ASIC

Australian Securities & Investments Commission

Productivity Commission Inquiry into the state of competition in the Australian financial system: Roundtable – ASIC Opening Statement

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Productivity Commission Inquiry into the state of competition in the Australian Financial System: Roundtable (Melbourne, Australia)
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CHECK AGAINST DELIVERY

ASIC welcomes the Productivity Commission Inquiry into competition in the Australian financial system, and we are pleased to appear before the Productivity Commission today.

I have a brief opening statement which outlines some areas ASIC suggests the Commission could consider in response to the Inquiry's terms of reference. We look forward to providing more detail in our submission.

Fundamentally we consider competition is about enhancing the long-term interests of consumers.

We believe an important focus for the Inquiry is how to improve:

- Consumer choice – for example, innovative or new products and services
- Consumer access – such as reduced barriers to switching
- Consumer decision making – enabling informed and confident consumers
- Consumer outcomes – with lower prices, products and services that meet consumer needs, and good conduct by firms.

ASIC is the market conduct regulator for the Australian financial sector. Our mandate is to promote fair and efficient markets, and to protect consumers so that they can have trust and confidence in the markets we regulate.

ASIC does not have an express competition mandate. Nonetheless, we fulfil an important role in encouraging competition in the financial system. For example:

- we led the introduction of competition in exchange markets
- our 'Innovation Hub' helps support start-ups with innovative new business models navigate our regulatory system
- our work on a wide range of consumer issues helps to address competition failures, such as our recent work on add-on insurance sold through car dealers.

We oversee a diverse range of markets with different structures and unique competition issues. For example, we regulate the small amount lending market where lenders provide loans as small as a few hundred dollars for periods as short as 16 days. In that market there are detailed consumer protections including legislated interest rate caps.

By contrast, we also regulate the monopoly clearing market for cash equities that deals with billions of dollars every day.

Importantly, given the global nature of many financial markets, our work also has a significant international dimension. This includes work on international regulatory standards that ensure appropriate conduct and facilitate competition.

As a result, it is difficult to make a general assessment of competition in the Australian financial system. There are clearly areas where competition is helping to ensure better products and services to end-users, such as online and mobile banking innovations.

However, we have observed – in the context of our regulatory work – a range competition problems and, at times, market failures in the sectors that we regulate, resulting in poor consumer or end-user outcomes. We look forward to setting these out in more detail in our submission to the Inquiry.

In my opening comments I wanted to quickly touch on two broad themes that warrant further consideration: the lack of effective demand-side pressure, and the impact of vertical integration on competition.

Lack of effective demand-side pressure

We observe that a key driver of market problems is a lack of effective demand-side pressure.

Competition is not only a supply-side issue. Consumers and small businesses play an important role in placing competitive pressure on suppliers by switching products or services; however, there are significant barriers to this. For example:

- The ‘credence goods’ nature and complexity of financial products makes it difficult for consumers to compare and switch products.
- Contracts can be long-term and generally provide the supplier with unilateral variation rights: another disincentive to compare and switch. This has been a particular concern in small-to-medium enterprise (SME) lending.

- In addition, information asymmetries and behavioural biases that affect consumer decision making can be exploited by suppliers. For example, research shows consumers will often disregard an interest rate when purchasing a credit card, believing they will always pay the outstanding amount on time – even when, in practice, this will not occur. This can be exploited by suppliers through 'low fee' or 'reward' products with high interest rates. As a result, there are competition problems despite a large number of credit card offers.

In this context, one competition theme that we believe would benefit from careful consideration by the Productivity Commission is post-sale consumer experience with financial products and services, including issues such as ongoing pricing, exit fees, renewal practices and the like. We have seen numerous examples that indicate potential problems with competition, such as:

- favourable upfront pricing followed by significant increases at the point of renewal in insurance policies
- lenders offering new borrowers better discounts than existing borrowers
- financial advice clients being charged annual fees for advice reviews despite being provided with no advice.

A recent survey found that over 50% of Australian adults have always been with the bank they first opened an account with.

Suppliers can afford to risk treating long-term or 'loyal' customers unfairly by denying them access to better prices and terms offered to new customers, and existing customers can end up 'cross subsidising' new customers.

The Inquiry may be interested in obtaining data to look at whether the treatment of customers post-sale is indicative of competition weaknesses in financial services.

More broadly, the Inquiry may want to examine the restraints on effective demand-side pressure in more detail, including whether the 'disclosure' based regulatory regime is achieving appropriate outcomes. While prescribed disclosure is important, it has distinct limitations as a regulatory tool, including in dealing with collective action problems.

The impact of vertical integration on competition

The issue of vertical integration is regularly raised with ASIC, and is one that warrants careful consideration by the Productivity Commission in relation to both the benefits and costs.

Vertically integrated firms can provide economies of scale in the provision of products and services, and they can provide consumers with integrated product offerings. They are also often better placed to deal with consumer problems if something goes wrong.

However, there are some clear issues from a competition and consumer outcomes perspective. For example, ASIC's recent work on mortgage brokers, as well as our work on wealth management, indicates vertical integration creates conflicts of interest, including misaligned incentives and conflicted remuneration.

For example, in mortgage broking, for the two major banks that own intermediary channels, there is a significant increase in the proportion of loans (including white label loans) being written to those banks through these channels compared to the banks' general market share.

In this context, multi-brand strategies can disguise the level of consumer choice and market concentration.

We have often seen product issuers compete vigorously for distribution channels (e.g. financial advisers) as a way of increasing customers, rather than directly offering better products and prices to customers. This arises through ownership links or paying higher incentives. This has resulted in conflicts of interest and poor consumer outcomes.

A key driver of poor outcomes is remuneration that incentivises the sale of products that are inappropriate for consumers. Acknowledgment of this problem has driven a number of recent and current reforms including the Future of Financial Advice (FOFA) reforms, changes to life insurance, and current proposals to reform mortgage broker remuneration.

However, while FOFA reforms have helped to raise standards and remove remuneration conflicts, preliminary analysis from our current work on vertical integration in financial advice suggests that the majority of customer funds for vertically integrated institutions are still invested in related-party products. We expect to release the results of this work later in the year.

In light of this, the Inquiry may want to consider the broader question of how intermediaries and distribution channels mediate consumer access to financial products – including the role of ownership, remuneration, investment platforms and approved product lists.

Responses to market failure

This leads to the question: what are appropriate responses to market failure in the financial system?

Even with well-acknowledged market failures, particular industry segments are often faced with 'first-mover' problems. Our experience in prohibiting 'flex-commissions' in the car finance market suggests that regulatory action is required in markets where competitors risk significant erosion of market share if they unilaterally improve their behaviour.

Further, disclosure has never been sufficient to allow market forces to drive fairness in the provision of all financial products and services. This is evidenced most recently by the extent to which SME lending contracts are being adjusted to comply with the unfair contract terms law.

In this broad context, ASIC supports the key recommendations of the Financial System Inquiry that expand ASIC's regulatory mandate and toolkit:

- an explicit competition mandate for ASIC will ensure we have a clear basis to consider and promote competition in our regulatory decision making
- reforms around broadly formulated product intervention powers and product design and distribution obligations will help address market failures that lead to poor consumer outcomes.

Finally, better and more transparent data in a wide variety of the markets we regulate will, we believe, enhance competition. For example, rather than relying on lengthy individual disclosure of legal and contractual terms, providing transparent data around the broader 'performance' of a product would facilitate better consumer decision making. An example is the current work on developing a public reporting framework around life insurance claims outcomes.

That concludes my comments, and we look forward to engaging with the Productivity Commission on this important inquiry.

Thank you.