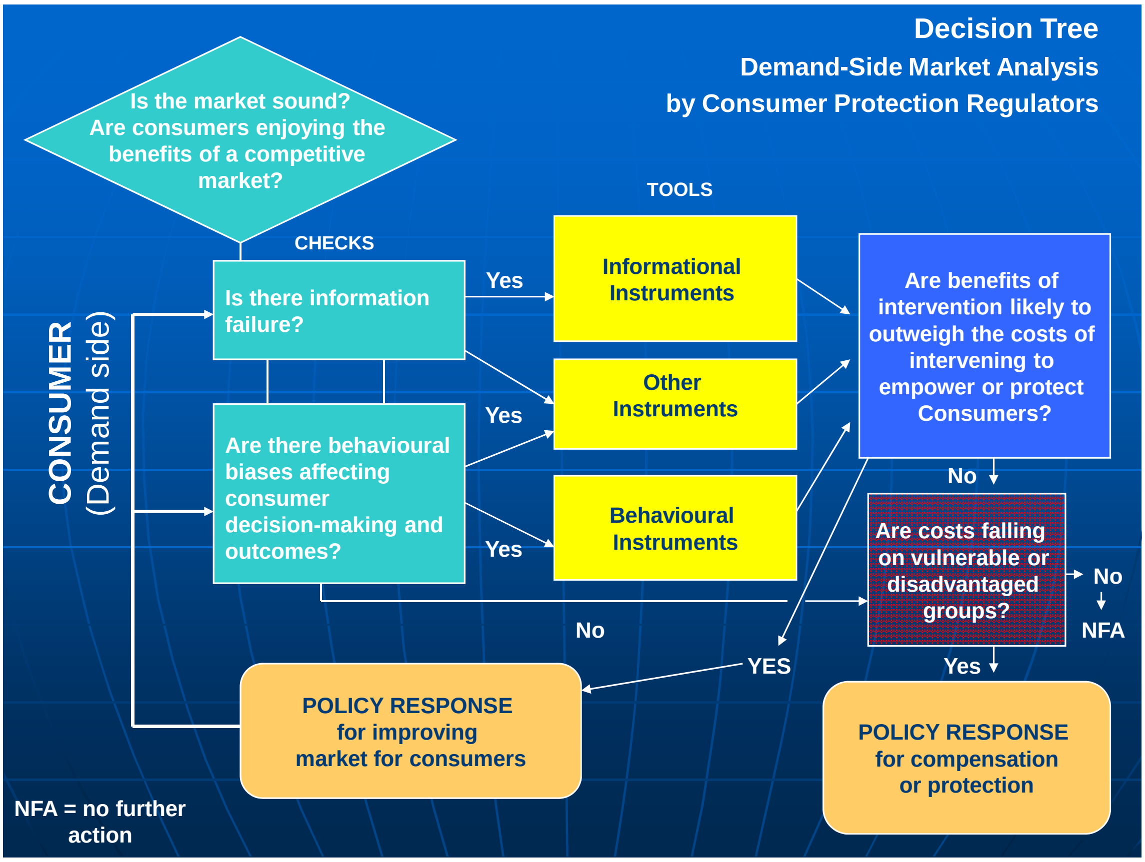
She sought a loan for $2,000 but only got $1,090.97 of this herself. This was because the lender refused to extend her credit unless she paid two outstanding debts that were listed on her credit report. As a result, $909.30 of Ms S's loan went towards paying out two old loans.

One of these debts was paid to Alliance Factoring for an old Telstra debt. This debt was statute-barred at the time the lender made Ms S pay it. It appears that the lender was aware of the fact that it was statute-barred because Telstra was unable to track down the debt on behalf of Ms S, so the lender contacted Alliance Factoring on our client's 'behalf' to find out the details of this debt and how she could pay it.

As well as making Ms S pay the above debts, the lender charged her a $3,000 'Loan advance and Administration fee' and a $30 Application fee together with interest at a rate of 7% (all for Ms S to obtain the benefit of $1,090.97).

Appendix B


CONSUMER
(Demand side)
Information Failure
-misleading conduct
-complexity and bundling
-credence goods
-lemons
-etc
Consumer Behaviour
(costly biases – see descriptive text)
-choice overload
-endowment
-defaults
-hyperbolic discounting
-framing
-biases related to risk
-over confidence
-fairness
-Etc
Informational Instruments
(laws and other – reducing mis-selling and/or reducing search and switch costs)
-misleading conduct laws
-disclosures (mandated and voluntary)
-provision of comparative information by independent body or required of providers
-calculators (online interactive tool for selecting complicated products)
-labelling
-etc
Other Instruments (including redress)
-small claims tribunals/courts
-complaints systems
-statutory/industry ombudsman schemes
-mandated standards (eg pesticide residue limits, electrical safety laws, retail scanner accuracy code)
-banning unfair terms in contracts
Behavioural Instruments
(see descriptive text)
-resetting defaults
-reframing
-cooling off periods
-general debiasing
-self-binding contracts
-production transparency (fairness)



Source: Jenkin, M. & Sylvan. L. *Consumers and Competition: making policies that work together*. Paper presented at the National Consumer Congress, Melbourne, 15 March 2007.

Appendix C

Consumer Action Law Centre

Defining the 'public benefit' - Social and Environmental Considerations in Part VII of the *Trade Practices Act 1974* (Cth)

References

ANZ/Chant Link & Associates. *A report on financial exclusion in Australia*. November 2004.

Australian Bureau of Statistics. *Australian Social Trends 2006*. Canberra: ABS.

Australian Bureau of Statistics. *Household Use of Information Technology, Australia, 2005-06*. Canberra: ABS.

Australian Bureau of Statistics. *Household Wealth and Wealth Distribution, Australia, 2003- 04*. Canberra: ABS.

Australian Bureau of Statistics. *Internet Activity Australia*. September 2006. Canberra: ABS.

Australian Government Inspector-General in Bankruptcy. *2005-2006 Annual Report on the Operation of the Bankruptcy Act*. Canberra: Australian Government.

Australian Prudential Regulation Authority. 2003. *Report on broker originated lending*. Sydney: APRA.

Bakos, Y. & Brynjolfsson, E. 2000. Bundling and Competition on the Internet. *Marketing Science*. 19(1): 63-82. http://portal.acm.org/citation.cfm?id=768983&dl=ACM&coll=portal (accessed 10/5/07).

Black, J. 2007. *Principles Based Regulation: Risks, Challenges and Opportunities*. Paper presented at the Banco Court, Sydney, 27 March 2007.

Cain, D.M., Loewenstein, G. & Moore, D.A. 2005. The Dirt on Coming Clean: Perverse Effects of Disclosing Conflicts of Interest. *Journal of Legal Studies*. 34: 1 - 25.

Camerer, C., Issacharoff, S., Lowenstein, G., O'Donoghue, T. & Rabin M. 2003. Regulation for Conservatives and the Case for "Asymmetric Paternalism". *University of Pennsylvania Law Review*. 151: 1211-1254.

Caplovitz, D. 1967. *The Poor Pay More: Consumer Practices of Low Income Families*. New York: Free Press.

Consumer Affairs Victoria. 2003. *Guidelines for preventing unfair contract terms in consumer contracts*. Melbourne: CAV.

Consumer Affairs Victoria. 2004. *Discussion paper: What do we mean by 'vulnerable' and 'disadvantaged' consumers?* Melbourne: CAV.

Consumer Affairs Victoria. 2006. *Unfair Terms in Consumer Contracts Industry Factsheet*. Melbourne: CAV.

Consumer Affairs Victoria. 2006. *Consumer detriment in Victoria: A survey of its nature, costs and implications*. Research paper number 10. Melbourne: CAV.

Consumer Law Centre Victoria and Centre for the Study of Privatisation & Public

Accountability. 2004. *Electricity Reform in Victoria: Outcomes for Consumers.*

Council of Australian Governments. 2006. *Council of Australian Governments Meeting Communiqués - 10 February 2006 and 14 July 2006*.

Cox, Eva. 2007. Making time and taking our time. *New Matilda*. 30 March 2007.

D'Aloiso, T. *Statement on Australian Capital Reserve*. Australian Securities & Investments Commission, 30 May 2007.

Drummond, M. ASIC profilers target retail investors. *Australian Financial Review*. 8 June 2007.

Energy and Water Ombudsman Victoria. 2005. *Resolution: Bulletin 4*. Melbourne: EWOV.

Financial Services Authority. 2006. *Treating customers fairly – towards fair outcomes for consumers.* London: FSA.

Giulietti, M., Waddams Price, C. & Waterson, M. 2005. Consumer Choice and Competition Policy: A Study of UK Energy Markets. *The Economic Journal*. 115 (506): 949–968.

Insolvency and Trustee Service Australia. 2007. *Provisional Bankruptcy Statistics*. Media release, 11 April 2007. Canberra: ITSA.

Iyengar, S. & Lepper, M.R. 2000. When Choice is Demotivating: Can One Desire Too Much of a Good Thing? *Journal of Personality and Social Psychology*. 79(6): 995-1006.

Jenkin, M. 2007. *What's Hot and What's Not - Consumer Policy on the Global Stage*. Paper presented at the National Consumer Congress, Melbourne, 14 March 2007.

Kahneman, D., Knetsch, J.L. & Thaler, R.H. 1991. "Anomalies: The Endowment Effect, Loss Aversion, and Status Quo Bias." The Journal of Economic Perspectives 5(1):193-206 at 193.

Khaneman, D. 2002. *Maps of bounded rationality: A perspective on intuitive judgement and choice.* Nobel Prize Lecture.

Khadem, N. 2007. "ASIC chief vows to look at schemes". *The Age*, 31 May 2007.

Klemperer, P. 1995. Competition when consumers have switching costs: An overview with applications to industrial organization, macroeconomics, and international trade". R*eview of Economic Studies.* 62: 515–539.

McLaren, J. & Zappala, G. 2002. *The new economy revisited: an initial analysis of the digital divide among financially disadvantaged families.* Sydney: The Smith Family Research and Policy Team.

Moncrief, M. 2005. Bank home loan sector under siege. *The Age*. 19 October 2005.

Muncaster, P. 2007. Low consumer confidence impacting on e-commerce. *IT Week*. www.itweek.co.uk/itweek/news/2184024/low-consumer-confidence (accessed 2 May 2007).

Muris, T. J. 2002. *The Interface of Competition and Consumer Protection*. Paper presented at The Fordham Corporate Law Institute's 29th Annual Conference on International Antitrust Law and Policy, New York, 7 November 2002.

Office of Fair Trading. 2006. *Calculating fair default charges in credit card contracts: A statement of the OFT's position*. London: Office of Fair Trading.

National Consumer Council. 2003. *Self-regulation: the National Consumer Council's Position*. London: NCC.

New Economics Foundation. 2005. *Behavioural economics: seven principles for policy makers*. NEF: London.

New Zealand Ministry for Economic Development. 2006. *Behavioural analysis for policy – new lessons from economics, philosophy, psychology, cognitive science and sociology*. Wellington: MED.

Peterson, G. Aslani, P. & Williams, K.A. 2003. How do Consumers Search for and Appraise Information on Medicines on the Internet? A Qualitative Study Using Focus Groups. *Journal of Medical Internet Research*: 5(4). http://www.jmir.org/2003/4/e33 (accessed 11/5/07).

Productivity Commission. 2004. *Public Enquiry Review of National Competition Policy Reforms - Discussion Draft*. 27 October 2004.

Reserve Bank of Australia. 2003. Banking Fees in Australia. *Reserve Bank of Australia Bulletin.* April 2003.

Reserve Bank of Australia. 2005. Banking Fees in Australia. *Reserve Bank of Australia Bulletin*. May 2005.

Reserve Bank of Australia. *Credit and Charge card Statistics – C01*. Canberra: RBA.

Reserve Bank of Australia. *Debt to disposable income ratio - Household Finances – Selected Ratios - B21*. Canberra: RBA.

Reserve Bank of Australia. *Financial Stability Review - September 2004*. Canberra: RBA.

Reserve Bank of Australia. *Financial Stability Review - March 2007*. Canberra: RBA.

Rich, Nicole. 2004. *Unfair fees: A report into penalty fees charged by Australian banks*. Melbourne: Consumer Law Centre Victoria.

Standing Committee of Officials of Consumer Affairs Unfair Contract Terms Working Party. 2004. *Unfair Contract Terms*.

Stewart, A. (ed.). 2005. *Do the Poor Pay More? - A research report*. Melbourne: Consumer Law Centre Victoria.

Sylvan, Louise. 2006. *The Interface between Consumer Policy and Competition Policy*. 2006 Consumer Affairs Victoria Lecture, in honour of Dr Maureen Brunt AO.

Thaler, R. 1980. Towards a positive theory of consumer choice. *Journal of Economic*

Behavior and Organization. 1: 39-60.

Tversky, A. & Kahneman, D. 1974. Judgment under uncertainty: Heuristics and biases. *Science* 185L 1124-1130.

Tversky, A. & Kahneman, D. 1991. Loss Aversion in Riskless Choice: A Reference Dependent Model. *Quarterly Journal of Economics*. 106: 1039-1061.

Victorian Competition & Efficiency Commission. *Hints and Tips on Writing a Regulatory Impact Statement or Business Impact Assessment*. Melbourne: VCEC.

Victorian Competition and Efficiency Commission. 2006. *Annual Report 2005-06*. Melbourne: VCEC.

Victorian Competition & Efficiency Commission. 2007. *Victorian Regulatory System 2007: New report released today*. Media release, 19 April 2007.

Victorian Competition & Efficiency Commission. 2007. *Victorian Guide to Regulation*. Melbourne: VCEC.

Waterson, M. 2000. *The Role of Consumers in Competition and Competition Policy*. University of Warwick Economic Research paper no.607.

Waddams, C., Giulietti, M. & Waterson, M. 2005. Consumer Choice and Industrial Policy: a study of UK Energy Markets. *The Economic Journal*. 115: 949-968.

Wilson, D. 2002. *Payday Lending in Victoria - A research report*. Melbourne: Consumer Law Centre Victoria.