ASIC

Australian Securities & Investments Commission

Productivity Commission Inquiry into competition in the Australian financial system

Submission by the Australian Securities and Investments Commission

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Contents

Executive summary

1 ASIC welcomes the opportunity to contribute to the Productivity Commission's inquiry into competition in the Australian financial system, its consideration of what competition in the Australian financial system should look like, and the challenges that need to be overcome to ensure competition is working as effectively as possible.

Competition and poor consumer outcomes in financial markets

2 We consider that the fundamental purpose of competition in markets for financial products and services is to enhance the long-term interests of the end users of the financial system. Rather than competition occurring for its own sake, competition should drive markets to meet consumer needs and preferences.[1]

3 However, we have observed that competition appears to operate less effectively in some of these markets than others.

4 In particular, persistent problems in a market—such as inefficient pricing and excess profits, poor service and deteriorating product quality, leading to poor consumer outcomes—can be a sign that competition is not working as effectively as it could be.

5 For competition to work in the interests of consumers, both supply and demand sides must work well, in a 'virtuous circle'. However, various forces can weaken or impede competition, and the virtuous circle can be fragile.[2]

Nature of financial products and services

6 Competition laws are an essential underpinning of effective competition in markets for financial products and services, as for any other market. However, in our experience, the cause of consumer problems relating to financial products and services is generally not the kind of behaviour that would clearly breach competition laws (e.g. cartel conduct or misuse of market power). Rather, many current competition issues in markets for financial products and services are derived from the nature of the markets themselves, and often require a tailored regulatory approach.

[1] I Harper, P Anderson, S McCluskey & M O'Bryan QC, *Competition policy review*, final report, March 2015, p. 7.
[2] UK Office of Fair Trading, *What does behavioural economics mean for competition policy?* (PDF 344 KB), March 2010. This work has been subsequently built on by Amelia Fletcher.

7 There are a number of factors that may make it more difficult for competition to effectively operate in markets for financial services and products than in other markets. These include:

(a) the 'credence' quality of some financial products and services, which means suitability and quality are hard to gauge before or even after purchase;

(b) asymmetric information and power between providers, intermediaries and consumers;

(c) the inherent risk and uncertainty, and complexity, of many financial products and services; and

(d) the fact that financial products are an infrequent purchase, and it may be more difficult to shop around and exert competitive pressure.

Note: See Table 2 for further details.

8 Additionally, even where industry recognises that particular practices are producing poor consumer outcomes, 'first mover' disadvantage and the difficulty of collective action means that regulatory intervention will be required to address the issue.

Note: See paragraphs 64–66 for further details on 'first mover' and collective action problems.

How this impacts supply-side and demand-side competition

On the demand side

9 For consumers to exert demand-side pressure that drives effective competition they need to be able to:

(a) *access* information about the products and services available in the market;

(b) *assess* the information available about these products and services to compare them; and

(c) *act* on this information by purchasing or switching to a product or service that offers the best value to them.[3]

10 However, evidence and insights from the behavioural sciences show that there are much more complex factors that can affect consumers' interaction with information and their decision making. A significant body of work by policy makers, academics and regulators has been built over recent years

[3] Ibid.

from a range of social and behavioural sciences, describing how and why people think and behave in certain ways.

11 These factors are particularly relevant in the context of the retail financial services sector, which is recognised as a rich environment for behavioural factors to affect individuals' decision making, including because of the impact of the inherent features of financial products and services described in paragraph 7 and in Table 2.

On the supply side

12 There are a range of factors that may limit supply-side competition from working effectively in markets for financial products and services, as in all markets, including where there is low 'contestability' and high barriers to entry, and a lack of transparency in the provision of products and services.

13 However, the presence of behavioural biases and other factors weakening demand-side competition (e.g. lack of financial capability) could also provide opportunities for firms to exploit these to maximise profit, particularly where their interests are misaligned with those of consumers (e.g. conflicted remuneration structures).

Why financial services and products require special regulation to promote effective competition

14 In our regulatory experience, financial products and services warrant a specific regulatory regime to promote effective competition, especially in retail markets.

15 Regulation and regulatory oversight must be well designed and executed in order to enhance competition, rather than reduce it. However, we think there is no necessary trade-off between regulation and facilitating competition, or between competition and consumer protection.

16 While the objectives of financial system regulation are similar to those applying in all markets (i.e. to prevent a range of possible market failures), the means of achieving them often needs to take specific forms due to the nature and complexity of markets for financial products and services.

17 Thinking on the best way for regulation to promote competition and good consumer outcomes has evolved over time through major inquiries into, and regulatory changes to, the financial system.

Wallis Inquiry

18 At a general level, a key underpinning of financial regulation, established through the 1997 Financial System Inquiry (Wallis Inquiry), has been that

regulation should be set at the minimum level necessary to respond to market failures, with disclosure as the key regulatory tool to address such failures.

19 Nevertheless, both before and after this inquiry, more interventionist regulatory approaches were in use for specific markets and products to address significant market failures affecting consumers. This is particularly so for mass-market products (e.g. consumer credit and insurance products), where regulation has long intervened directly into product design or distribution. (e.g. prohibitions on particular contract terms for credit or insurance products).

Murray Inquiry

20 The 2014 Financial System Inquiry (Murray Inquiry) established a shift in regulatory philosophy away from a reliance on disclosure to address market problems, towards using regulation as a tool to actively promote fair consumer outcomes and effective competition.

21 We strongly support the recommendations of the Murray Inquiry to expand ASIC's regulatory mandate and toolkit, to provide us with a means to better analyse and respond to competition issues: see paragraphs 28–29.

ASIC's role in competition

22 ASIC is the market conduct regulator for the Australian financial system.

23 While we are not a competition regulator, our regulatory framework, policies and decision making play an important role in shaping competition in the financial system. Where possible, we consider competition in carrying out our work, although it is not currently a primary feature.

24 We maintain a strong working relationship with the Australian Competition and Consumer Commission (ACCC), as the national regulator responsible for competition law.

Facilitating effective competition in the financial system

25 Understanding the inherent features of financial products and services, and the supply-side and demand-side interactions described in paragraphs 72–85, helps inform the type of regulatory interventions that may be most appropriate to address specific market problems.

26 To address competition weaknesses and promote effective competition, we think the most appropriate response is to craft tailored regulatory solutions that are appropriate to address such complex dynamics, which may involve:

(a) dealing with barriers to effective demand-side competition (e.g. by better informing consumers about the choices available to them, or more effectively overcoming behavioural defaults that are not in consumers' interests); and/or

(b) addressing structural issues on the supply side that are leading to poor consumer outcomes (e.g. by removing conflicts of interest that are leading providers to exploit demand-side weaknesses).

27 ASIC's submission highlights various current or potential future reforms that we think are likely to address specific competition weaknesses, or promote effective competition, more generally: see Table 1.

28 In particular, we believe the recommendations of the Murray Inquiry to expand ASIC's regulatory mandate and toolkit provide us with a means to better analyse and respond to competition issues. These recommendations, which the Government has committed to implement, are for:

(a) an explicit and broad competition mandate for ASIC, to ensure we have a clear basis to consider and promote competition in the financial system; and

(b) new product design and distribution obligations, and a product intervention power, to help address market failures that lead to poor consumer outcomes.

29 In combination, these tools will:

(a) enable us to evaluate and take into account a range of competition factors that result in market problems, including demand-side factors;

(b) enable us to effect targeted and evidence-based change to address market failures and market-wide problems more quickly than law reform;

(c) deal with 'first-mover' problems that may inhibit industry-led responses to market failures; and

(d) help promote competition, and not act as a barrier to entry.

Note: See paragraphs 347–352 for a more detailed discussion of these reforms.

Table 1: ASIC's competition reform priorities

Priority	Description
Support for ASIC having a competition mandate	An explicit and broad competition mandate for ASIC will ensure we have a clear basis to consider and promote competition in the financial system. Note: See Section D, paragraphs 347–352.
An enhanced toolkit for ASIC	An enhanced regulatory toolkit will enable ASIC to address significant consumer detriment, through: • appropriately broad product design and distribution obligations for issuers and distributors of financial products; and • a product intervention power to enable us to respond to market problems in a flexible, targeted, effective and timely way. In concert with the competition mandate, these reforms will enable ASIC to better address market-wide issues, including both supply-side and demand-side factors. Note: See Section D, paragraphs 353–356.
Greater transparency around ownership structures and branding	This will increase the transparency of consumers' interactions with providers, and promote consumers' ability to assess and make decisions about financial products and services. Note: See Section B, paragraphs 189–208, for a discussion of issues relating to transparency in markets for financial products and services. This could be a prominent, simple statement about the relationship of the intermediary to the issuer and the limited range of products that an adviser or broker is able to, or likely to, recommend. Note: This was a recommendation of the Murray Inquiry.
Greater public availability of private sector data	Greater public availability of private sector data (e.g. on life insurance claims outcomes) will help drive demand-side competition and improve market outcomes. Note: See Section D, paragraphs 381–395.
Regulatory neutrality	Further consideration could be given to reviewing regulatory neutrality issues, such as the regulation of securities dealers and market participants. Note: See Section D, paragraphs 367–370, and Table 6.
Globally comparable regulatory regime	This means ensuring that Australia's regulatory framework for financial services is at least as adequate as those of comparable overseas jurisdictions, does not impose any unnecessary regulation or barriers to entry and does not allow opportunities for global regulatory arbitrage. A key example of an area of the current regulatory regime that is inadequate relative to comparable overseas jurisdictions is the types, levels and consistency of penalties available in ASIC-administered legislation. This issue is currently under review as part of Treasury's ASIC enforcement review taskforce.[4] Note: These issues are described in more detail in our submission to the Murray Inquiry.

[4] The Hon Kelly O'Dwyer MP, *ASIC enforcement review taskforce*, media release, 19 October 2016.

Priority	Description
Sector-specific reforms	This could include various sector-specific law reforms that are open to and/or could promote competition, including: • the distinction between general and personal advice; and • a Government commitment for law reform to grant ASIC rule-making powers and the ACCC arbitration powers in relation to market-driven competition outcomes in clearing and settlement facilities. Note: See Table 6.
Ongoing monitoring	Ongoing monitoring of competition in the financial system by ASIC and the ACCC would support the above measures. This would include increased focus on demand-side competition issues and tailored remedies to address them (e.g. more targeted and useful disclosures or reviewing product design features).

ASIC's submission

30 This submission discusses:

(a) competition in the financial system and ASIC's role, and potential regulatory responses to address competition issues (see Section A);

(b) observations about the supply-side market dynamics that provide a backdrop to understanding the environment in which consumers operate (see Section B);

(c) insights into how consumers think and behave, which help us understand competition problems in retail markets for financial products and services (see Section C); and

(d) regulatory approaches to facilitate effective competition in the financial system (see Section D).

31 Appendices are also attached in a supplementary volume to this submission. These describe some of the key markets we regulate of interest to the inquiry, and particular issues relating to competition within them.

A Competition in the financial system and ASIC's role

Key points

Competition has a key role to play in ensuring the efficiency, integrity and growth of the Australian financial system.

We consider the fundamental purpose of competition is to enhance the long-term interests of the end users of the financial system.

For competition to work well for consumers, both supply and demand sides must work effectively. However, there are a range of supply-side and demand-side factors that can impede and cumulatively weaken competition in various markets within the financial system.

Competition operates less effectively in some of these markets than others. Even where there is significant competition, there may be specific issues than can or should be addressed to enhance its effectiveness.

Regulation supporting both market integrity and consumer protection is necessary for effective competition in the financial system. ASIC regulates market conduct in the financial system. While we are not a competition regulator, our policies and decision making can play an important role in influencing competition in the financial system.

An explicit and broad competition mandate focused on the long-term interests of consumers, and the ability to make tailored interventions to address areas of market failure adversely affecting consumers, will better enable ASIC to promote competition in the financial system.

Purpose of competition

32 Competition has a key role to play in ensuring the efficiency, integrity and growth of the Australian financial system. It can provide better and more efficiently priced products for consumers, and facilitate increased funding and investment for businesses, and financial wellbeing for all Australians.

33 We consider that the fundamental purpose of competition is to enhance the long-term interests of the end users of the financial system.

Note: In this submission, we have generally used the term 'consumers'. This term broadly includes the customers and users of financial products and services, and may, depending on the context, encompass wholesale (including institutional) and retail investors, small to medium enterprises (SMEs), and large corporations.

34 Rather than competition occurring for its own sake, competition should drive markets to meet consumer needs and preferences.[5]

35 In theory, well-informed, confident and effective consumers play a key role in activating vigorous competition. In response, these demand-side factors should provide firms with incentives to deliver products and services that are fit for purpose by competing on price, service and quality.

36 For competition to work in the interests of consumers, both supply and demand sides must work well, in a 'virtuous circle'. However, various forces can weaken or impede competition, and the virtuous circle can be fragile.[6] Regulators, market infrastructure providers, product issuers, distributors, investors and other consumers all play an integral role in shaping effective competition in the financial system.

Competition and poor consumer outcomes in financial markets

37 Persistent problems in a market—such as inefficient pricing and excess profits, poor service and deteriorating product quality, leading to poor consumer outcomes—can be a sign that competition is not working as effectively as it could be.

38 The *Competition policy review* found that:

> Competition policy is aimed at improving the economic welfare of Australians. It is about meeting their needs and preferences by making markets work properly.[7]

39 Within the broader competition policy framework, competition laws are an integral instrument for regulating particular types of conduct that are anti-competitive.

> Note: Paragraphs 107–110 set out information on the respective roles of ASIC, as the market conduct regulator, and the ACCC, as the competition law regulator, in relation to competition issues in the financial system.

40 The overarching objectives and requirements of competition laws are an essential underpinning of competition in markets for financial products and services as they are in other markets. However, in our experience, the cause of consumer problems relating to financial products and services is generally not the kind of behaviour that would clearly breach competition laws (e.g. cartel conduct or misuse of market power). Rather, many current competition issues in markets for financial products and services are derived

[5] I Harper, P Anderson, S McCluskey & M O'Bryan QC, *Competition policy review*, final report, March 2015, p. 7.
[6] UK Office of Fair Trading, *What does behavioural economics mean for competition policy?* (PDF 344 KB), March 2010. This work has been subsequently built on by Amelia Fletcher.
[7] I Harper, P Anderson, S McCluskey & M O'Bryan QC, *Competition policy review*, final report, March 2015, p. 7.

from structural problems in the markets themselves, and often require a tailored regulatory approach.

41 A tailored solution may involve, for example:

(a) dealing with barriers to effective demand-side competition (e.g. by better informing consumers about the choices available to them, or more effectively overcoming behavioural defaults that are not in consumers' interests); and/or

(b) addressing structural issues on the supply side that are leading to poor consumer outcomes (e.g. by removing conflicts of interest that are leading providers to exploit demand-side weaknesses).

42 Most often, we have observed that a tailored market-wide regulatory response will be required because a practice producing poor consumer outcomes will not change unless the whole industry acts to change it. Generally, it will be difficult for industry to agree to voluntarily change a practice collectively and, in any case, competition law may prevent such action.

43 Individual firms may understand there are practices that are producing poor consumer outcomes but cannot address them through individual action because of the 'first mover' disadvantage of doing so.

44 Further, demand-side behaviour in many of the industries we regulate exacerbates this situation, because the demand-side cannot exert sufficient pressure to incentivise firms to change their practices.

Note: See paragraphs 64–67 for further details on 'first mover' and collective action problems.

45 These include significant barriers to effective demand-side competition. It is difficult for end users in financial markets to exert effective demand-side pressure due to factors such as the inherent complexity of some financial products and services, and the 'credence' quality of some financial products and services, making them inherently difficult for consumers to assess even after consumption.

Note: See Table 2 for further details on how the inherent nature of financial products and services affects market dynamics and competition in the financial system.

46 Additionally, the significant role that intermediaries play may mean that providers are directing competitive energy at securing distribution channels rather than directly attracting consumers. Here, competition is intense, but in many cases may not be not working in the interests of end users.

Note: These issues are described further in Section B, paragraphs 152–155.

47 It is in such circumstances—where a practice risks significant harm to end users, but there is minimal demand-side pressure for change to occur—that

we see a product intervention power for ASIC being most effective, to allow us to construct a tailored response to the problem: see paragraph 114 for more details about the proposed product intervention power for ASIC.

Effective competition

48 The ultimate purpose of competition in the financial system should be to promote the long-term interests of consumers—that is, competition should be ‘effective’.

49 However, the financial system is made up of complex and diverse markets. A range of demand and supply factors can impede and cumulatively weaken effective competition in the financial system.

Note: In limited cases (e.g. critical centralised financial market infrastructure), the introduction of competition can impose material additional costs or introduce externalities affecting consumers beyond the actual user of the financial infrastructure, and effective competition also needs to adequately account for these factors.

Role of suppliers

50 From the supply side, effective competition occurs when firms actively compete on price, quality and service to win customers and maximise profit, are driven to invest in products and services, and innovate to meet changing consumer needs and preferences.

51 However, there are a range of factors that may limit supply-side competition from working effectively in markets for financial products and services, as in all markets. These include where there is low ‘contestability’ and high barriers to entry, and a lack of transparency in the provision of products and services. Further, a firm’s interests may not always align with the best interests of consumers.

Note: These issues are described further in Section B.

52 As discussed in Section C, the presence of behavioural biases and other factors weakening demand-side competition (e.g. lack of financial capability) could provide opportunities for firms to exploit these to maximise profit. Technology also provides opportunities for firms to, for example, segment the market and engage in price discrimination in a way that negatively affects consumers.

Role of consumers

53 Consumers are both the beneficiaries, and key drivers, of effective competition.

54 Where competition is working effectively, consumer welfare is enhanced through more efficient prices, better quality products and standards of

service, and higher levels of investment and innovation. On the other hand, well-informed and engaged consumers also play a key role in driving effective competition. They place ‘demand-side’ pressure on firms based on their ability to exert choice and switch products.

55 However, there are inherent barriers to the ability of consumers to exert demand-side pressure. These include the inherent complexity of financial products and services, information asymmetry and behavioural biases.

Note: The inherent complexity of financial products and services is described further in paragraphs 58–0. Issues around consumer decision making and behavioural biases are examined in Section C.

Consumer outcomes

56 Ultimately, competition weaknesses can lead to poor consumer outcomes, including:

(a) inefficient or high prices;

(b) poor service; and

(c) lack of improvement in the quality of products and services.

Competition weaknesses may also foster unfair practices and poor conduct.

57 Poor post-consumer sales experiences can also be a strong indicator of how effectively competition is working.

Why financial services and products require special regulation to promote effective competition

58 As discussed in paragraphs 61–0, markets for financial products and services are affected by their unique characteristics. Financial products and services are intangible and often very complex.

59 In our regulatory experience, financial products and services warrant a specific regulatory regime to promote effective competition, especially in retail markets.

60 While the objectives of financial system regulation are similar to those applying in all markets (i.e. to prevent a range of possible market failures), the means of achieving them often needs to take specific forms due to the nature and complexity of markets for financial products and services.

Nature of financial products and services

61 The Productivity Commission, in its 2008 review of Australia’s consumer policy framework, outlines where it may be appropriate for particular markets to have specific regulation that overlays a generic regime to provide more effective and certain consumer protection—specifically:

(a) where the risk of consumer detriment is relatively high and/or the detriment suffered if things go wrong is potentially significant or irremediable; and/or

(b) where products are 'credence goods'—that is, their suitability and quality is hard to gauge before or even after purchase.[8]

62 Many markets for financial products and services exhibit these characteristics, making it more difficult for competition to effectively operate. Additionally, different competitive forces may operate between different parts of the market, and even in relation to different aspects of the same product (e.g. on pricing structures): see Table 2.

Table 2: Nature of financial products and services that affect market dynamics

Characteristics	Explanation
Credence quality	Consumers cannot evaluate some aspects of the financial product or service before buying, or even after purchase, and must trust the supplier or adviser about the benefits and use of the products. For example, the performance of an investment product may not be apparent until many years after purchase.
Asymmetric information and power	The provider of a financial product or service generally has more information than the consumer about the terms and conditions of the product or service. Consumers are generally unable to negotiate more favourable terms or conditions. This information asymmetry creates opportunities for inappropriate or exploitative behaviour by providers. Providers could potentially design products or services that maximise their interests over that of consumers. This information asymmetry may also potentially apply between providers and intermediaries.
Risk and uncertainty	Financial products and services are often long term or open ended. They are often inherently risky and the benefits to the consumer from holding them may be uncertain. They may rely on external factors for performance that cannot be assessed by the consumer or supplier (e.g. the performance of the market).
Complexity of product	Financial products and services are often complex. While information may be provided to consumers about products in the form of disclosure, many consumers lack the financial comprehension required to understand this information.
Complexity of pricing	Given the long lifetime of many financial products, they are often subject to initial, ongoing and event-specific fees. There may be variable competitive forces at work between different parts of the pricing structure—for example, there may be strong competition on headline rates and entry fees but less efficient pricing on event-specific fees such as default fees. The tendency of consumers to focus only on upfront costs and benefits may incentivise providers to structure pricing in a way that obscures this: see Section C.

[8] Productivity Commission, *Review of Australia's consumer policy framework*, Inquiry Report, Vol. 2—Chapters and Appendices, No. 45, 30 April 2008, p. 25.

Characteristics	Explanation
Infrequent purchase, more difficult to shop around	Many financial products are often purchased infrequently as a 'one-off', and, in the case of superannuation, obtained by compulsion. Others may be necessity goods (e.g. deposit accounts), which are necessary for general social function and with no natural trigger for renewal or switching. As financial products are not a common purchase, it is more difficult for consumers to effectively exert competition pressure by choosing a range of providers until they find a product meeting their needs, and some products may be structured to restrict consumers' ability to withdraw from them.
Competing indicators of the product's quality	More so than other types of products, financial products have a number of features that seem to provide competing indicators of their quality (e.g. price to acquire the product, past performance, rewards for acquiring the product (i.e. initial discount rates), and ongoing costs), and it is difficult to be aware of and effectively evaluate all of these aspects simultaneously.
Detrimental aspects only emerge long after sale	In many cases, if there are detrimental aspects to the product, these may only become apparent at some time after the product is purchased (e.g. whether the product meets claimed investment performance or objectives or not).
Misalignment of interests	The interests of some providers and distributors may be misaligned with those of consumers.

Source: Partly adapted from Financial Services Authority (FSA), *Product intervention*, discussion paper (DP 11/1), January 2011.

63 If things go wrong for consumers, the consequences can be more severe than other types of goods and services: they may lose their home, their provision for retirement, or suffer extreme financial hardship. After suffering a loss, they may not be able to recover their previous financial position.

The limitations of collective action and 'first mover' disadvantage

64 It is often not possible for the supply side itself to address problems that are affecting competition and causing poor consumer outcomes without the support of regulatory intervention.

65 This is because of the inherent difficulties of collective action—where even those in the industry who would like a particular practice to end cannot act. The 'first mover' disadvantage of doing so would be too great and competition laws may be a barrier to industry acting collectively in some cases.

66 This includes industry-wide practices that can cause consumer detriment and that most, if not all, within the industry recognise as problematic.

Example: Flex commissions

In some cases when car finance has been arranged directly through car dealers as intermediaries, financiers have had a practice of allowing dealers to set the interest rate for the finance, within a range of permissible rates. Dealers have received commissions from the financier for arranging such finance, and the higher the interest rate set, the higher the commission received by the dealer. Such arrangements are referred to as 'flex commissions'. Consumers have generally been unaware of the arrangement.

Flex commissions create an incentive to supply car finance at higher interest rates to consumers. This is an example of a market that is characterised by supply-side competition and where the dealer intermediaries have significant conflicts of interest. While the arrangements may also be costly for financiers, and some financiers may be uncomfortable with them, it has been difficult for any individual financier to end flex commission arrangements with dealers because of the risk of losing market share.

Following our work to understand this industry, ASIC has formally banned flex commissions, through a legislative instrument.[9] Lenders and dealerships have until November 2018 to update their business models, and implement new commission arrangements that comply with the new law: see also Table 8.

67 This example provides a case study of an industry that was aware of its own internal problems, but where a 'first mover' disadvantage would apply to any single entity that sought to improve its practices.

Evolving thinking on the role of regulation in the financial system

68 Appropriate regulation can overcome some of the issues described above and make financial markets work properly to meet consumer needs and preferences.

69 Regulation and regulatory oversight must be well designed and executed in order to enhance competition, rather than reduce it. We think there is no necessary trade-off between regulation and facilitating competition, or between competition and consumer protection.

70 The economic philosophy that has traditionally underpinned the Australian financial services regulatory regime is that markets drive efficiency and that markets operate most efficiently when there is a minimum of regulatory intervention.

[9] See ASIC Media Release (17-301MR) *ASIC bans flex commissions in car finance market*, 7 September 2017.

71 However, thinking on the best way for regulation to promote competition and good consumer outcomes has evolved over time through major inquiries into, and regulatory changes to, the financial system.

Wallis Inquiry

72 In accordance with efficient markets theory, the 1997 Financial System Inquiry (Wallis Inquiry) found that:

> In designing regulatory arrangements, it is important to ensure minimum distortion of the vital roles of markets themselves in providing competitive, efficient and innovative means of meeting customers' needs.[10]

73 The basic features of the current financial services regulatory regime were developed following these principles, and favour:

(a) efficient and flexible allocation of risk and resources, and a low cost of capital;

(b) promotion of competition, innovation and flexibility; and

(c) retail investors having access to a wide range of products.

74 Nevertheless, this underlying philosophy accepts that regulation is necessary to deal with factors that prevent the market operating efficiently (e.g. fraudulent conduct by industry participants, information asymmetries and anti-competitive conduct), as long as such regulation is set at the minimum level necessary to respond to market failures.

75 The key regulatory tool of this approach is imposing disclosure requirements. This is on the assumption that consumers, armed with this information, will be empowered to make effective choices. Disclosure is also required to promote the overarching goal of transparency in financial markets.

Evolution in financial regulation between major inquiries

76 Thinking on the level of regulation required within financial markets to promote efficient competition and good consumer outcomes has shifted since the Wallis Inquiry.

77 Even at the time the Wallis Inquiry's report was released, the position taken in that report did not necessarily accurately reflect the state of the law for all financial products and services. While the Wallis Inquiry's philosophy was reflected in the regulation at the time of investment products, for products that had long been available as mass-market retail financial products (e.g. various forms of consumer finance and general insurance), the law at that

[10] *Financial System Inquiry final report* (Wallis Inquiry report), March 1997, p. 15.

time contained a wide range of measures that went well beyond disclosure and intervened more directly into product design or product distribution. These include prohibitions on particular terms in contracts for credit or insurance products.

78 Those measures had been put in place to address significant market failures that had had widespread negative impacts on consumers. While interventionist, these measures had been closely targeted, had addressed issues or practices that had been exposed as being unfair or persistently problematic, and had become widely accepted by all stakeholders and were thus reasonably non-controversial. There was no indication in the Wallis Inquiry, or the submissions to that inquiry, that these particular forms of regulation were inhibitions to competition or innovation.

79 Following the Wallis Inquiry's report, at a broad level, subsequent regulatory change generally adopted its philosophy of the primacy of disclosure. Nevertheless, the process of seeking to address persistent problems of poor consumer outcomes arising from market failure has continued within specific markets, including cases where disclosure has proved an inadequate remedy.

80 This has included a number of instances where regulatory reform has addressed competition and other issues to produce better consumer outcomes: see Table 3.

Table 3: Regulatory interventions that have addressed competition issues

Intervention	Description
Credit reform (2010)	In 2010 the Government introduced credit reforms through the National Credit Act to address a range of market failures that were observed nationally and internationally, including: • predatory lending where consumers were entered into credit contracts that they could not repay; • fraud by intermediaries such as brokers—who were incentivised by commissions to enter consumers into credit contracts that may not have been suitable to them (including sub-prime lending); and • consumer over-indebtedness. These market failures showed that unregulated, supply-driven competition was not sufficient to meet the needs and interests of consumers. The reforms imposed minimum competency and honesty standards on credit service providers. These standards apply consistently across all Australian jurisdictions and include a number of areas not adequately covered by previous state-based regulation, such as mortgage brokers and investment loans. The reforms introduced responsible lending obligations to ensure that credit licensees do not suggest, assist with, or provide a credit contract or consumer lease to a consumer that is unsuitable for the consumer. Building onto these reforms, from 1 July 2013, the Government introduced a national maximum cap on costs for all credit contracts (excluding those offered by an ADI). The cap varies based on the term of a contract and the amount of credit, with specific protections for small amount or payday loans, which are a product the Government identified as holding specific risks of financial detriment or harm to financially vulnerable consumers: see Table 8. We consider that the regime established a more even playing field in credit markets and has realigned the interests of industry participants in the value chain with those of consumers.
Competition in exchange markets (2010)	In 2010, the Government introduced competition in exchange markets operating in Australia to ensure that Australia's financial markets are innovative and efficient. The introduction of competition in exchange markets represented one of the most significant structural changes to Australia's financial system in recent years. Since its formation, ASX had held a virtual monopoly over exchange market services. The reform resulted in new entrants and contestability in exchange markets.

Intervention	Description
Unfair contract terms (2011)	The unfair contract term protections for consumers were introduced as part of the broader national Australian Consumer Law, which was fully implemented from 1 January 2011. Aspects of this law, including the unfair contract term protections, are also reflected in the *Australian Securities and Investments Commission Act 2001* (ASIC Act). The Australian Consumer Law prohibition on unfair contract terms applies to many financial and credit products. This means that products cannot be designed with standard terms that are inherently unfair to the investor or financial consumer—for example, a term that: • would cause a significant imbalance in the parties' rights and obligations arising under the contract; • is not reasonably necessary to protect the legitimate interests of the party that would benefit from its inclusion; and • would cause financial or other detriment (e.g. delay) to a consumer if it were to be applied or relied on. This acknowledges that investors and financial consumers have little ability to discover or renegotiate unfair contract terms at the point where they are choosing a product or service, and rebalances competitive forces in the market.
Banning of early termination fees on home mortgages (2011)	As part of the broader credit reforms, the Government also banned early termination fees on variable rate home mortgages. This reform was introduced in order to facilitate competition by removing impediments to consumer switching. For the same reason, the ban extended to deferred establishment fees, which had been charged on early termination.
Future of financial advice reform (FOFA) (2013)	The objectives of the FOFA reforms were to improve the trust and confidence of retail investors in the financial planning sector after a series of financial advice scandals and concerns raised by ASIC's work that consistently showed: • inadequate consideration of clients' needs; • inadequate justification or lack of credible reasons for recommending that clients switch products; and • the impact of conflicted remuneration structures on the quality of advice. The reforms sought to address these market failures by increasing the standard of financial advice and removing conflicts of interest, such as commissions. Before the FOFA reforms, the provisions of the Corporations Act did not require a financial adviser to act in the best interests of their client or to prioritise the client's interests when providing advice. These obligations realigned the actions of firms with the interests of consumers.

81 However, one area that was not as strong a focus in these reforms was poor consumer outcomes stemming from the design and distribution of retail investment products.

Murray Inquiry

82 The 2014 Financial System Inquiry (Murray Inquiry) established a shift in regulatory philosophy away from a reliance on disclosure to address market problems. It actively supported a regulatory regime that focused on

delivering 'fair treatment' to consumers, recognising that financial products and services should perform in the way that consumers expect or are led to believe.

83 The Murray Inquiry noted that insights into consumers' behavioural biases undermine the assumption that individuals are 'rational'. This limits the efficacy of disclosure as a regulatory tool and can lead to sub-optimal outcomes for consumers. As a result, the Murray Inquiry recognised that, although disclosure is a valuable tool to improve consumer outcomes, it should not be relied on in isolation.

84 The Murray Inquiry found that, although regulation should not be expected to prevent all consumer losses, a more proactive regulatory regime is required to identify and respond to market problems as they arise. This included recommendations aimed at expanding ASIC's regulatory toolkit to ensure that ASIC can operate as a proactive and forward-looking regulator: see paragraphs 114–115.

85 We think that this shift in regulatory focus towards promoting fair outcomes for consumers is an essential basis for effective competition.

Current trends and forces shaping competition in the financial system: Structural change, globalisation and technology

86 Current trends that are shaping the financial system, and that are central to ASIC's thinking and priorities, are:

(a) digital disruption and cyber resilience in financial services and markets;

(b) globalisation of financial markets, products and services; and

(c) structural and demographic change in our financial system enhancing the role of market-based financing.

These are some of the current challenges that are informing ASIC's work.

Note: For more details on particular areas of focus for ASIC flowing from these challenges, see *ASIC's Corporate Plan 2017–18 to 2020–21*.

Digital disruption

87 As described in Section B, new and enhanced technologies and increased computing capabilities are enabling the development of new products and services that can meet the needs of financial consumers and market participants more efficiently and more cost effectively. This has the potential to further enhance consumer choice, lower search costs, reduce impediments to switching, and encourage new entrants: see paragraphs 235–237.

88 Underpinning this technological change is 'big data' and the ability of businesses to collect, store and analyse a large range of data on consumers. Globally, governments and regulators are considering what can be done to ensure that this trend can be harnessed to empower consumers and improve their decision making to enhance consumer outcomes and drive competition by: see paragraphs 381–395 in Section D.

89 However, despite the potential benefits, there are also risks from this, including:

(a) people not understanding what they are buying, as a result of streamlining consumer engagement processes;

(b) increased market fragmentation and complexity;

(c) new products and services testing regulatory boundaries; and

(d) cyber threats because new business models rely on digital delivery.

Globalisation

90 In Australia, globalisation has been central to the economy since the exchange rate was deregulated in the 1980s. Australia's financial markets are now much more integrated with international markets than at the time of the Wallis Inquiry, and global integration is continuing to increase at a rapid pace.

91 Australia has relatively open financial markets. As an open economy, Australia is one of the top 10 destinations for foreign direct investment.[11] Some Australian providers of financial products and services are genuinely competing in an international marketplace (e.g. market operators). Generally, foreign financial services providers and market operators may provide financial services in Australia, meeting the same regulatory requirements as domestic competitors. Regulatory arrangements also exist to allow some foreign financial services providers to provide services within Australia without additional licensing requirements when providing financial services to wholesale clients in Australia.

Note: For example, ASIC can exempt a foreign financial services provider from the requirement to hold an AFS licence where the entity is regulated by an overseas regulatory authority and it provides services to wholesale clients.

92 Australia benefits from the links between world financial markets through increased product and asset class offerings, lower costs from competition and the expanded pool from which businesses can raise funds. In recognition of this, the Memorandum of Cooperation on the Establishment and Implementation of the Asia Region Funds Passport was signed in 2016, and

[11] United Nations Conference on Trade and Development, *World investment report 2017* (PDF 1.67 MB), Figure 1.11, p. 12.

is scheduled to start in 2018: see Appendix C in the Appendices attached to this submission.

93 However, protectionist sentiment has increased following major elections and referendums in 2016, which may lead to reduced global trade and capital flows.

94 In this environment, international relations are crucial. This includes:

(a) participation in the process of international standard setting, which has arisen alongside the globalisation of markets as a means of both controlling the risks associated with those markets and facilitating cross-border activity; and

(b) more generally, cooperating with international regulatory agencies to promote market integrity and trust and confidence.

95 Another element is ensuring that Australia's financial services regulatory framework is at least as adequate as those of comparable overseas jurisdictions, does not impose any unnecessary regulation or barriers to entry, and does not allow opportunities for global regulatory arbitrage: see Table 5.

Structural and demographic change

96 Australia's financial landscape is continually evolving. For example:

(a) Demographic changes in our population affect the way people engage with financial markets, including older Australians, with the proportion of Australians aged over 65 expected to grow from around 15% currently,[12] to 21% by 2050.[13]

(b) Structural changes, including increased wealth held in superannuation, should continue to enhance the role of market-based financing.

97 The growing importance of the managed funds sector should support market-based financing, such as peer-to-peer lending and other non-bank financing models. These new and innovative types of financing currently represent only a small proportion of the market; however, they are creating greater competition for traditional methods of raising capital and risk sharing.

[12] Australian Bureau of Statistics, *Australian demographic statistics Dec 2016*, Cat. No. 3101.0, 27 June 2017.
[13] Australian Bureau of Statistics, *Population projections, Australia, 2012 (base) to 2101*, Cat. No. 3222.0, 26 November 2013, Table B9.

ASIC's current role in competition

ASIC's role in the financial system

98 ASIC is the market conduct regulator for the Australian financial system.

99 The ASIC Act establishes that ASIC has the function of monitoring and promoting market integrity and consumer protection for the Australian financial system.

100 Our vision is to allow markets to fund the economy and, in turn, economic growth. In doing so, we will contribute to the financial wellbeing of all Australians. We do this by:

(a) promoting investor and consumer trust and confidence;

(b) ensuring fair and efficient markets; and

(c) providing efficient registration services.

Who we regulate

101 ASIC regulates Australian companies, financial markets, financial services organisations and professionals who deal in and advise on investments, superannuation, insurance, deposit taking and credit.

102 Our regulated population is large and our remit is wide, covering all aspects of the financial system. This regulated population operates across a number of markets, offering distinct financial services and products: see Table 4.

Table 4: ASIC's regulated population

Our role	Regulated population
Corporate regulator	As the corporate regulator, we ensure that companies, schemes and related entities meet their obligations under the Corporations Act. We register, regulate and monitor companies at every point from their incorporation to fundraising activities and financial reporting through to their winding up, and ensure that company officers comply with their responsibilities. We also register and, where necessary, take disciplinary action against company auditors and liquidators. Regulated corporate sector entities include: • 23,908 public companies (including 2,200 listed entities); • 711 registered liquidators; • 4,364 registered company auditors; • 28,000 entities required to produce financial reports; and • 6,341 self-managed superannuation fund auditors.

Our role	Regulated population
Financial services regulator	As the financial services regulator, we have responsibility for investor and consumer protection in financial services. We administer the Australian financial services (AFS) licensing regime under the *Corporations Act 2001* (Corporations Act) and monitor financial services businesses to ensure that they operate efficiently, honestly and fairly. We also administer the consumer protection regime under the ASIC Act for consumers and small businesses that use financial products and services—including misleading and deceptive conduct, unconscionable conduct and unfair contract terms. We regulate 6,058 AFS licensees, including: • 466 responsible entities (operating 3,632 managed investment schemes); • 1,548 wholesale trustees; • 197 managed discretionary account operators; • 92 investor directed portfolio service operators; • 135 superannuation trustees; • 956 custodial service providers; • 829 foreign financial services providers; • 152 authorised deposit-taking institutions; • 91 general insurers; • 29 life insurers; • 12 friendly societies; • 622 licensed non-cash payment facility providers and distributors; and • 13 trustee companies. There are 4,185 licensees that are authorised to provide personal advice, with 25,379 financial advisers.
Financial markets regulator	As the markets regulator, we assess how effectively financial markets are complying with their legal obligations to operate fair, orderly and transparent markets. We also advise the Minister about authorising new markets. On 1 August 2010, we assumed responsibility for the supervision of trading on Australia's domestic licensed equity, derivatives and futures markets. Our regulation of market infrastructure includes: • 18 licensed domestic and overseas financial markets; • 7 licensed clearing and settlement facilities; and • 2 derivative trade repositories. Our regulation of market participants includes: • 121 market participants; • 700 securities dealers; • 66 retail over-the-counter derivative issuers; • 24 investment banks; and • 7 credit ratings agencies.

Our role	Regulated population
Consumer credit regulator	As the consumer credit regulator, we license and regulate people and businesses engaging in consumer credit activities (including banks, credit unions, finance companies, and mortgage and finance brokers). We ensure that licensees meet the standards—including their responsibilities to consumers—that are set out in the *National Consumer Credit Protection Act 2009* (National Credit Act) and the ASIC Act. Our regulation of credit licensees includes: • 5,468 non-ADI credit licensees (lenders and intermediaries); and • 33,038 credit representatives.

Note: Figures as at 30 June 2017.

Considering competition

103 While we are not a competition regulator, our regulatory framework, policies and decision making play an important role in shaping competition in the financial system. Where possible, we consider competition in carrying out our work.

104 We think that competition considerations generally underlie our current mandate to:

(a) maintain, facilitate and improve the performance of the financial system and the entities within that system in the interests of commercial certainty, reducing business costs, and the efficiency and development of the economy; and

(b) promote the confident and informed participation of consumers and investors in the financial system (ASIC Act, s1(2)).

105 We have undertaken a number of actions to actively encourage competition with the aim of improving consumer outcomes. For example:

(a) Our ‘Innovation Hub’ helps start-ups with innovative new business models for providing financial products and services navigate our regulatory system. Our ‘regulatory sandbox’ enables eligible fintech businesses to test certain specified products or services for up to 12 months without an AFS licence or credit licence: see paragraphs 272–277.

(b) Work through the Council of Financial Regulators (CFR), which comprises the RBA, APRA, ASIC and the Australian Treasury, has established, with the ACCC, a robust regulatory framework for introducing safe and effective competition for critical centralised financial market infrastructure. We have also facilitated the entry into Australia of global market infrastructure providers, and facilitated Australian institutions accessing overseas capital markets efficiently.

(c) We continue to take a multifaceted approach to reducing red tape, consistent with the Government's regulatory reform agenda,[14] with the aims of removing any regulatory barriers to competition, reducing costs to business overall, and ensuring our regulation is appropriate and proportionate. For example, we have undertaken significant work reviewing existing regulatory requirements to improve and streamline them, reducing requirements where appropriate.

Note: Since September 2013, these efforts have reduced ongoing annual compliance costs for business by almost $455.7 million.[15]

106 However, competition is not formally included within our legislative decision-making framework. Currently, we are more likely to consider competition issues:

(a) incidentally, in the course of undertaking a risk-based surveillance on a specific compliance or conduct concern;

(b) as a result of an external request, such as from the Minister (e.g. Report 516 *Review of mortgage broker remuneration* (REP 516) (April 2017) (s12, ASIC Act) or from the Council of Financial Regulators; or

(c) in our contextual analysis for proposed policy changes, including responses to Government law reform, our own regulatory guidance, or licensing requirements.

ASIC's role in relation to the ACCC

107 While the ACCC is the regulator with key jurisdiction to promote competition across the economy, ASIC and the ACCC share jurisdiction for consumer protection laws—with ASIC responsible for consumer protection laws applying to financial products and services, and the ACCC responsible for those laws as they apply to all other products and services.

Perimeter issues: ASIC and the ACCC

Section 131A of the *Competition and Consumer Act 2010* provides that the Australian Consumer Law does not apply to financial services or financial products. Financial products and services are instead subject to the consumer protection provisions in Div 2 of Pt 2 of the ASIC Act, which is administered by ASIC.

ASIC and the ACCC share jurisdiction for consumer protection laws—with ASIC's jurisdiction applying to financial products and services. As a result, both agencies have, on occasion, referred powers to each other where it is prudent for matters notionally within one regulator's jurisdiction to be dealt with by the other regulator.

[14] See ASIC, Report 466 *ASIC's work to reduce red tape* (REP 466), January 2016.
[15] Australian Government, *Regulatory reform agenda to focus on productivity and states*, media release, 12 November 2015.

Our view is that this provision (and division of responsibility more generally) is working well. It has the benefit of:

- ensuring clarity between the ACCC and ASIC about which regulator is responsible for particular conduct;
- minimising the risk of competing investigations and information requests by the ACCC and ASIC; and
- reducing uncertainty for industry about what consumer protection obligations they must comply with.

Dealing with perimeter issues

In some very limited cases, it can be unclear whether a particular product or service is subject to the Australian Consumer Law or the ASIC Act. In those cases, ASIC and the ACCC work closely with one another and each delegate respective parts of their jurisdiction to the other agency. This removes doubt about which laws apply and allows the most appropriate agency to take action.

Areas where the ACCC and ASIC have reciprocal delegations in place include:

- credit repair and debt collection;
- consumer leases;
- extended warranties; and
- for-profit budgeting and financial difficulty services.

As an example, for extended warranty products:

- ASIC generally takes the lead on warranties offered with the sale of motor vehicles on finance; and
- the ACCC focuses on sales of warranties with electrical and household goods sold through retail outlets.

The reciprocal delegations that are in place mean that each agency does not face jurisdictional barriers in its work in relation to warranty products.

The process that supports the reciprocal delegations requires ASIC and the ACCC to communicate clearly and work closely together. This helps ensure the agencies have a clear understanding of which regulator will take the lead in a particular area and avoids the risk of both regulators taking action.

108 ASIC maintains a strong working relationship with the ACCC. ASIC and the ACCC are signatories to a memorandum of understanding that provides a framework for the exchange of information and mutual assistance.

109 In some areas, the regulators also coordinate their efforts and work on joint initiatives. An example is a joint guideline on debt collection prepared by ASIC and the ACCC.[16]

[16] ACCC and ASIC, *Debt collection: For collectors and creditors*, July 2017.

110 If, as recommended by the Murray Inquiry, ASIC is provided with a competition mandate, this would not change ASIC's or the ACCC's respective roles. However, having a competition mandate would strengthen and provide an additional dimension to our decision making: see Section B, paragraphs 114–115, and Section D.

Regulatory responses to address competition issues

111 The complexity of financial markets, the range of inherent factors that may weaken competition within them, and the 'first mover' disadvantage that makes collective industry action difficult to achieve, mean that regulatory responses may be necessary to address competition weaknesses and promote effective competition.

112 While no single response is likely to be sufficient of itself to address competition issues across all markets, we think that competition issues in the financial system will generally require specific and tailored regulatory responses, to address the specific reasons why competition is not working in the interests of consumers, rather than competition laws applied at a general level.

113 We also think there needs to be regular monitoring and assessment of competition in the financial system, to enable better focus on competition in markets where there may be indicators of systemic consumer detriment or market failure.

114 In this broad context, we believe the recommendations of the Murray Inquiry to expand ASIC's regulatory mandate and toolkit provide us with a means to better analyse and respond to competition issues. These recommendations, which the Government has committed to implement, are for:

(a) an explicit and broad competition mandate for ASIC to ensure we have a clear basis to consider and promote competition in the financial system; and

(b) new product design and distribution obligations, and a product intervention power, to help address market failures that lead to poor consumer outcomes.

Note: These Murray Inquiry recommendations focused on retail consumers. For centralised financial market infrastructure, the Murray Inquiry recommended that the Government implement regulatory reforms previously identified by the Council of Financial Regulators, to give ASIC and the ACCC regulatory powers that would enable the regulators to further facilitate safe and effective competition for centralised financial market infrastructure.

115 In combination, these tools will:

(a) enable us to evaluate and take into account a range of competition factors that result in market problems, including demand-side factors;

(b) enable us to effect targeted and evidence-based change to address market failures and market-wide problems more quickly than law reform;

(c) deal with first-mover problems that may inhibit industry-led responses to market failures; and

(d) help promote competition, and not act as a barrier to entry.

Note: See Section D, paragraphs 345–359, for a more detailed discussion of these reforms.

116 Whether regulatory responses are delivered by Government through legislation, or by ASIC through our current and future powers, competition issues may need to be mitigated through regulation that:

(a) addresses supply-side issues that are leading to poorly functioning markets and impeding competition, or creating barriers to entry for new providers (see Section D, paragraphs 360–374); and/or

(b) empowers consumers to exert more effective demand-side competition, including providing data in a form that helps consumers better assess and manage risks, and assists them to make better decisions (see Section D, paragraphs 375–395).

ASIC's competition reform priorities

117 The financial system has undergone significant scrutiny in recent years, through inquiries including the comprehensive Murray Inquiry. Many recommendations from these inquiries are still in the process of being implemented by the Government.

118 For this reason, this submission does not propose significant additional regulatory reforms to address competition issues in markets for financial products and services.

119 Nevertheless, we believe it is important to highlight various current or potential future reforms that we think are likely to address specific competition issues, or enhance ASIC's toolkit to deal with competition issues in general: see Table 5.

Table 5: ASIC's competition reform priorities

Priority	Description
Support for ASIC having a competition mandate	An explicit and broad competition mandate for ASIC will ensure we have a clear basis to consider and promote competition in the financial system. Note: See Section D, paragraphs 347–352.
An enhanced toolkit for ASIC	An enhanced regulatory toolkit will enable ASIC to address significant consumer detriment, through: • appropriately broad product design and distribution obligations for issuers and distributors of financial products; and • a product intervention power to enable us to respond to market problems in a flexible, targeted, effective and timely way. In concert with the competition mandate, these reforms will enable ASIC to better address market-wide issues, including both supply-side and demand-side factors. Note: See Section D, paragraphs 353–356.
Greater transparency around ownership structures and branding	This will increase the transparency of consumers' interactions with providers, and promote consumers' ability to assess and make decisions about financial products and services. Note: See Section B, paragraphs 189–208, for a discussion of issues relating to transparency in markets for financial products and services. This could be a prominent, simple statement about the relationship of the intermediary to the issuer and the limited range of products that an adviser or broker is able to, or likely to, recommend. Note: This was a recommendation of the Murray Inquiry.
Greater public availability of private sector data	Greater public availability of private sector data (e.g. on life insurance claims outcomes) will help drive demand-side competition and improve market outcomes. Note: See Section D, paragraphs 381–395.
Regulatory neutrality	Further consideration could be given to reviewing regulatory neutrality issues, such as the regulation of securities dealers and market participants. Note: See Section D, paragraphs 367–370, and Table 6.
Globally comparable regulatory regime	This means ensuring that Australia's regulatory framework for financial services is at least as adequate as those of comparable overseas jurisdictions, does not impose any unnecessary regulation or barriers to entry and does not allow opportunities for global regulatory arbitrage. A key example of an area of the current regulatory regime that is inadequate relative to comparable overseas jurisdictions is the types, levels and consistency of penalties available in ASIC-administered legislation. This issue is currently under review as part of Treasury's *ASIC enforcement review taskforce*.[17] Note: These issues are described in more detail in ASIC's submission to the Murray Inquiry, April 2014.

[17] The Hon Kelly O'Dwyer MP, *ASIC enforcement review taskforce*, media release, 19 October 2016.

Priority	Description
Sector-specific reforms	This could include various sector-specific law reforms that are open to and/or could promote competition, including: • the distinction between general and personal advice; and • a Government commitment for law reform to grant ASIC rule-making powers and the ACCC arbitration powers in relation to market-driven competition outcomes in clearing and settlement facilities. Note: See Table 6.
Ongoing monitoring	Ongoing monitoring of competition in the financial system by ASIC and the ACCC would support the above measures. This would include increased focus on demand-side competition issues and tailored remedies to address them (e.g. more targeted and useful disclosures or reviewing product design features).

120 General approaches and specific regulatory responses to facilitate competition are discussed further in Section D.

Current law reform priorities to facilitate competition

121 Table 6 outline some current law reform priorities that are either already in train, or that, if progressed, could promote competition in the financial system for particular market sectors.

Table 6: Sector-specific law reform priorities

Sector	Initiative
Financial advice	*Financial advice professional standards* The reforms will introduce new professional, education and training standards for financial advisers who provide personal advice on more complex financial products. The Government has also agreed to establish an independent body, recognised in legislation, to set details of the new standards. Subject to some limited exceptions, only advisers who meet the new training standards will be permitted to call themselves ‘financial adviser’ or ‘financial planner’ or similar terms. Legislation passed both Houses of Parliament in February 2017. Phased commencement will start 1 January 2019. *Renaming general advice and disclosing adviser and mortgage broker ownership* This Murray Inquiry recommendation is designed to improve consumer outcomes. The Government has agreed to both reforms and has indicated it will consult on their implementation.

<table>
<tr><th>Sector</th><th>Initiative</th></tr>
<tr><td>Insurance</td><td>Life insurance reforms

This reform package is aimed at better aligning the interests of providers of financial advice in the life insurance sector with those of consumers. Legislation passed both Houses of Parliament in February 2017. ASIC has made a legislative instrument setting caps and clawback arrangements: see ASIC Corporations (Life Insurance Commissions) Instrument 2017/510. The reforms will commence 1 January 2018.</td></tr>
<tr><td>Credit</td><td>Small amount credit contracts and consumer leases

The reform of small amount credit contract laws is the Government's response to the final report of the independent review of the small amount credit contract laws, which was released on 28 November 2016.

Credit card reforms

The Government has created a credit card law reform package in response to the Senate Inquiry into the credit card market (Treasury Laws Amendment (2017 Measures No. 8) Bill 2017: Credit card reforms). These reforms include:
• requiring affordability assessments be based on a consumer's ability to repay the credit limit within a reasonable period;
• banning unsolicited offers of credit limit increases;
• simplifying how interest is calculated; and
• requiring online options to cancel cards or to reduce credit limits.</td></tr>
<tr><td>Superannuation and managed investment schemes</td><td>Superannuation efficiency and competitiveness

In February 2016, terms of reference were given to the Productivity Commission by the Government, requesting that the Commission conduct:
• a study to develop criteria to assess the efficiency and competitiveness of the superannuation system; and
• an inquiry to develop alternative models for a formal competitive process for allocating default fund members to products.

We provided our submissions in May and November 2016.

Comprehensive income product for retirement (CIPR)

The Murray Inquiry recommended that superannuation trustees develop comprehensive income products for retirement to improve outcomes for retirees. In response, the Government has consulted on the key issues in developing the framework for comprehensive income products for retirement, proposed to be labelled 'MyRetirement products'. Submissions closed on 9 July 2017.

Innovative retirement products

Also in response to a recommendation of the Murray Inquiry, from 1 July 2017 the Government has opened up favourable tax treatment to a wide range of new pooled retirement income products that address longevity risk. From 1 July 2017 the Australian Taxation Office (ATO), APRA, ASIC and the Department of Social Services have also made available a 'one-stop shop' for product issuers looking to develop these new retirement income products.</td></tr>
</table>

Sector	Initiative
Superannuation and managed investment schemes—*continued*	*Finalisation of Stronger Super reforms: Superannuation choice dashboards and portfolio holdings disclosure* This reform is designed to increase the quality of information available to superannuation fund members and others, while ensuring that the current obligations in the Corporations Act in relation to Choice product dashboards and portfolio holdings disclosure are workable for industry. In the absence of regulations or amending legislation to fully implement the Stronger Super reforms, we have made a legislative instrument to delay the commencement of the requirements until 2019: see ASIC Corporations (Amendment) Instrument 2017/569. The Government has recently proposed a revised regime for portfolio holdings disclosure in the Treasury Laws Amendment (Improving Accountability and Member Outcomes in Superannuation Measures No. 1) Bill 2017. *Accountability and member outcomes* We have worked with Treasury on the recently introduced Treasury Laws Amendment (Improving Accountability and Member Outcomes in Superannuation Measures No. 1) Bill 2017. This Bill includes proposals for new disclosures to members about trustees' management of the fund, expenses and the trustee's duties to members, and for annual members meetings where the trustee would be required to answer questions about the management and operation of the fund. *Asia Region Funds Passport* This reform provides a multilaterally agreed framework to facilitate the cross-border marketing of managed funds across participating economies in the Asia region. On 28 April 2016, the Government signed a Memorandum of Cooperation with Japan, Korea and New Zealand, which sets out the internationally agreed rules and cooperation mechanisms of the Asia Region Funds Passport. The Government's public consultation on the draft chapter to insert the regime into the Corporations Act closed on 21 September 2017. *Collective investment vehicles* This reform introduces collective investment vehicles as a tax-effective alternative to the current Australian pooled investment trusts to ensure that the Australian funds management sector is internationally competitive. The Government's public consultation on the draft chapter to insert the regime into the Corporations Act closed on 21 September 2017.
Financial market infrastructure	*Competition in clearing and settlement of equities* In 2016, as part of the CFR work on the Government's commitment to openness to competition in clearing and settlement, the Government committed to make legislative changes to grant the relevant regulators rule-making (ASIC) and arbitration powers (ACCC) in relation to clearing and settlement facilities in Australia. The proposed law reform will support the policy statements summarising the CFR's expectations with regard to the single service provider and minimum conditions for the provision of clearing and settlement services by competing facilities.

B Market dynamics

Key points

This section discusses the following key characteristics and dynamics of the financial system:

- concentration and contestability in key financial markets;
- transparency and switching;
- price discrimination; and
- the key role played by technology and innovation.

122 ASIC oversees a diverse range of markets. 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 single clearing provider for cash equities, which deals with billions of dollars every day.

123 Competition does not currently form an explicit part of our mandate and we do not propose to make a general assessment about the state of competition across each market we regulate. However, in the course of regulating these markets, we have made a number of observations about their supply-side market dynamics, including:

(a) concentration and contestability;

(b) transparency and switching;

(c) price discrimination; and

(d) the key role played by technology and innovation.

124 We have set out some of these observations in this section. They illustrate key issues in markets for financial products and services, and also provide a backdrop to understanding the environment in which consumers operate, which is discussed further in Section C.

125 Importantly, we have identified poor consumer outcomes in some of these markets. We often see these poor consumer outcomes where suppliers are not incentivised to compete on price, service and quality to consumers. Such problems represent barriers to the effective operation of the 'virtuous circle' of competition: see paragraph 36.

126 When considering market dynamics, it is also important to bear in mind the overarching influence of particular regulatory safeguards and initiatives. The most significant of these in this context are:

(a) prudential regulation of some parts of the financial system;

(b) the Government's Financial Claims Scheme (FCS), which protects deposits; and

(c) the compulsory nature of superannuation, which impacts on the number and range of consumers participating in the financial system, and the channels through which products are distributed.

Market concentration and contestability

127 The level of contestability is a key influence on competition in the financial system. However, contestability is difficult to measure and evaluate. It encompasses barriers to entry and exit (including the threat of entry), regulatory impediments, information asymmetry, technology and switching costs, and is affected by a number of behavioural biases such as inertia. To overcome this difficulty in assessing contestability, analytical work has often focused on structural features like concentration.

128 Concentration is one indicator of contestability in the financial system. While it has limitations,[18] there is still insight to be gained from understanding the level and change in concentration in key areas of the Australian financial system.

Concentration and the dominance of incumbents

129 The Australian banking, insurance and financial services industries have become increasingly concentrated over the past two decades.

130 Market shares are concentrated with the big four banks across a number of products and services. In effect, the major banks operate like financial supermarkets, offering various financial products and services that can be bundled together and sold under one umbrella.

131 Market concentration is particularly apparent in credit and deposit markets. For example:

(a) in the mortgage market (as at June 2017), the major banks hold 80.6% of residential term loans for authorised deposit-taking institutions (ADIs);[19]

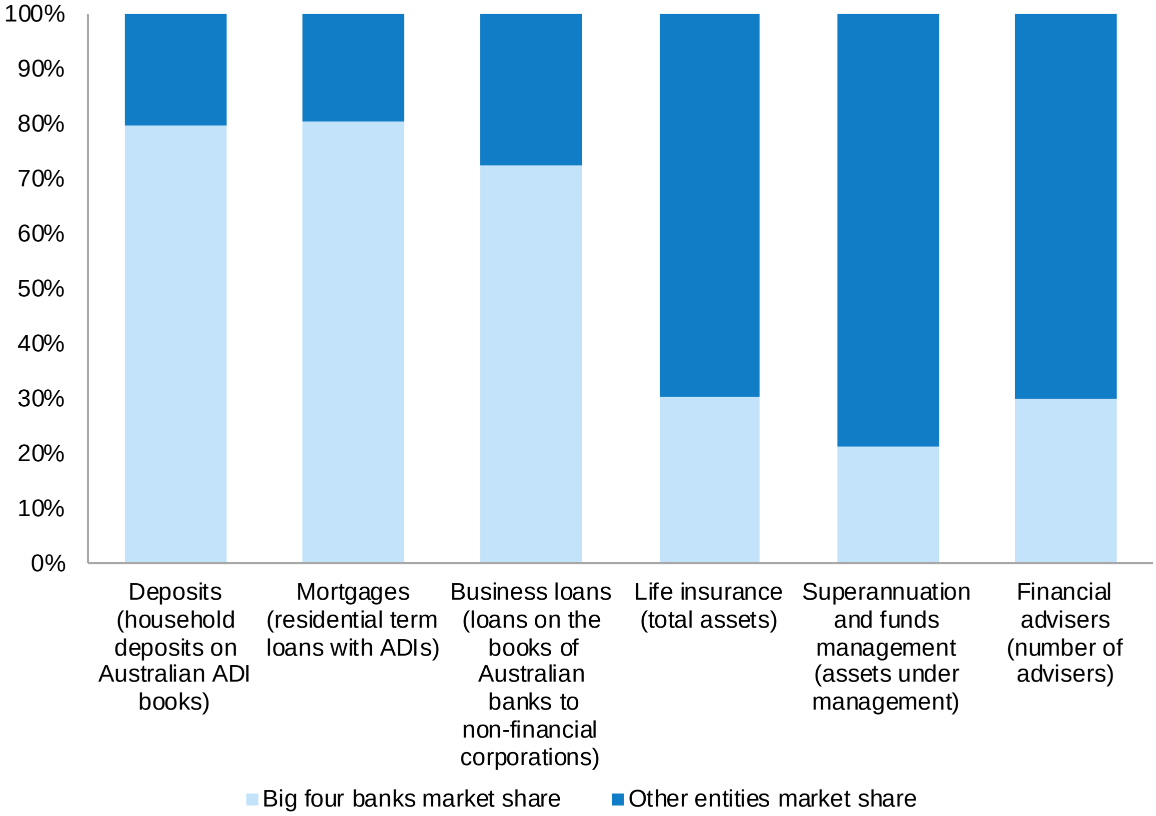
(b) in the credit card market (as at June 2017), the major banks account for around 83% of outstanding credit card debt;[20] and

[18] Organisation for Economic Co-operation and Development (OECD), *Bank competition and financial stability* (PDF 984.3 KB), report prepared for the G20 workshop, 'The new financial landscape', sponsored by Australian Treasury and the Reserve Bank of Australia, 2011, p. 16.
[19] Australian Prudential Regulation Authority (APRA), *Monthly banking statistics*, June 2017.

(c) the four major banks hold 80% of the total value of household deposits and 77% of the value of all deposits.[21]

132 In the financial advice market, around 30% of the 25,379 financial advisers listed on the financial advisers register work for one of the big four banks[22] and the big four banks hold approximately 21% of superannuation and fund manager assets under management: see Figure 1.

Figure 1: Market share of the big four banks across selected domestic markets



Note: Deposits, mortgages and business loans data, as at June 2017; life insurance data, as at December 2016; superannuation data, as at June 2016; funds management data based on latest data reported to ASIC; financial adviser data, as at August 2017.

Source: APRA, *Monthly banking statistics*, July 2017; APRA, APRA, Quarterly authorised deposit-taking institution performance statistics, June 2017, *Quarterly authorised deposit-taking institution property exposure statistics*, June 2017; APRA, *Life insurance institution level statistics*, December 2016; APRA, *Annual fund-level superannuation statistics*, June 2016; ASIC, *Financial advisers dataset*, 1 August 2017; ASIC internal data; ASIC calculations.

133 The general insurance market is also concentrated. The four largest firms[23] accounted for approximately 77% of the market by gross earned premiums for the calendar year 2016.[24]

[20] Ibid.
[21] APRA, *Monthly banking statistics*, July 2017 (released 31 August 2017).
[22] ASIC, financial advisers register, 30 June 2017.
[23] Insurance Australia Group Limited, Suncorp Group Limited, QBE Insurance Group Limited and Allianz Australia Limited.
[24] APRA, *Quarterly general insurance performance statistics*, Table 1A.

134 Within the context of these concentrated market conditions it is difficult for new players to enter the market due to the market power and economies of scale held by incumbents. This is particularly the case in markets with prudential requirements, which are necessary to promote financial system stability and confident consumers and investors.

135 Since 2007, 26 ADIs, 30 general insurers, three life insurance companies and 12 registrable superannuation entities have been granted a licence from APRA. However, in the large majority of cases the licences have been granted to foreign entrants that have established banking or insurance operations in Australia, with backing from their foreign parent company.[25]

136 For the entities that do enter the market, developing sufficient economies of scale can be difficult and requires significant investment to build brand loyalty and consumer trust.

137 The global financial crisis had a significant impact on supply-side market dynamics, in particular the credit markets. During the global financial crisis, the major banks acquired a number of smaller lenders and have had access to lower funding costs relative to competitors. This was due to a collapse in securitisation markets, which had previously allowed the non-major banks to access cheaper wholesale funding.

Note: See the discussion in Appendix A in the Appendices attached to this submission.

138 It should be noted that the level of concentration and the entities within markets are constantly changing. For example, some of the big banks have recently indicated they may exit the wealth management sector: see paragraph 144. We have also seen the emergence of crowd-sourced equity funding and marketplace lending: see paragraphs 251–257. It is not clear at this stage, what impact these changes will have on competition in these markets.

Consolidation following the global financial crisis

139 The global financial crisis triggered some level of consolidation in the financial system, with the big four banks in particular making a number of significant acquisitions: see Table 7.

[25] APRA, *Licensing: A phrased approach to authorising new entrants to the banking industry*, 15 August 2017.

Table 7: Major bank consolidation

Year	Acquisition
2007	Westpac acquires RAMS franchise distribution business (including the RAMS brand, franchise network and associated mortgage origination and servicing systems and contracts).[26]
2008	Westpac merges with St George Bank (which at the time owned BankSA).[27] CBA acquires Bankwest, St Andrew's Australia[28] and a 33% stake in Aussie Home Loans.[29] CBA acquires up to $4 billion of Wizard Home Loans prime mortgages in conjunction with the purchase by Aussie Home Loans of the Wizard Homes Loans brand and distribution network.[30]
2009	ANZ acquires full ownership of ING, wealth management, life insurance and advice businesses (ING Australia Limited and ING (NZ) Holdings Limited become wholly owned subsidiaries of ANZ).[31] NAB acquires Challenger Financial Services mortgage business (which includes PLAN, Choice and FAST mortgage aggregation businesses and 17.5% in Homeloans Limited).[32] NAB acquires AVIVA Australia Holdings Limited (including its life insurance operations and investment platform).[33] NAB acquires an 80.1% stake in the wealth management division of Goldman Sachs JBWere.[34]
2012	CBA increases its holding in Aussie Home Loans to 80%.[35]
2017	CBA acquires full ownership of Aussie Home Loans.[36]

140 The four big banks, all of which have significant fund management operations, have each increased their share of the wealth management industry over the last two decades. The Reserve Bank of Australia (RBA) has noted that:

> … during the late 1990s and early 2000s, each of the major banks acquired or merged with a fund manager; with only AMP remaining independent.[37]

[26] Westpac ASX announcement, *Westpac to acquire RAMS distribution franchise*, 2 October 2007.
[27] Westpac ASX announcement, *Implementation of merger of WBC and SGB*, 1 December 2008.
[28] CBA ASX announcement, *CBA completes acquisition of Bankwest and St Andrew's*, 19 December 2008.
[29] CBA ASX announcement, *Commonwealth Bank makes strategic investment in Aussie*, 29 August 2008.
[30] CBA ASX announcement, *Commonwealth Bank to acquire up to $4 billion of Wizard originated prime mortgages*, 24 December 2008.
[31] ANZ ASX announcement, *Acquisition of ING Australia and ING NZ joint ventures*¸25 September 2009.
[32] NAB ASX announcement, *NAB completes Challenger Mortgage Management acquisition*, 30 October 2009.
[33] NAB ASX announcement, *NAB acquires Aviva Australia wealth management business*, 22 June 2009.
[34] NAB ASX announcement, *Completes strategic alliance in private wealth with GSJBW*, 2 November 2009.
[35] CBA, ASX announcement, *Commonwealth Bank increases investment in Aussie Home Loans*, 18 December 2012.
[36] Aussie Home Loans, *Our history*, accessed 14 September 2017.
[37] RBA, *Bulletin*, September 2016, p. 54.

141 The RBA reports that these acquisitions resulted in the major banks' assets under management in the wealth management sector[38] increasing from 13% of the Australian total in the late 1990s to around 20% (or $530 billion) in 2016.[39]

142 The RBA considers the key motivations for these acquisitions to be:

> … the opportunity to cross-sell a broader range of financial services to [the banks'] existing customer base and to gain exposure to the rapidly growing superannuation market.[40]

143 The general post financial crisis consolidation in the Australian banking sector suggests the major banks have increasing market power. This is a potential concern if it leads to poor consumer outcomes in terms of pricing, quality and choice of products.

144 More recently we have observed a reversal in this trend. For example, in 2015 Westpac sold part of its share in BT Investment Management Limited.[41] In 2016, NAB sold 80% of its life insurance arm to Japan's Nippon Life Insurance Company.[42] In 2017 Westpac sold a further 19% of its holding in BT Investment Management Limited and stated that it intended to sell its remaining 10% holding in the future, subject to favourable market conditions.[43] ANZ has also announced that it is seeking to sell its wealth management business.[44]

Barriers to entry

145 There are a number of reasons why entities find it difficult to enter markets in the financial system. These can include:

(a) commercial barriers, including building brand awareness and consumer trust, which is particularly important for goods with credence qualities when assessing the quality of the product is difficult;

(b) regulatory requirements, including licensing and operational requirements and in some markets prudential requirements, which are important to promote financial stability and consumer and investor confidence;

(c) limited resources; and

(d) lack of experience with the regulatory framework.

[38] For the purposes of its report, the RBA defined wealth management as various forms of funds management (superannuation, managed funds and life insurance) and financial advisory services.
[39] RBA, *Bulletin*, September 2016, p. 54.
[40] Ibid.
[41] Westpac ASX announcement, *WBC announces close of retail offer for sale of BTIM shares*, 15 July 2015.
[42] NAB ASX announcement, *NAB completes sale of 80% of life insurance business*, 3 October 2016.
[43] Westpac ASX announcement, *Westpac Group announces BTIM institutional offer*, 24 May 2017; Westpac ASX announcement, *Westpac Group completes BTIM institutional offer*, 25 May 2017.
[44] ANZ ASX announcement, *2016 annual general meeting: CEO's address*, 16 December 2016.

146 In some markets there has been significant law reform, as well as regulatory action, to foster competition and market contestability—for example, in centralised financial market facilities: see paragraphs 169–186.

Banking

147 Banks in Australia are subject to prudential requirements to ensure financial system stability, including approval by APRA for a banking licence and ongoing compliance with prudential standards. These requirements are considered necessary to ensure the stability of our financial system and protect deposit-holders from financial loss. They are also subject to the market conduct requirements administered by ASIC.

148 As noted in the *Review of the four major banks*,[45] in the last decade only one entity that was not associated with an existing bank has been granted a new banking licence. In addition to regulatory barriers to entry, the review identified commercial barriers to entry, including:

(a) to operate as an ADI, an institution must be approved by APRA for a banking licence;

(b) once licensed, an ADI must comply with APRA's prudential requirements on an ongoing basis;

(c) under the *Financial Sector (Shareholdings) Act 1998* (FSSA), a shareholder or group of associated shareholders cannot hold more than 15% of the prospective ADI's voting share without an exemption;

(d) existing ADIs (particularly the major banks) hold significant amounts of consumer and business data that allows them to accurately model and price risk; and

(e) existing ADIs (particularly the major banks) have strong brands and sophisticated distribution networks that are expensive to replicate.[46]

149 The Government has announced that it will act to reduce these regulatory barriers to entry. The Government has also announced that it plans to:

(a) legislate to lift the prohibition on the term 'bank' by ADIs with less than $50 million in capital, to allow them and other ADIs to benefit from the reputational advantages of the term;

(b) introduce an open banking regime that will increase access to banking product and consumer data by consumers and third parties, if the consumer consents (see paragraph 385(a) in Section D), and has commissioned an independent review to recommend the best approach to implement the regime in Australia, to report by the end of 2017. [47]

[45] Standing Committee on Economics, *Review of the four major banks: First report*, tabled 24 November 2016.
[46] Ibid., p. 34.
[47] The Hon Scott Morrison MP, *Building an accountable and competitive banking system*, media release, 9 May 2017.

150 The Government is also supportive of a phased approach to licensing banks and welcomes APRA's review of prudential licensing arrangements and consideration of such approaches.

151 We support the Government's proposed measures and consider that they will supplement our existing work to support new entrants, including the Innovation Hub and regulatory sandbox: see paragraphs 272–277.

Competition for distribution channels

152 A broader issue is how intermediaries and distribution channels mediate consumer access to financial products—including the role of ownership and remuneration.

153 We have often seen product issuers compete vigorously for distribution channels, rather than directly offering better products and prices to customers. This arises through ownership links or paying higher incentives (or a combination of these things) and often produces poor consumer outcomes.

154 Examples of where we have observed this behaviour include:

(a) flex commissions, which create an incentive to supply car finance at higher interest rates to consumers (flex commissions are discussed further in the example below paragraph 66); and

(b) add-on insurance through car dealers, where we found for example that across all add-on general insurance products sold during the 2015 financial year, car dealers earned over four times more in commissions than was paid to consumers in claims[48] (add-on insurance is discussed further at paragraphs 220–231).

155 It is often not possible for the supply side itself to address problems that are affecting competition and causing poor consumer outcomes without the support of regulatory intervention due to 'first mover' disadvantage.[49]

Vertical integration

156 The business model of combining activities at two different stages of production is known as 'vertical integration'. It is a model that exists across the financial services sector in various forms.

[48] ASIC, Report 492 *A market that is failing consumers: The sale of add-on insurance through car dealers* (REP 492), September 2016.
[49] See the discussion above at paragraphs 17–18.

157 Vertical integration can provide benefits for both the institution and the consumer. For the institution, benefits include economies of scale and access to a wide database of consumers.

158 Consumers may prefer to obtain both advice and financial products from a large institution due to the perceived safety of a relationship with a large institution. For the consumer, vertically integrated businesses have:

(a) integrated product offerings and a single point through which to deal with their financial affairs;

(b) better recourse when things go wrong; and

(c) where necessary, the resources to carry out large proactive remediation programs.

159 The fact that vertically integrated institutions have the resources to compensate consumers is highly significant in an industry where consumers are facing uncompensated losses.[50]

160 Without vertical integration, there is likely to be competition for distribution channels in other ways and this supply-side competition can have adverse impacts for consumers: see paragraphs 152–155.[51]

161 Further, when vertical integration works effectively, the savings and efficiencies from operating in this way (e.g. by giving a business economies of scale) can be passed onto consumers.

162 However, this business model gives rise to inherent conflicts of interest. For example, in the financial advice sector, there is a clear tension between providing advice that is in the best interests of the client, while at the same time selling products that the vertically integrated business has manufactured. While the law permits this conflict of interest to exist, it must be appropriately managed.

163 It has also been argued that the financial advice arms of large vertically integrated institutions may be subsidised by the product manufacturing arms because the financial advice business can provide a ready distribution channel. This may make it difficult for non-vertically integrated businesses to compete on price with financial advice businesses that are subsidised.

164 A further concern is how external providers access the approved product lists of vertically integrated institutions and, further, how products are selected by advisers operating in these business models. In a vertically integrated

[50] Financial Ombudsman Service (FOS), *Circular*, issue 29, April 2017 (unpaid FOS determinations total $13,909,635.50) and *Interim report: Review of the financial system external dispute resolution and complaints framework*, released on 6 December 2016, p. 165 (unpaid CIO determinations total $414,443 as at 1 November 2016).
[51] See the discussion above at paragraph 41.

institution, the conflict between the interests of the advice licensee and the interests of the consumer is acute in two situations:

(a) when the advice licensee decides which products to put on an approved product list; and

(b) when the adviser decides which products to recommend to an individual customer.

165 We have observed the effects of vertical integration in the context of mortgage brokers. Our findings from our report on mortgage broker remuneration are discussed below.

Findings: Our review of mortgage broker remuneration

Mortgage brokers potentially provide an important source of competition in the home loans market. This is because they can:

- provide a distribution channel for lenders—especially smaller lenders—without their own distribution network (e.g. branches); and
- exert downward pressure on home loan pricing, by forcing lenders to compete more strongly with each other for business.

Aggregators, which provide aggregation services to brokers and have a contractual relationship with lenders, can also improve the level of competition in this market because they can maintain large and varied selections of lenders on their panels.

However, in practice, we have found that ownership structures and remuneration can inhibit the consumer and competition benefits that can be achieved by brokers and aggregators flowing to consumers.

Our review of remuneration in the mortgage broking market (REP 516)[52] found that brokers almost universally receive commissions paid by the 'supply side' of the market (i.e. the lender or the aggregator), rather than by the consumer. While these remuneration structures varied, generally we found that commission models are made up of an upfront and a trail commission. We consider this standard model of commissions creates conflicts of interest because:

- A broker could recommend a loan that is larger than the consumer needs or can afford to maximise their commission payment. This may also involve recommending a particular product or strategy to maximise the amount that the consumer can borrow (e.g. through the choice of an interest-only loan) ('product strategy conflict').
- A broker could also be incentivised to recommend a loan from a particular lender because the broker will receive a higher commission, even though that loan may not be the best loan for the consumer ('lender choice conflict').

[52] ASIC, Report 516 *Review of mortgage broker remuneration* (REP 516), 16 March 2017.

In addition to standard commission, we found that aggregators also receive bonus commissions from lenders which can be passed on to brokers. We also found that brokers receive soft dollar benefits from lenders and aggregators, such as through loyalty programs (known as 'broker clubs') and travel and hospitality benefits

Our review also found that often lenders will have ownership stakes in one or more aggregators, a form of vertical integration. Vertical integration between lenders and aggregators affects the share of home loans provided by brokers associated with these aggregators. We found that aggregators that were owned or part-owned by lenders were significantly more likely to arrange white-labelled loans funded by their shareholders.

On average, aggregators in our review sent loans to 29 lenders. However, we found that, in practice, broker businesses tended to recommend loans from a much smaller number of lenders. We found that individual broker businesses had four preferred lenders, which received 80% of loans (by value) from that business.

To improve consumer outcomes and competition in the home loan market, we put forward six proposals in REP 516:

- changing the standard commission model to reduce the risk of poor consumer outcomes;
- moving away from bonus commissions and bonus payments, which increase the risk of poor consumer outcomes;
- moving away from soft dollar benefits, which increase the risk of poor consumer outcomes and can undermine competition;
- clearer disclosure of ownership structures within the home loan market to improve competition (this proposal is consistent with the findings and recommendation of the Murray Inquiry to rename 'general advice' and require advisers and mortgage brokers to disclose ownership structures);
- establishing a new public reporting regime of consumer outcomes and competition in the home loan market; and
- improving the oversight of brokers by lenders and aggregators.

Treasury consulted on these proposals. In August, the Government welcomed the mortgage industry's creation of a forum to develop an industry-led response to ASIC's review and noted that it will take the mortgage industry forum's process into account when finalising its response to the review.[53]

166 We are continuing to assess the impact of vertical integration on consumer outcomes. We are currently undertaking a review to understand how well Australia's largest banking and financial services institutions manage the conflict of interest that arises when they engage in both providing personal

[53] The Hon Kelly O'Dwyer MP, *ASIC review of mortgage broker remuneration*, media release, 29 August 2017.

advice to retail clients and manufacturing financial products. We expect to release our findings from this review in the coming months.

167 While there may be benefits to operating in this way for both institutions and consumers, there are also aspects of how vertically integrated businesses work that may result in poor consumer outcomes.

168 It is not clear at this stage whether reforms, in particular the FOFA reforms which were aimed at addressing conflicts of interest, will be sufficient to address the risks raised by vertical integration. An additional step may be to better inform clients about the nature of vertically integrated business models and their implications for financial decision making. For example, this could be a prominent, simple statement about the relationship of the adviser to the issuer and the limited range of products that the adviser is able to recommend: see Table 5 in Section A. However, as discussed elsewhere in this submission, there are limitations to disclosure: see, in particular, Section C.

Centralised financial market facilities

169 The mere existence of competition between multiple providers does not always produce the best competition outcome and consumer outcomes. In relation to centralised market facilities, the long-term interests of consumers would be met where the regulatory regime provides a framework for safe and effective competition that seeks to ensure market contestability, and which facilitates broadly market-driven competition outcomes. This means that, while the regime seeks to ensure market contestability, whether or not new competitor(s) emerge should be market driven.

170 Importantly, when considering safe and effective competition outcomes for consumers, the relevant consumers go beyond participants and users of centralised market facilities, and include a wide range of retail and wholesale investors and market participants that benefit from well-functioning centralised market facilities such as clean and orderly markets, or safe and resilient clearing and settlement facilities.

171 These considerations mean that regulation plays a greater role in influencing market contestability, including to facilitate both demand-side and supply-side competition within 'safe and effective' parameters.

Clearing and settlement facilities

172 Clearing and settlement facilities are used to provide risk management services for high-value financial contracts over the lifetime of the contract (e.g. 20–50 years). As such, the long-term interests of consumers include having the confidence that the facilities will remain financially viable and therefore able to perform these key risk management services for the

duration of the financial contracts. Safe and effective competition, and users' access to clearing and settlement facilities, is a core part of the prudential regulatory settings for these facilities.

173 ASIC and the RBA have facilitated the entry of competitor clearing services for non-exchange traded derivative products. ASIC has worked within the Council of Financial Regulators (CFR) and with the ACCC to establish a framework to facilitate safe and effective competition for clearing and settlement services for critical cash equity markets.

174 CFR, in collaboration with the ACCC, has released policy statements setting out the minimum conditions for safe and effective competition in cash equity clearing and cash equity settlement (in October 2016 and September 2017 respectively).[54] These statements set out the minimum regulatory requirements that would apply if a competitor should emerge for some or all parts of the clearing and settlement services currently provided by a single service provider, to ensure the long-term interests of consumers are met.

175 Also in October 2016, the CFR published the *Regulatory expectations for conduct in operating cash equity clearing and settlement services in Australia* (regulatory expectations). These regulatory expectations would apply to the clearing and settlement services provided by a single service provider if no competitor emerges.

176 The regulatory expectations are intended to support the long-term interests of the Australian market by delivering outcomes that are consistent with those that might be expected in a competitive environment.

177 Together, the minimum conditions (clearing) and the regulatory expectations provide a flexible regulatory framework that sets out expectations for the conduct of single service providers and the requirements for safe and effective competition should a competing provider emerge.

178 Elements of the minimum conditions (clearing) and the regulatory expectations are not enforceable under the existing Australian regulatory framework. In March 2016, the Government announced its commitment to legislative changes to grant the relevant regulators rule-making powers (ASIC) and arbitration powers (ACCC) to impose requirements on clearing and settlement facilities in Australia.

179 We consider it highly desirable for the proposed law reform to be implemented in a timely way so that the regulatory settings to enable competition would be completed for clearing and settlement facilities.

[54] CFR, *Minimum conditions for safe and effective competition in cash equity clearing in Australia* (minimum conditions (clearing)), October 2016; and CFR, *Minimum conditions for safe and effective competition in cash equity clearing in Australia* (minimum conditions (clearing)), September 2017.

180 Additionally, as broadly similar competitive dynamics and considerations apply to competition relating to financial market facilities, we see a case for these proposals to also apply to financial markets, as discussed see below.

Financial markets

181 Market facilities provide infrastructure that assists listing companies in elements of the capital-raising process. They help to bring together buyers and sellers of financial contracts, which in turn helps users to determine the market price of those financial contracts, and in doing so also centralises oversight of those activities.

182 In addition to direct considerations of issues like service fees, the long-term consumer interests include having the confidence that:

(a) the facility is effectively bringing together a critical mass of the trading interests;

(b) the trading interests are brought together in a way that is fair to all buyers and sellers; and

(c) the prices for the financial contracts are not subject to manipulation.

183 Over the past 15 years, ASIC has worked to support competition and the entry of new competitors in financial markets.

184 In 2010, the Government introduced significant law reform to implement a framework that facilitates the entry of new financial market competitors. Key aspects of the reforms were:

(a) giving ASIC the power to write enforceable rules about the conduct of market operators and their participants; and

(b) ASIC taking over supervision of financial markets (previously market supervision was performed by the single provider exchange).

185 ASIC has applied the legal framework to facilitate the emergence of competitors to the single provider, in a way that has still sought to facilitate the long-term interests of consumers for financial markets. This includes licensing new domestic exchanges (including Chi-X) and overseas exchanges, and enabling non-exchange ‘dark pools’ to compete with the exchanges by writing market integrity rules that are tailored to the business models and risks of dark pools.

186 The introduction of competition saw Chi-X commence operating its financial market in October 2011. Chi-X now accounts for 20% of ASX equity trading (80% occurs on ASX). Competition in this market is likely to have been a causal factor for benefits to participants, including greater incentives for innovation (with the introduction of new trading platforms, products and order types) and the reduction in trading fees.

187 ASIC has facilitated competition and market contestability in non-exchange financial markets. Reflecting the nature of global capital markets, here the process of facilitating the long-term interests of consumers and market contestability has focused on ensuring that Australian market facilities can attract and retain overseas market participants, as well as ensuring that Australian market participants face no barriers to accessing overseas market facilities.

188 Lastly we consider there is a case for the proposed reforms relating to competition in cash equity clearing and settlement to also be applied to financial markets.

Transparency

189 The ability for consumers to switch products and services cheaply and easily is critical to consumers' ability to exert demand-side pressure on firms. To promote switching, consumers require sufficient transparency in order to compare and evaluate financial products and services.

190 This section identifies examples where a lack of transparency has limited consumers' decision making and can impede their ability to switch.

191 Within some of the markets that we regulate, we have observed costs or barriers that prevent consumers from easily switching suppliers (e.g. exit fees, contract break-fees and transaction costs). It may be in the interests of suppliers for the switching process to be difficult, or at least in their interests not to remove barriers, in order to retain customers.

White labelling and multi-branding

192 Within financial services there are two supply-side structures that can give the impression that markets are more competitive than they actually are:

(a) multi-branding strategies, where one commercial entity owns multiple distributor brands; and

(b) white-labelling arrangements, where a white label product is distributed by another company under their brand.

193 Where these structures reduce transparency in markets, we encourage the Productivity Commission to consider its impact on competition. In this context, the Productivity Commission may want to consider whether products are being priced effectively, given they are often accessed by consumers through comparison websites—some of which have relationships with issuers that manufacture white label products or have multiple brands: see paragraphs 204–208.

Banking

Mortgage market

194 As noted above, market concentration is particularly apparent in the mortgage market. Mortgage brokers, along with aggregators which maintain a selection of lenders on their panel, can play an important role in encouraging competition through lowering search costs and facilitating consumer choice.

195 However, ownership structures and white-labelling can inhibit the benefits of competition flowing from aggregators and brokers to consumers.

196 At the request of the Government, we conducted a review of the mortgage broking market.[55] As part of this review we considered all loans, including white label loans—being loans that are issued under the brand name of another business.

197 In the mortgage broking market, the brand name of a white label loan is usually that of the aggregator and, typically, the particular white label loan will be sold exclusively through that aggregator's broker network.[56] The white label loan will not be available through other aggregators or through direct channels. They are often marketed to consumers as simple but cost-effective alternatives to standard home loan offerings.

198 White label loans are different from 'mortgage manager' arrangements where the aggregator accesses a line of funds from a lender to offer a home loan under the aggregator's brand and takes a more active role in the application process and subsequent management of the home loan. We were informed by some industry participants that use of mortgage manager arrangements has decreased over recent years, with a shift to white label arrangements. This was consistent with our findings.

199 Overall, we found that the combination of an ownership relationship with a white label arrangement may result in a higher than average loan flow between related aggregators and lenders compared to all aggregators. We also found that, while an aggregator may offer what appears to be a large selection of lenders on its panel, in practice, the number of lenders actually providing home loans to consumers through the aggregator may be significantly less than the number of home loan products (or home loan 'brands') on the aggregator's panel. For example, while an aggregator such as Aussie Home Loans may have CBA-branded loans, Aussie Home Loans-

[55] ASIC, Report 516 *Review of mortgage broker remuneration* (REP 516), 16 March 2017.
[56] While the loan is offered using the brand name of the aggregator, the actual lender is generally responsible for the initial assessment of the loan application and all the servicing tasks associated with that loan.

branded loans and Bankwest-branded loans on its panel, all three of these brands are funded by the same lender (CBA).

200 See the example below paragraph 165 for a more detailed discussion on our findings from REP 516 in the context of vertical integration.

Insurance

General insurance

201 We have observed the use of white labelling in the general insurance market. These white label products may appear to consumers as alternate offerings with different providers. However, these products have the same underwriter as other offerings in the market.

202 For example, in some product sectors of general insurance, we have observed a very small number of product issuers, when there are many distributor brands offering the issuers white label product, which creates the illusion that the market is more competitive than it actually is.

Example: Our review of funeral insurance

Our work reviewing the funeral insurance market in Australia is an example of where we have observed white labelling in the general insurance market.[57] REP 454 gives a snapshot of the funeral insurance market in Australia in 2013 and 2014. It also includes our recommendations for improving the features of funeral insurance products to potentially address issues raised in the report.

In undertaking this work we selected nine insurers who sold direct funeral insurance products in the Australian market at 30 June 2013. We found that these nine insurers had a total of 42 different funeral insurance products under different brands.

203 The effect of these white label arrangements on consumers may be further exacerbated by price comparison tools (e.g. websites), which are often owned by insurers and do not always show the full market of products, as discussed below.

Comparison tools

204 Comparison tools made available to consumers are a further supply-side complexity that affects the quality of demand-side competition.

205 As discussed further in Section C, when consumers have been prompted to begin to search for a financial product or service, or consider switching, the

[57] ASIC, Report 454 *Funeral insurance: A snapshot* (REP 454), October 2015.

process needs to be relatively easy—allowing people to seek out the information they need to be able to make a decision.

206 Consumers are generally able to deal with an issuer or distributor directly and compare their products and services either in person or online. However, to compare products and services across issuers and distributors, consumers will often turn to tools such as comparison websites.

207 Product comparison websites enable consumers to view a wider range of products and can facilitate consumer choice and decision-making. However, comparison websites may:

(a) receive commissions or use sponsored or promoted links, which often means that search results show sponsored links ahead of non-sponsored links;

(b) have a relationship to the issuers or distributors that are being compared, which may mean that:

(i) certain products are shown ahead of others on the basis of this relationship; and

(ii) only products from related parties are compared;

(c) only cover a portion of the market, not the whole market; and

(d) focus on comparing products based on one feature (e.g. price or interest rate), when there are other important features that consumers need to consider (e.g. terms and conditions).

208 These factors affect a consumer's ability to properly access and assess information relating to products and services available in the market: see Section C.

Price discrimination

209 Price discrimination occurs where firms charge prices to different consumer groups, with different mark-ups on the costs of supplying the product to these groups. Cross-subsidisation is the distributional consequence of price discrimination—consumers who are charged high mark-ups may be considered to 'subsidise' those who are paying lower mark-ups.[58]

210 The Productivity Commission may wish to consider further the occurrence of price discrimination and cross-subsidisation between segmented consumer groups and the relationship between these pricing practices and competition.

[58] UK Financial Conduct Authority (FCA), *Price discrimination and cross-subsidy in financial services*, Occasional Paper No. 22, September 2016, p. 3.

211 The FCA's paper on price discrimination and cross-subsidisation in financial services examines, among other things, the link between pricing practices and competition. It explains that there can be no presumption that these practices are either harmful or beneficial:

> Price discrimination can occur in markets where firms compete for consumers. Such pricing may encourage competing firms to charge lower prices to win customers and may make all consumers better off than uniform pricing. Moreover, price discrimination can be an efficient way for firms to cover their fixed and common costs and it can expand the market, allowing some previously priced-out customers to access the market.[59]

212 However, the FCA also notes that such pricing can signal weak or distorted competition:

> Some forms of price discrimination and cross-subsidy, especially when used by firms with substantial market power, can drive out actual and exclude potential rivals, further reducing competition in the market. A firm's ability to identify a consumer group and charge them high mark-ups may indicate those consumers have few available competing options – or that barriers stop consumers accessing these options.[60]

213 In respect of intervention, the FCA takes the view that:

> … the mere presence of price discrimination or cross-subsidy does not necessarily warrant an intervention. Whether an intervention is appropriate depends on the identification of harm resulting from the practice, as well as the expected material improvement in welfare from the intervention.[61]

214 We have observed these pricing practices in the markets we regulate and identified instances where these practices have led to poor consumer outcomes, which are set out below.

Consumer leases

215 In September 2015, we released a report setting out our findings on the costs charged by providers of leases of household goods.[62] Two key findings of this report were that:

(a) different lessors charged significantly different amounts for the same goods (price dispersion); and

(b) the same lessor would charge significantly different amounts for the same goods for different customer segments (price discrimination).

216 In both instances, the consumers more likely to pay the higher amounts were Centrelink recipients, despite having lower income as a class and therefore being more financially vulnerable.

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[59] Ibid., pp. 3–4.
[60] Ibid., p. 4.
[61] Ibid.
[62] ASIC, Report 447 *Cost of consumer leases for household goods* (REP 447), September 2015.

217 We provided a copy of our findings to the panel reviewing the effectiveness of the law relating to small amount credit contracts (SACCs).

218 The final report of the SACCs review has recommended, among other things, that:

(a) there be a cap on the total amount of payments to be made under a consumer lease of household goods;

(b) the base price for new goods should be the recommended retail price or the price agreed in store, where this price is below the recommended retail price; and

(c) a protected earnings amount requirement be introduced for leases of household goods, whereby lessors cannot require consumers to pay more than 10% of their net income in rental payments under consumer leases, so that the total amount of all rental payments (including under the proposed lease) cannot exceed 10% of their net income in each payment period.[63]

219 The Government has accepted the above recommendations.[64] In respect of the base price of goods, the Government has accepted this recommendation with an amendment—that second-hand goods be subject to the same cap as new goods, with a 10% discount to the original base price per annum, up to a maximum of 30%.

Add-on insurance

220 In February 2016, we released a report on ASIC's findings in relation to the sale of life insurance components of consumer credit insurance (CCI) sold through car dealers (car yard life insurance).[65] This report found, among other things, that:

(a) Insurers charged consumers on average 50% more for personal-use car yard life insurance than for ADI-distributed life insurance. In one instance, an insurer charged personal-use consumers four times more for its car yard life insurance than for its ADI-distributed life insurance. We did not identify any additional benefits or difference in cover to justify the difference in costs.

(b) Car yard life insurance is often substantially more expensive than term life insurance, even though term life insurance provides more cover.

221 In our report, we noted that the disparity in price suggests insurers are paying a higher price to car dealers in commissions in order to obtain access

[63] Treasury, *Review of the small amount credit contract laws: Final report*, March 2016. See, in particular, recommendations 11–18.

[64] The Hon Kelly O'Dwyer MP, *Government response to the final report of the review of the small amount credit contract laws*, media release, 28 November 2016.

[65] ASIC, Report 471 *The sale of life insurance through car dealers: Taking consumers for a ride* (REP 471), February 2016.

to them as a distribution channel. The effect of this competition would be to increase the price paid by the consumer (because insurers would need to recoup the commissions paid to car dealers). This outcome is known as 'reverse competition' because it is competition that increases the cost to the consumer.

222 REP 471 formed part of a series of reports we released on add-on insurance products. During 2016 we also released:

(a) REP 470,[66] which analysed qualitative research on consumers' experience of buying add-on insurance through car dealers; and

(b) REP 492,[67] which analysed data from seven general insurers selling five different add-on insurance products.

223 These reports found systemic problems in this distribution channel, resulting in a market that is failing consumers. In particular, we found that add-on insurance products were being 'sold to' rather than 'bought by' consumers, and that these products are both high cost and poor value measured in claims outcomes.

224 We also found that there is an absence of a broad competitive market for these add-on products in that generally they are:

(a) only offered by a small number of insurers;

(b) only available with the sale of a vehicle or a loan; and

(c) not available for direct sale from the insurer, but only through caryard intermediaries.

225 By comparison, a competitive market for add-on insurance products would be characterised by features such as those associated with the sale of home insurance, including advertising and promotion through different mediums, distribution through a range of channels (including online), and innovation in product design to deliver benefits to consumers.

226 Given the risk of continuing harm and the limited effectiveness of other measures, we have proposed reforms to the sale of add-on insurance through caryard intermediaries.[68]

227 CP 294 sets out two proposed reforms:

(a) the introduction of a deferred sales model for add-on products when sold by caryard intermediaries (Proposal 1)—that is, the sale of add-on

[66] ASIC, Report 470 *Buying add-on insurance in car yards: Why it can be hard to say no* (REP 470), February 2016.
[67] ASIC, Report 492 *A market that is failing consumers: The sale of add-on insurance through car dealers* (REP 492), September 2016.
[68] See ASIC, Consultation Paper 294 *The sale of add-on insurance and warranties through caryard intermediaries* (CP 294), August 2017.

products by caryard intermediaries for a new or used car should be permitted only after a certain period of time has elapsed (the deferral period); and

(b) enhanced supervision obligations on product providers (Proposal 2), which would introduce specific requirements for the supervision and monitoring by providers of their authorised representatives, based on the risks for consumers in this distribution channel.

228 Our objectives in proposing these reforms are that:

(a) add-on products should offer improved value;

(b) premiums for add-on products should be more competitive;

(c) sales processes should be fairer and assist consumers to make better decisions;

(d) add-on products that offer no benefits to consumers should not be sold and products that offer minimal benefits should be reduced; and

(e) changes should be market-wide and competitively neutral.

229 The deferred sales model aims to give consumers additional time to navigate the complexities of add-on products and facilitate improved decision making.

230 The introduction of a deferred sales model could also enhance competition if these products become more widely available. Currently, consumers only have the choice of buying the products offered to them by the caryard intermediary because insurers do not make them available through other distribution channels (e.g. online or direct sales by phone).

231 Because consumers would have a greater opportunity to obtain information about competing products, providers currently locked out of car dealership distribution points could be encouraged to offer add-on products online. If online distribution becomes widespread, it could generate increased competition between providers and improved transparency on product price and cover, benefiting all parties. These proposals complement other work we are undertaking, including:

(a) working with the insurance industry to drive voluntary changes to product design, distribution and sales practices; and

(b) commencing a data collection program with insurers to better assess and monitor the progress of this sector.

Back-book cross-subsidisation

232 In some markets, new customers may be subsidised by higher prices paid by existing or ongoing customers. In some circumstances, a consumer’s lack of

knowledge or inertia may be leveraged by the product provider and lead to poor consumer outcomes.

233 This may suggest that competition in these markets is not as effective as it could be.

234 Our reviews of term deposits,[69] in 2010 and 2013, found that ADIs promoted their term deposits by advertising the high rates available on a limited number of term deposit periods, while maintaining significantly lower rates for all other deposit periods (‘dual pricing’). This resulted in many customers receiving significantly lower rates if they stayed with their provider through automatic rollover of their deposit. Our findings from this report are discussed further in Section C.[70]

Technology and innovation

The role of fintech

235 New and enhanced technologies and increased computing capabilities are enabling the development of new products and services that can meet the needs of financial consumers and market participants more efficiently and more cost effectively. These advances also have the potential to enhance financial inclusion, bridge financing gaps and develop financial capabilities.

236 Within the context of financial services, technology has the potential to:

(a) reduce the cost and improve the efficiency of product and service delivery;

(b) empower customers by enabling them to deal directly, more seamlessly, and more flexibly with product and service providers; and

(c) empower businesses by enabling them to deliver a better value proposition and customer experience to their customer base.

237 A number of new technologies and innovations have emerged in recent years, which have the potential to disrupt existing markets. Some examples are set out below.

Distributed ledger technology

238 In recent years, there has been intense interest in distributed ledger technology (DLT), which includes blockchain technology, from operators of centralised market facilities, financial institutions, financial services

[69] See ASIC, Report 185 *Review of term deposits* (REP 185), February 2010, and ASIC, Report 353 *Further review of term deposits* (REP 353), July 2013.
[70] See the example discussed below paragraph 321.

providers and innovative financial technology (fintech) firms around the world.

239 Potential advantages of distributed ledgers include efficiency and speed relative to current clearing systems and reduced transaction costs. Some protocols may remove the need for trusted third party intermediaries and improve market access for consumers.

240 DLT underpins digital currencies, such as Bitcoin. Potential applications of DLT include payments, reconciliation for correspondent banking, private securities transactions, securities registration and trade finance.[71]

241 In March 2017, we released an information sheet[72] for both existing licensees and start-ups that are considering operating market facilities, or providing financial or consumer services, using DLT.

Digital currencies and tokens

242 Digital currencies have developed as an alternative form of currency. Digital currencies have no physical form and no intrinsic value, but have a market value based on the willingness of others to accept the digital currency as consideration.

243 The use of digital currencies is increasing in Australia, although it remains at relatively low levels. In September 2017, the Government introduced legislation to align the GST treatment of digital currency with money to address the issue of double taxation.[73]

244 We have also seen the emergence of initial coin offerings (ICOs). An ICO is a new form of funding where a person sends virtual currencies to people or firms developing blockchain projects. In return, they receive digital tokens related to that blockchain project. ICO tokens are held in a digital wallet, similar to those of virtual currencies.

245 The legal status of an ICO and whether an ICO will be regulated by ASIC is dependent on how it is structured. We have encouraged entities considering the use of these structures to contact us via our Innovation Hub.

Market licensing

246 We are currently consulting on a revised licence regime for domestic and overseas market operators, which will allow for flexibility in an area that has seen significant disruptive developments in market structure and business models affecting traditional exchanges and a range of non-exchange trading

[71] CSIRO and DATA61, *Risks and opportunities for systems using blockchain and smart contracts*, May 2017.
[72] ASIC, Information Sheet 219 *Evaluating distributed ledger technology* (INFO 219), March 2017.
[73] The Hon Scott Morrison MP, *Removing the double taxation of digital currency*, 14 September 2017.

venues.[74] In particular, it will allow for the entry of operators of emerging and specialised market venues.

247 This proposal follows the passage of the *Corporations Amendment (Crowd-sourced Funding) Act 2017*, which made changes to the market licence regime. Previously, the regime only allowed:

(a) a trading venue operator to be licensed subject to *all* of the obligations under the regime; or

(b) to exempt the operator from licensing *altogether*.

248 If some licence obligations that were more directed to regulating exchange market venues were not appropriate to alternative market venues, there was no ability to provide an exemption from those specific obligations. As an interim measure we have been providing exemptions to certain market venues subject to a number of targeted conditions.

249 We are proposing to administer the amended market licence regime using a two-tiered framework. The tiers will be differentiated based on a risk assessment of the market or class of market. This approach will allow us to create a more flexible model, which will:

(a) facilitate oversight of traditional market models and significant exchanges (tier 1); and

(b) appropriately tailor regulator obligations for a broad range of specialised and emerging market venues (tier 2).

250 Importantly, we consider this will implement the policy of the crowd-sourced funding (CSF) amendments, by making the licence regime more adaptable to the different types of trading venues that may emerge.

Crowd-sourced equity funding and marketplace lending

251 There are a number of new platforms, such as CSF and marketplace lending, which could disrupt traditional fundraising models. These platforms are in their early stages and are relatively small. It is not yet clear whether they can provide an effective competitive challenge to established fundraising and lending business models. At this stage, we suspect that such funding structures will remain a niche offering.

252 CSF is a financial service where start-ups and small businesses raise funds, generally from a large number of investors that invest small amounts of money. From September 2017, there will be a legislative framework for equity-based CSF.

[74] ASIC, Consultation Paper 293 *Revising the market licence regime for domestic and overseas operators* (CP 293), July 2017.

253 Under the CSF regime, eligible public companies will be able to make offers of their shares, via an intermediary CSF service, using an offer document. Unlisted public companies with less than $25 million in assets and annual turnover will be eligible to raise funds under the CSF regime. Eligible companies will be able to make offers of ordinary shares to raise up to $5 million in any 12-month period.

254 The CSF regime aims to facilitate access to capital for small to medium sized unlisted public companies by reducing the regulatory requirements for making public offers of shares, while ensuring adequate protections for retail investors.

255 Marketplace lending generally describes an arrangement through which retail or wholesale investors invest money which is then lent to borrowers. This is generally structured through a managed investment scheme. Under Australia's financial services and credit laws, providers of marketplace lending products and related services will generally need to hold:

(a) an AFS licence; and

(b) an Australian credit licence if the loans made through the platform are consumer loans.

256 A distinguishing feature of marketplace lending is the matching of investors to borrowers and the use of platform technology. Marketplace lending competes against other lenders, including the banking sectors. It has the potential to become another source of funding for consumers and SMEs.

257 Marketplace lending is relatively new to Australia. In March 2016, we released an information sheet to assist providers of marketplace lending products and others providing financial services in connection with these products.[75] In June 2017, we published a report on the results of a survey we conducted of the sector.[76]

New payments platform

258 The new payments platform was an industry response to the RBA's strategic review of innovation in the payments system.[77] The platform, due to launch in September 2017, will enable real-time clearing and settlement for simple or complex payment solutions, between two people or between many. It will also allow payments to be addressed with an email or mobile phone number, as well as offer the ability to include more information with payments, such as texts or links to externally hosted documents.

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[75] ASIC, Information Sheet 213 *Marketplace lending (peer-to-peer lending) products* (INFO 213), March 2016.
[76] ASIC, Report 526 *Survey of marketplace lending providers* (REP 526), June 2017.
[77] RBA, *Strategic review of innovation in the payments system: Conclusions*, June 2012.

259 The new payments platform will also allow companies to develop new payment services, either in competition or collaboration with banks or fintech start-ups. This could include overlay services that automatically link one transaction to another.

Digital advice

260 Digital advice (also known as robo-advice or automated advice) is the provision of automated financial product advice using algorithms and technology and without the direct involvement of a human adviser.

261 Since 2012, digital advice has been growing in popularity in the US and in Europe. Licensees in Australia have observed the growing popularity of digital advice models offshore and are now actively developing their own digital advice models.

262 ASIC supports digital advice. It has the potential to offer Australian consumers good quality, low-cost, financial advice. We also see benefits such as improved compliance and record keeping.

263 Digital advice has the potential to increase competition in the financial advice industry because:

(a) a number of new entrants are entering the financial advice market;

(b) the costs associated with starting a digital advice business in comparison with a traditional advice business are relatively low; and

(c) overseas digital advice providers are likely to offer their services in the Australian market in the coming years.

264 A key risk, however, is that a digital advice provider could potentially provide poor quality advice on a large scale to Australian consumers. This would undermine consumer confidence in the advice sector and, in particular, digital advice.

265 In August 2016, we released a regulatory guide that brings together some of the issues that digital advice providers need to consider when operating in Australia.[78]

Exchange-traded funds

266 Innovation is also occurring throughout the financial system in the products and services available to consumers and investors. Although some of these have been enabled by developments in technology (e.g. DLT and digital advice) and others are supported by regulatory changes (like the market licence regime), there are many driven by competitive forces within the

[78] ASIC, Regulatory Guide 255 *Providing digital financial product advice to retail clients* (RG 255), August 2016.

industry, such as the growth in exchange-traded funds (ETFs) in recent years.

267 As at 30 June 2017, there were 160 ETFs on ASX with a combined funds under management of $29.11 billion. This compares to 78 ETFs listed as at 30 June 2012 with funds under management of $5.18 billion and four ETFs listed with funds under management of $857 million as at 30 June 2007.[79] The growth in ETFs has also been a trend globally.

268 The growth in ETFs could be in part a result of consumers (in particular self-managed superannuation funds) wanting to manage their wealth in a more direct and low cost way.

269 The growth in ETFs is also demonstrated by the increase in investment net flows:

(a) over the 12 months to June 2007, net flows into ETFs averaged $7.7 million per month, with a total inflow of $91.86 million;

(b) over the 12 months to June 2012, net flows into ETFs averaged $9.95 million per month, with a total inflow of $119.42 million; and

(c) over the 12 months to June 2017, net flows into ETFs averaged $305.8 million per month, with a total inflow of $3.67 billion.[80]

270 We expect competition among ETF providers to continue in coming years, particularly in relation to:

(a) the range of ETF products offered; and

(b) management fees.

271 The increase in demand for ETFs may negatively affect the demand for other products and services, such as mutual funds and active investment advice.

Innovation Hub and regulatory sandbox

272 In 2015 we established ASIC's Innovation Hub, primarily to assist fintech start-ups with innovative financial products or services to navigate our regulatory system. The Innovation Hub aims to reduce regulatory barriers to entry and increase market contestability, while ensuring businesses understand the regulatory settings and consumer protections and safeguards they must have in place.

[79] © 2017 Morningstar, Inc. All rights reserved. Morningstar Direct, data accessed 4 September 2017. This information: (1) is proprietary to Morningstar and/or its content providers; (2) may not be copied or distributed; and (3) is not warranted to be accurate, complete or timely. Neither Morningstar nor its content providers are responsible for any damage or losses arising from any use of this information.

[80] Ibid.

273 In 2016, we expanded the scope of the Innovation Hub to engage with and provide informal assistance to regulatory technology (regtech) businesses. We have also collaborated with regulators in other jurisdictions to understand developments, and help entrepreneurs expand their target markets.

274 As of August 2017, the Innovation Hub has worked with 200 entities—164 of which have received informal assistance. Since March 2015, ASIC has granted 36 new AFS/credit licences to entities that received informal assistance.[81]

275 To assist fintech businesses, a key initiative of the Innovation Hub has been the creation of a regulatory sandbox framework—essentially, a lighter touch regulatory environment—aimed at addressing three interconnected issues that we found Australian fintech businesses were facing:

(a) *speed to market*—by providing an environment for testing without a licence;

(b) *organisational competence*—by bridging knowledge gaps with more examples; and

(c) *greater flexibility and access to capital*—by reducing testing costs.

276 The regulatory sandbox enables fintech entities the opportunity to test a business model and investigate what strategy will work best for their business. At the same time, it ensures that financial consumers who access their services still have fundamental protections under the law, such as conduct and disclosure standards, dispute resolution and professional indemnity insurance.

277 In August 2017, we issued regulatory guidance to explain the options available to fintech businesses for testing without a licence.[82]

[81] See ASIC, Report 523 *ASIC's Innovation Hub and our approach to regulatory technology* (REP 523), May 2017, and our Innovation Hub results.
[82] ASIC, Regulatory Guide 257 *Testing fintech products and services without holding an AFS or credit licence* (RG 257), August 2017.

C Consumer behaviour

Key points

A significant body of work by policy makers, academics and regulators has been built over recent years from a range of social and behavioural sciences. This work describes how and why people think and behave in certain ways—that is, how they *actually* behave.

These insights can help us understand problems we have seen with the operation of retail markets we regulate.

278 As the consumer protection and conduct regulator of financial services and products in Australia, we have observed a number of ongoing problems in the markets we regulate. These problems have often resulted where complex and systemic supply-side and demand-side factors that are particularly characteristic of financial markets (including market structures and the behaviours of both firms and consumers) lead to poor consumer outcomes.

279 These factors mean that in some retail markets, competition cannot currently fully deliver what it is intended to deliver.

280 The UK Office of Fair Trading has characterised the model of competition as a virtuous but fragile circle.[83] In theory, well-informed, confident and effective consumers play a key role in activating vigorous competition. In response, these demand-side factors should provide firms with incentives to deliver products and services that are fit for purpose by competing on price, service and quality.

281 In the retail markets we regulate, however, we have constantly seen problems that have required regulatory intervention because market forces have not been able to resolve these issues as predicted by traditional models. These have included, for example, the need to ban conflicted remuneration, and the current proposal to mandate a deferred sales model for add-on insurance sold through car yards.[84]

282 The persistence of these problems suggests there are significant barriers to the effective operation of the virtuous circle of competition in retail financial markets, and this submission sets out where we believe some of these barriers may be being encountered.

[83] UK Office of Fair Trading, *What does behavioural economics mean for competition policy?* (PDF 344 KB), March 2010. This work has been subsequently built on by Amelia Fletcher.
[84] ASIC, Consultation Paper 294 *The sale of add-on insurance and warranties through caryard intermediaries* (CP 294), August 2017.

283 Both the demand and supply sides of markets are critical if competition is to operate effectively and sustainably to deliver outcomes that are in the long-term interests of consumers.

284 When competition is working effectively, consumer outcomes can be improved through lower prices and the provision of better quality products and services that are fit for purpose. At the same time, consumers play a key role by exerting demand-side pressures that should incentivise firms to compete vigorously to deliver products that facilitate good consumer outcomes.

285 However, when systemic market problems exist it is critical we understand where and why the market is not working as it should. We believe an important issue is to explore and understand how particular market factors affect the interaction of the supply side and the demand side in retail financial markets, and the subsequent impact on consumer outcomes.

The role of behavioural sciences

286 A significant body of work by policy makers, academics and regulators has been built over recent years from a range of social and behavioural sciences. This work describes how and why people think and behave in certain ways—that is, how they *actually* behave. Through decades of empirical research and testing, these insights have added to traditional economic models, which are often based on assumptions about how an average person *should* behave.

287 The behavioural sciences are increasingly being applied in a government policy-making context, as well as in private industries. Insights from the behavioural sciences are relevant because they identify factors that can contribute to a significant weakening of the demand-side pressures that are key to driving competition.

288 These behavioural factors, which include behavioural biases, can create barriers for consumers and investors being able to access and assess information, and make decisions about financial products and services in ways assumed by traditional models.

> Note: A behavioural bias is a systematic tendency, inclination or opinion in relation to someone or something. They are often observed as shortcuts in our decision making. Everyone has a set of biases. They may be conscious or unconscious because we are usually not aware when we move between our instinctive and 'deeper' styles of thinking. Biases are shaped by long-term effects (such as culture, previous experiences and personal tastes) and short-term effects (such as the amount of available information or even the time of day).

289 In our role as regulator, we have seen that the presence of behavioural biases and other factors on the demand side provides clear opportunities for firms

to engage in conduct that exploits these biases in attempts to maximise profits and/or capture market share.[85] Such opportunities can lead to sales practices, advertising, product structures/design and other conduct that amplify the effect of these behavioural factors and lead to suboptimal consumer outcomes.

290 In cases where the whole market is thus incentivised, there may be no motivation for firms to cease such practices unilaterally where they risk damaging their profits or market shares (i.e. they create a first-mover *dis*advantage).

291 These factors are particularly relevant in the context of the retail financial services sector, which is recognised as a rich environment for behavioural factors to affect individuals' decision making.

292 As discussed in Table 2, financial products and services:

(a) are inherently complex, and often require people to make decisions about risk and future outcomes under uncertainty;

(b) represent extreme examples of 'credence goods' and consumers may not discover the real value or quality of the product for years;

(c) often 'one-off' in nature, which provides limited opportunity for learning or prompts for shopping around; and

(d) often involve significant sums of money and the decisions being made can be emotionally charged (e.g. buying a house, decisions relating to the death of a close relative).

293 This section of our submission describes some of the behavioural factors and resultant practices that we have observed may interact to weaken competition. It draws on illustrative case studies to show how these factors can play out in a financial services context.

Consumer behaviour

294 For consumers to exert demand-side pressure that drives effective competition they need to be able to:

(a) *access* information about the products and services available in the market;

[85] For theoretical underpinnings, see X Gabaix & D Laibson, 'Shrouded attributes, consumer myopia and information suppression in competitive markets', *Quarterly Journal of Economics*, vol. 121, May 2006, pp. 505–40, which includes a useful description/model of how a competitive equilibrium may exist in which firms deliberately exploit consumer biases to weaken demand-side pressure.

(b) *assess* the information available about these products to compare them; and

(c) *act* on this information by purchasing or switching to a product that offers the best value to them.[86]

295 Traditionally, it has been simple asymmetries in information between firms and consumers that have been considered a key market failure—the response to which has almost overwhelmingly been mandating disclosure of more information by firms.

296 Evidence and insights from the behavioural sciences show, however, that there are much more complex factors that can affect consumers' interaction with information and their decision making.

297 The final report of the Murray Inquiry acknowledged this shift in our understanding of consumer behaviour, noting:

> … in itself, mandated disclosure is not sufficient to allow consumers to make informed financial decisions … disclosure can be ineffective for a number of reasons, including consumer disengagement, complexity of documents and products, behavioural biases, misaligned interests and low financial literacy.[87]

298 These factors highlight that the issue is not simply provision of information, but that there is a need to take an evidence-based approach to understanding the underlying causes of market problems that can prevent competition from operating as intended, and the responses that may be designed to try and correct them.

Step 1: Accessing information and products

Intermediaries and the search process

299 When consumers have been prompted to begin to search for a financial product or service, or consider switching, the process needs to be relatively easy—allowing people to seek out the information they need to be able to make a decision.

300 Intermediaries such as financial advisers and mortgage brokers play a significant role in the search process for some consumers. Consumers rely on these providers to help make the search process easier but can be at a disadvantage where their chosen intermediary is incentivised by commission structures and other factors (such as approved product lists that focus on in-

[86] UK Office of Fair Trading, *What does behavioural economics mean for competition policy?* (PDF 344 KB), March 2010. This work has been subsequently built on by Amelia Fletcher.
[87] *Financial System Inquiry: Final report* (Murray Inquiry final report), November 2014, pp. 193 and 199.

house products), which many not align with consumers' interests: see paragraph 164 in Section B.

301 This disadvantage on the part of consumers can be exacerbated when there is a trust relationship with the intermediary. When a decision is complex, consumers may fall back on the use of heuristics, or rules of thumb, to help make the decision simpler. In some cases trust may be used as a proxy or substitute for quality or value where it is difficult for the consumer to attempt to objectively assess the advice given or products recommended.

302 Research on the importance of trust in achieving successful consumer transactions has found a range of factors are important for generating trust, including perceptions of salesperson competence and service quality, low pressure sales tactics and a consumer's general tendency to trust.[88] A salesperson's 'likeability' has also been shown to be an important factor for generating consumer trust.[89]

Example: Shadow shopping of retirement advice[90]

In 2011, ASIC conducted shadow shopping research on financial advice about retirement. Participants in the research were real consumers of financial advice who were intending to seek advice about retirement, or who had sought such advice in the previous 15 months.

Participants provided 64 examples of retirement advice they had received from their chosen provider. ASIC analysts assessed both the quality of the advice, as well as its compliance with the law. We found that 58% of advice examples were 'adequate', 39% were 'poor' and just 3% of examples were assessed as being 'good'.

In contrast, participants rated their advisers and the advice they received highly, with 86% saying they felt they had received good quality advice and 81% saying they trusted the advice received from their adviser 'a lot'.

Follow-up in-depth interviews with some of the participants suggested that participants' level of comfort with their adviser was an important factor when evaluating their satisfaction with the advice and the advice experience.

Choice overload

303 The presence of different products in a market can allow consumers more opportunities to find a product with features or pricing that is more suitable for them.

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[88] MS Kennedy, LK Ferrell & DT LeClair, 'Customers' trust of salesperson and manufacturer: An empirical study', *Journal of Business Research*, vol. 51, 1998, pp. 73–86, and cited in ASIC, Report 15 *Hook, line and sinker: Who takes the bait in cold calling scams?* (REP 15), June 2002.
[89] CY Nicholson, LD Compeau & R Sethl, 'The role of interpersonal liking in building trust in long-term relationships', *Journal of the Academy of Marketing Science*, vol. 29, 2001, pp. 3–5, and cited in REP 15.
[90] See ASIC, Report 279 *Shadow shopping study of retirement advice* (REP 279), March 2012.

304 Traditional economic theory holds that more choice will always be better for people than less. Insights from behavioural science research have shown, however, that the issue of choice is not as simple as assumed and that in some situations more choice is not always better, for a number of reasons.

305 Firstly, the extent of *real* choice available to consumers can be obfuscated by the practice of 'white-labelling' and multi-branding. These arrangements can make the particular market appear more competitive than it is, and more difficult for consumers to understand which firms are the original issuers of products they are considering: see Section B, paragraphs 192–193.

306 Secondly, in different contexts multiple factors can interact to affect consumer decision making. In some instances the presence of too much choice can make it difficult for consumers to make a decision about products and services. This means consumers may not always reap the full benefits assumed to flow from the mere presence of more products to choose between.[91]

307 When faced with a large number of products that appear the same or similar, consumers may instead search only on headline price or other singular factors rather than considering all the benefits and costs of a product. This tendency can be exacerbated by how products are framed, and which features or price elements are highlighted or downplayed, by firms.

308 When faced with too many options individuals can also be more likely to fall back on heuristics, or mental shortcuts, such as searching for products based primarily on brand, or going with the default option. Alternatively, it may lead people to give up their search and make no choice at all, or revert to the status quo, remaining with their current provider.

309 Some of these tendencies were borne out in research by The Australia Institute in 2008. A nationally representative survey found that 42% of respondents agreed with the statement 'When I need to make a financial decision, I often find there is too much choice', while only 18% of respondents disagreed.[92] The same research project also conducted six focus groups of seven to nine participants each from a cross-section of the Australian population. The researchers found that for participants in these focus groups:

(a) advertising and branding was a 'major influence' on financial decisions;

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[91] See, for example, SS Iyengar & MR Lepper, 'When choice is demotivating: Can one desire too much of a good thing?' (PDF 1.62 MB), *Journal of Personality and Social Psychology*, vol. 79, 2000, pp. 995–1006, and RB Settle & LL Golden, 'Consumer perceptions: Overchoice in the market place', in *NA—Advances in Consumer Research*, vol. 1, 1974.

[92] J Fear, *Choice overload: Australians coping with financial decisions*, discussion paper no. 99, The Australia Institute, Canberra, May 2008, and cited in ASIC, Report 230 *Financial literacy and behavioural change* (REP 230), March 2011.

(b) many people said they 'often went with companies or products that they were already familiar with'; and

(c) many participants in the research 'admitted to being so overwhelmed by the range of choices … they ended up taking no action whatsoever'.[93]

310 A study by Iyengar et al (2003) further highlighted the impact of choice overload with respect to financial decisions. They analysed records of over 790,000 participants contributing to 401(k) retirement savings plans in the US. Having controlled for a number of employee attributes, the researchers found that if an employer offered more fund options within their 401(k) plan, there was a lower probability of employee participation.[94] Instead, they found plans offering fewer than 10 options had significantly higher employee participation rates in their sample.[95]

Step 2: Assessing products and information about them

Product framing and sales practices

311 Research from the behavioural sciences shows that people are particularly sensitive to the way information and choices are presented, or 'framed'. Any number of small details—who delivers the information, the timing of the information, and the delivery itself (e.g. format, emphasis, ordering and tone)—can have significant impacts on how people understand and recall information, and how they make decisions.

312 This is particularly relevant in sales contexts in the financial system where sales processes and practices can harness behavioural biases to 'nudge' consumers towards taking up certain products and services. These effects can affect the extent to which consumers effectively assess information and compare products when purchasing or switching.

Example: Sale of add-on insurance in car yards

ASIC commissioned qualitative research to understand the sale of add-on insurance products to consumers in Australian car dealerships.

We analysed and reported on the findings of the research.[96] We found most consumers' were focused on the vehicle they intended to purchase and had given little thought to insurance. This meant most were unaware of the cost or the cover provided.

[93] Ibid.
[94] SS Iyengar, W Jiang & G Huberman, *How much choice is too much? Contributions to 401(k) retirement plans*, Pension Research Council Working Paper, Pension Research Council, The Wharton School, University of Pennsylvania, Philadelphia, 2003.
[95] Ibid.
[96] ASIC, Report 470 *Buying add-on insurance in car yards: Why it can be hard to say no* (REP 470), February 2016.

Add-on insurance was actively sold to many consumers, generally just after they had agreed to purchase a vehicle. This means that having spent time and cognitive resources on buying the vehicle, consumers were then provided with significant additional information about finance, after-market products and add-on insurance, and asked to make multiple decisions.

A number of factors about how the products were offered and framed had an impact on a consumer's decision to purchase, including:

- Many consumers recalled being provided with minimal information about the products specifically discussed. Consumers tended to rely on what they were told by salespeople rather than any documents provided, and information that was provided was unbalanced, promoting potential benefits without explaining exclusions.
- The cost of add-on insurance products was often reported to be promoted in monthly rather than annual terms, making it seem like a small ongoing expense rather than a total cost. This is a form of price framing known as the 'pennies-a-day' effect and it has been shown to influence people's perception of the cost of a transaction.[97]
- The bundling of add-on insurance products with vehicle finance caused confusion about the total cost for some consumers.
- The approaches of sales staff also had a significant impact. Some consumers felt the sales approach was pushy or aggressive and they felt urged to make decisions on the spot rather than shop around. On the other hand, other consumers found sales staff to be engaging and persuasive; some seemed to believe sales staff were acting on the consumer's behalf or in their best interest.

As a result of these and other factors, many consumers had very poor recall and understanding of which add-on insurance products they had purchased, what they were covered for, and even what they paid.

Effects of present bias and overoptimism

313 People's tendency to be present-biased can lead them to focus only on upfront costs and benefits when comparing products, or to miscalculate their future behaviour in a way that leads them to incur unexpected charges or penalties.

314 This can incentivise firms to engage in price obfuscation and/or product bundling. For example, firms can structure product pricing in such a way to make initial or headline costs appear low, but then backload or obscure other charges and fees.

315 Even if consumers know about these additional fees and penalties, they may be overoptimistic and believe they will be disciplined enough to not incur

[97] JT Gourville, 'Pennies-a-day: The effect of temporal reframing on transaction evaluation', *Journal of Consumer Research*, vol. 24, 1998, pp. 395–408.

them. Instead they can choose products based on more immediate rewards or lower upfront costs and may not even realise they are incurring charges.

Case study: Credit cards in Australia

A senate inquiry submission by Treasury noted that in 2013 only 30% of surveyed users reported paying interest on their credit card balance.[98] Contrary to this self-reporting though, the share of balances attracting interest at the time was in fact closer to two-thirds.[99]

Consumers with strong present bias or overoptimism may set out with the expectation and intention of always paying off their balance in full. Believing they will not incur any interest, these consumers may instead choose cards based on features with more immediate benefits such as balance transfer periods or rewards points, rather than key cost drivers such as annual fees and interest rates. A 2015 Choice survey found that 29% of customers who switched in the last two years did so for an interest-free period and another 29% of this group switched for a balance transfer deal.[100]

Although consumers may benefit from initial deals, concerns arise when:

- Consumer intentions are not matched by actual behaviour over time and interest and/or other fees are in fact incurred. The 2015 Choice survey found over 64% of respondents did not know their interest rate and 54% said they did not know or answered incorrectly when asked about what the minimum monthly payment meant.[101]
- These initial benefits expire and cards revert to much higher rates and fees but consumers fail to switch. The 2015 Choice survey found only 11% of consumers reported switching in the last two years, with 72% not having considered switching at all, and 17% reporting they considered switching but had not done so.[102]

Competition is distorted when firms respond to consumer behaviour by competing on these upfront ancillary features whose benefit may be eroded or even reversed for the consumer over time, rather than competing on key cost drivers. The low rates of switching when these benefits end and credit cards revert to high annual fees and interest rates suggest consumers may suffer from low awareness or understanding of product features and their own spending tendencies as well as inertia.

Cognitive load

316 As previously noted, financial products and services often have high levels of underlying complexity, and can involve elements of risk or uncertainty, which consumers have to try and factor in to their decision making. Where

[98] Treasury, *Submission to the Senate Economics References Committee Inquiry into matters relating to credit card interest rates*, 11 August 2015.
[99] Ibid.
[100] Choice, *Cutting credit card confusion: Submission to Senate Economics References Committee—Matters related to credit card interest rates*, 2015.
[101] Ibid.
[102] Ibid.

firms have bundled products it can make it especially difficult for consumers to separate and assess the value of each part individually.

317 The traditional mechanism relied on to facilitate consumer understanding of these product features has been mandated disclosure documents, which are often long and technical.

318 This complexity of products and the technical nature of disclosure documents can increase consumers' cognitive load when assessing information about products they are considering. Having to process too much information can lead to a reduction in the quality of decision making.

319 These effects can be compounded by the timing of when information is provided to consumers. The same information provided at different times can have differing effects on people's propensity to read and understand it, and effectively account for it in decisions. It is important that consumers receive the right information (and other prompts relating to products and services) at the right time to be able to better assess their options.[103]

Example: Retail investor research into structured 'capital protected' and 'capital guaranteed' investments[104]

We commissioned qualitative research into retail investors' understanding of capital protected and capital guaranteed investments. The researchers found that for retail investors two impediments to comparing products included:

- difficulty reading information about the products—participants said the detailed information was too time-consuming for them to read about one product, let alone multiple products; and
- none of the investors interviewed understood enough of the product features to compare one type against another.

Limited learning opportunities

320 The long-term nature of many financial products and services means there is often no clear prompt for consumers to regularly review or compare their current product with others on the market (e.g. home loans). This is often exacerbated by the 'credence good' nature of many products in the financial system, where consumers cannot know if a product is good value until a period of time passes or a certain event (e.g. needing to claim on insurance) is triggered.

321 These elements may lead to inertia on the part of consumers when the opportunity cost (both real and perceived) of searching for and comparing

[103] O Service et al, *EAST: Four simple ways to apply behavioural insights*, Behavioural Insights Team, 2014.
[104] ASIC, Report 341 *Retail investor research into structured 'capital' protected' and 'capital guaranteed' investments*, (REP 341), May 2013.

other products for which the real value to the consumer cannot be known upfront may be quite high. This may be exacerbated where firms have the ability to unilaterally/easily change product terms and conditions.

Step 3: Taking action

Switching costs

322 Switching costs can prevent consumers from taking action. These costs can be both real (the actual time and any money or fees that might need to be expended to be able to switch) and perceived (even though structurally it might be easy, consumers may feel it will be 'too much of a hassle').

323 Burnham et al (2003)[105] distilled these switching costs into three broad categories, which include:

(a) *procedural switching costs*, which refer to the time and effort involved in evaluating options and familiarising yourself with new products and services (e.g. if each provider has a different digital platform that needs adapting to);

(b) *financial switching costs*, which include the expenditure of any financial resources (e.g. early redemption fees) as well as any benefit loss costs such as a perception of losing loyalty bonuses or discounts with the old provider; and

(c) *relational switching costs*—switching means losing the confidence and comfort of using familiar processes and platforms, and breaking bonds with familiar people (in the case of adviser relationships or branch-based services).

324 In their paper, Burnham et al (2003) found that consumers' perceptions of these switching costs were more important than satisfaction in explaining why consumers remain with their current provider.

325 Understanding these broader categories of switching costs is important when considering the information that is available on the rates of switching among retail financial products and services in Australia. As noted earlier, a 2015 survey by Choice found only 11% of consumers reported switching credit cards in the previous two years, with 72% not having considered switching at all, and 17% reporting they considered switching but had not done so. [106]

326 In its annual review of Australia's major banks, Canstar Blue's survey of major bank customers found 57% had always been with the same bank they

[105] TA Burnham, JK Frels & V Mahajan, 'Consumer Switching Costs: A typology, antecedents, and consequences' (PDF 1.93MB), *Academy of Marketing Science*, vol. 31, no. 2, Spring 2003.
[106] Choice, *Cutting credit card confusion: Submission to Senate Economics References Committee—Matters related to credit card interest rates*, 2015.

opened their first account with, and 58% have an additional financial product with the bank they use for everyday banking.[107] Rice Warner also found a significant number of members do not exercise choice in relation to their superannuation fund, ranging from almost 90% of younger members through to 47% for members who are close to retirement.[108]

Inertia

327 Where searching and switching are, or are perceived to be, difficult and time consuming, people may be prone to inertia or procrastination—putting off what they perceive to be a difficult or complex task now and believing their future self will deal with it at some point.

328 A related outcome may be the reversion to status quo bias—although consumers may understand the benefits that can come from shopping around, their preference for things to stay the way they are/not have to change can outweigh this.

329 Firms can exacerbate these issues by employing tools such as auto-renewals and default options at the point of sale.

Example: ASIC's review of term deposits

Report 185 *Review of term deposits* (REP 185)[109] reported on our ‘health check’ of the term deposit market covering the period 1 January 2008 to 27 February 2009. Information including interest rates, rollover patterns, disclosure documents and marketing was obtained from eight ADIs on household-sourced deposits.

Key findings from the review included:

- Seven of the eight ADIs used dual pricing on their term deposit products (i.e. high or low interest rates could apply to the same product depending on the term). On most interest rate schedules (typically showing at least 12 terms), between two and four terms would be at high interest rates, with the remaining terms at low interest rates.
- For the bank ADIs who used dual pricing, the low interest rates were, on average, 42% lower than the high interest rates and also 37% lower than what ADIs were offering for at-call deposits.
- At the initial point of entry, 98% of depositors chose a term with a high rate. All ADIs that ASIC reviewed relied on a default in which, unless otherwise instructed by the investor, a maturing term deposit rolled over into a new term deposit for the same term. The four ADIs able to provide data about the date of maturity in the review period reported 47% of these deposits rolled over from high to low interest rates.

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[107] Canstar Blue, *Major bank reviews*, accessed 11 September 2017.
[108] Rice Warner, *Superannuation efficiency and competitiveness*, submission to the Productivity Commission, September 2016.
[109] ASIC, Report 185 *Review of term deposits* (REP 185), February 2010.

The use of dual pricing in conjunction with the long established default rollover mechanism may have been a response to observed consumer inertia over multiple terms (on average, investors allowed their term deposit to roll over five times before withdrawing their money).

Report 353 *Further review of term deposits* (REP 353)[110] set out the findings of our follow-up review of this market. We found that although the eight ADIs we reviewed still used dual pricing models, they had largely implemented the recommendations we had made in relation to clearer and more timely disclosure of the risk of dual pricing, the existence of grace periods (which allow customers to re-lodge without penalty a deposit that rolls over automatically into a low rate) and the changes in interest rates between terms.

The follow-up review found significantly fewer consumers were defaulting from 'high' to 'low' interest rates through rollovers, and significant numbers of investors were making use of grace periods to make changes to their term deposit—leading to consumer outcomes in this market improving by billions of dollars. During the review period, a total of $97 billion of investors' funds that had rolled over into low rates were re-lodged or cancelled during the grace period.

Consumer vulnerability

330 Consumer vulnerability is a further important consideration for trying to understand why the demand side may not be able to drive competition or discipline firms within certain retail markets.

331 Vulnerability can be used to describe a wide variety of consumer circumstances.

332 For some consumers, vulnerability may be a transient or temporary state that arises due to unforeseen shocks such as sudden unemployment or separation from a long-term partner. Other consumers may be vulnerable in singular contextual factors such as their access to the internet or because they are geographically isolated.

333 Some cohorts of consumers however may be considered vulnerable where they are systemically disadvantaged—for example, older consumers suffering from cognitive decline, consumers who suffer from physical or mental illnesses, or those who face ongoing pressures (such as revolving credit card debt) because they earn low or volatile incomes or have uncertain job security.

334 During periods of vulnerability, consumers may be more affected by particular biases (such as scarcity, availability bias and information

[110] ASIC, Report 353 *Further review of term deposits* (REP 353), July 2013.

overload), which can significantly reduce their cognitive capacity and can lead to:

(a) a tendency to stop searching too early;

(b) disengagement from the search process; and

(c) being more likely to stay with the status quo or not take up vital financial products at all.

335 From a consumer protection perspective, these consumers may also be disproportionately affected (on a relative basis) by active mis-selling and other exploitative practices, where they pay proportionately more of their income for products that may not be good value or whose value they cannot realise at all due to their circumstances. In these situations, ASIC allocates regulatory resources to specifically target practices of concern where we know the market is unlikely to be able to correct itself.

336 A further barrier to access for some groups of consumers includes the price discrimination practices that can be engaged in by some providers. Such practices can restrict the type of products and services these consumers can access or can leave consumers having to pay significantly more for the same product than their peers.

Example: ASIC takes action against book-up practices in remote SA[111]

ASIC issued proceedings against the owner and operator of Nobby's Mintabie General Store (Nobby's) in the Anangu Pitjantjatjara Yankunytjatjara Lands (APY Lands) in remote South Australia.

Nobby's provided a form of credit known as 'book up' in which consumers could buy goods now and pay for them later. Book up is generally an informal arrangement commonly used in Indigenous communities where it can play a useful role where there is not ready access to alternative banking services in remote or regional areas.

However, we were concerned that Nobby's book-up practices were exploitative because consumers were required to provide their debit cards, PINs and details of their income. Nobby's then used this information and cards to withdraw all or nearly all of the customer's money from their bank account on or around the day they were paid.

The Federal Court found that the book-up practices tied customers to the store, leaving them with little practical alternative but to continue shopping at Nobby's. Further, the court found the system involved largely undocumented and poorly recorded transactions such that 'any audit of what has occurred is not feasible'; and the credit provided was of a very expensive kind and in most cases consumers were unaware they were being charged for the book-up service.

[111] See ASIC, Media Release (16-383MR) *Federal Court finds book up practices in South Australian Indigenous community unconscionable*, 10 November 2016.

Example: The cost of consumer leases for household goods

We analysed data sets including price data from consumer lease advertisements which was collected by RMIT in April 2015, and data on 69 leases entered into by two lessors between March 2014 and February 2015 with consumers in receipt of Centrelink payments.[112]

Among other things, we found Centrelink recipients were charged amounts consistently higher than the prices advertised in the leases collected by RMIT. In 20 out of 39 leases with a two-year term, Centrelink recipients were charged more than five times the retail price of the leased goods, equivalent to an interest rate of over 248%.

Behaviourally informed interventions

337 The factors described above highlight the importance of understanding the real drivers of, and barriers to, both supply-side and demand-side behaviours in identifying the underlying causes of market problems, which may be affecting consumer outcomes in the Australian financial system.

338 The traditional remedy of mandating disclosure or providing more information will often not be enough to facilitate effective demand-side competition in the face of the effects of behavioural factors, supply-side factors and the conduct firms can engage in to exacerbate these effects. In fact, this deeper analysis highlights that structural and behavioural market failures are complex, and proposed remedies can be difficult to design and implement successfully.

339 Market intervention should be based on a clear understanding of the underlying problem. When intervention is considered appropriate, it should be designed with the desired market/consumer outcome in mind.

340 Because of the complexity of market problems we often cannot know if a particular intervention will have the intended effect. Sometimes, a package of remedies is necessary to affect the desired change in a market of interest, and consideration should be given not only to demand-side remedies,[113] but also to solutions that target supply-side behaviours that exploit biases and make it difficult for consumers to engage and take action.

341 It is also critical that interventions are not 'set and forget'. We have seen that where remedies are based on assumptions about how those directly and indirectly affected by them are going to behave, then unintended outcomes can occur (see examples below).

[112] See ASIC, Report 447 *Cost of consumer leases for household goods* (REP 447), September 2015.
[113] See A Fletcher, *The role of demand-side remedies in driving effective competition: A review for which?* (PDF 649 KB), Centre for Competition Policy, November 2016, for a description of demand-side remedies and an analysis of their use and effectiveness in different markets (primarily in the UK).

342 The collection and analysis of data should be a key component in the design process of interventions, and can help policy makers avoid having to rely on assumptions when deciding on the best course of action. This evidence-based approach to interventions creates mutual obligations on the part of policy makers, regulators and firms to transparently collect and share data about consumer outcomes in their markets on an ongoing basis.

343 It is important to acknowledge that any effective remedy that attempts to solve a market problem is going to produce winners and losers both within and between the demand and supply sides of a market. Ex-post evaluation of post-sale consumer outcomes after the implementation of an intervention is also needed to ensure it has achieved the intended outcomes, and has not led to any unintended consequences. Where interventions are found to have had negligible impact, or have had unintended impacts, they should be proactively addressed by changing the intervention in line with available evidence.

Example: Unsolicited credit limit increase offers

Changes to the *National Consumer Credit Protection Act 2009* meant that, from 1 July 2012, credit providers could not send credit card limit increase invitations unless a customer had positively opted-in to receive them.

This measure acknowledged that consumers may have a natural inclination to accept such offers without necessarily considering their real need for the increased limit, or being able to predict their future capacity to repay the additional credit.

Certain elements of the legislation meant, however, that some providers were able to mute the intended functioning of the opt-in mechanism.

For example, in 2012 ASIC accepted an enforceable undertaking from CBA following concerns messages sent to customers about the changes to the law were misleading. Around 96,000 customers provided their consent in response to the message from the bank, which ASIC considered misleading because it:

- suggested that if customers did not complete the consent in response to the message they would lose the chance to receive credit limit increase offers;
- suggested that if they did not consent, customers would miss out on opportunities to access extra funds should they need them later; and
- created the impression that customers had to act urgently, which may have led them to respond without properly considering their options.[114]

In proceedings brought by ASIC, the Federal Court found that GE Capital told certain credit card customers that to activate their credit card, or apply for or obtain an increased credit limit, the customer also had to consent to

[114] See ASIC, Media Release (12-40MR) *ASIC accepts enforceable undertaking from Commonwealth Bank*, 7 March 2012.

receiving invitations to apply for credit limit increases. The court also found that:

> … the contraventions were serious and the reach of GE Capital's conduct was extensive and substantial [and it] was a systematic and deliberate attempt to mislead cardholders into giving their consent to receive invitations for future credit increases so as to avoid losses of up to $6 million which were projected to be suffered by GE Capital as a result of the tightening regulatory environment.

In May 2016, the Government proposed to expand the opt-in consent mechanism to a ban on unsolicited credit limit increase offers by providers, and applied it to all forms of communication.[115]

In setting out its reasoning for amending the original intervention, the Government said it was aware that some card issuers used other means of communication to obtain consumer consent (essentially thwarting the 'spirit' of the 2012 legislation). It also noted that consumers are often unaware they have already given consent, due to the way issuers build this in at the time of applying for a credit card.

Example: Price comparison tools

Examples of demand-side remedies that have been introduced are the various price comparison tools that operate in a number of retail financial markets. Some of these tools are market-based, while others have been created following a government mandate: see Section D, Table 8.

Price comparison tools allow consumers to view and compare particular products on a number of elements, including price and other features.

There can be instances in which price comparison tools are not able to achieve their intended aims because of supply-side factors, which can include non-transparent relationships between the owners of a comparison tool and the issuers/distributors of featured products, and the existence of commissions or sponsorship arrangements: see Section B, paragraphs 204–208.

There are also demand-side factors that can affect the use of, and reliance on, price comparison tools. The UK FCA has conducted three separate pieces of research into consumers' use of price comparison tools across general insurance,[116] payday loans[117] and shopping around for annuities.[118]

Across these pieces of research, there were a number of positive perceptions of price comparison tools by consumers, including that they

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[115] Treasury, *Credit cards: Improving consumer outcomes and enhancing competition*, May 2016.
[116] Atticus Research Limited, *Price comparison website: Consumer market research* (PDF 2.71 MB), FCA, June 2014.
[117] London Economics and YouGov, *High-cost short-term credit price comparison websites: A behavioural study for the Financial Conduct Authority* (PDF 2.21 MB), FCA, October 2015.
[118] Oxera and the Nuffield Centre for Experimental Social Sciences, *Increasing consumer engagement in the annuities market: Can prompts raise shopping around?* (PDF 4.55 MB), FCA, June 2016.

saved time and effort in the process of shopping around, and consumers believed they would also save money by finding the best value product.

Other findings from these research pieces highlight, however, that consumers can rely on price comparison tools in unintended ways. Some of the findings from the general insurance research included that:

- Authority bias (also known as the 'halo effect') can lead some consumers to attribute a perception of expertise to price comparison tools. Some consumers interpreted pre-populated insurance excess amounts and offers of add-on insurance as implicit advice.
- Many consumers tend to use price comparison websites in a way that simplifies the search process. Consequently, many focused on only a few features, such as headline price and quoted excess amounts, when comparing. A default belief for many was that cheaper quotes were competitive and the best choice, with an assumption that providers would have been vetted in some way before being included on the site.
- The framing of information can have a significant impact on consumer decision making when using price comparison tools. Some consumers in the research believed the features highlighted with salient visuals such as green ticks or red crosses were all they needed to make a 'good enough' decision.[119]

These findings highlight the importance of understanding both demand-side and supply-side interactions with interventions to ensure the perceived benefits of them are realised, and unintended consequences can be understood and mitigated.

[119] Atticus Research Limited, *Price comparison website: Consumer market research,* FCA, 2014.

D Facilitating effective competition in the financial system

Key points

As competition is driven by a broad range of factors, no single response is likely to be sufficient of itself to address competition weaknesses. However, we think a range of responses, in combination, will facilitate effective competition into the future.

In particular, we support the key competition recommendations of the Murray Inquiry to expand ASIC's regulatory mandate and toolkit through:

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

Additionally, in different situations, a tailored supply-side and/or demand-side response may be very effective in addressing a particular issue that is impeding effective competition.

344 This section describes the regulatory approach that we think is most effective to respond to competition weaknesses in markets for financial products and services, including:

(a) promoting competition in the financial system, through an enhanced regulatory toolkit for ASIC (see paragraphs 345–359);

(b) addressing structural issues on the supply side that are leading to poor consumer outcomes (e.g. by removing conflicts of interest that are leading providers to exploit demand-side weaknesses) or providing barriers to supply-side competition (e.g. promoting innovation or small businesses' ability to compete) (see paragraphs 360–374); and

(c) dealing with barriers to effective demand-side competition (e.g. by better informing consumers about the choices available to them in a way that is accessible and meaningful, through providing greater access to data) (see paragraphs 375–395).

Promoting competition in the financial system

345 The Murray Inquiry found that the focus on competition in the financial system should be strengthened and, to address this, among other things, it recommended including:

(a) consideration of competition in ASIC's mandate;

(b) strengthening ASIC's regulatory toolkit through new design and distribution obligations for providers and distributors and through a product intervention power for ASIC.

346 The Government has agreed to implement these recommendations, although the final form of each is yet to be determined.

ASIC competition mandate

347 Adding a requirement into ASIC's statutory mandate to formally consider the effect of our decision making on competition will not make us a competition regulator; however, we think this change will drive a greater focus on the long-term interests of consumers in the financial system.

Note: ASIC's mandate (ASIC Act, s1(2)) currently requires ASIC to strive to:

(a) maintain, facilitate and improve the performance of the financial system and the entities within that system in the interests of commercial certainty, reducing business costs, and the efficiency and development of the economy; and

(b) promote the confident and informed participation of investors and consumers in the financial system; and

(d) administer the laws that confer functions and powers on it effectively and with a minimum of procedural requirements; and

(e) receive, process and store, efficiently and quickly, the information given to ASIC under the laws that confer functions and powers on it; and

(f) ensure that information is available as soon as practicable for access by the public; and

(g) take whatever action it can take, and is necessary, in order to enforce and give effect to the laws of the Commonwealth that confer functions and powers on it.

348 How we implement a competition mandate will ultimately depend on its scope and form, which is still to be determined by the Government. We support an explicit broad mandate that enables us to:

(a) promote competition in regulated financial markets and services, including by factoring competition into our regulatory decision making;

(b) use our existing functions and powers (including information-gathering powers) to consider whether competition is working effectively in the markets we regulate; and

(c) do both of these in the long-term interests of consumers or end-users.

349 The competition objective would also bring us into line with the Australian Prudential Regulation Authority (APRA), which is required by legislation to consider the impact of its actions on competition in the financial system, and would be similar to the approach required of the UK's Financial Conduct Authority (FCA). As a result, ASIC would be better placed to engage with other domestic and international regulators to address competition issues in global financial markets.

350 We consider that a useful formulation of our competition mandate would be similar to the one set out in the mandate of the FCA to 'promote effective competition in the interests of consumers'.[120]

International comparison: UK Financial Conduct Authority

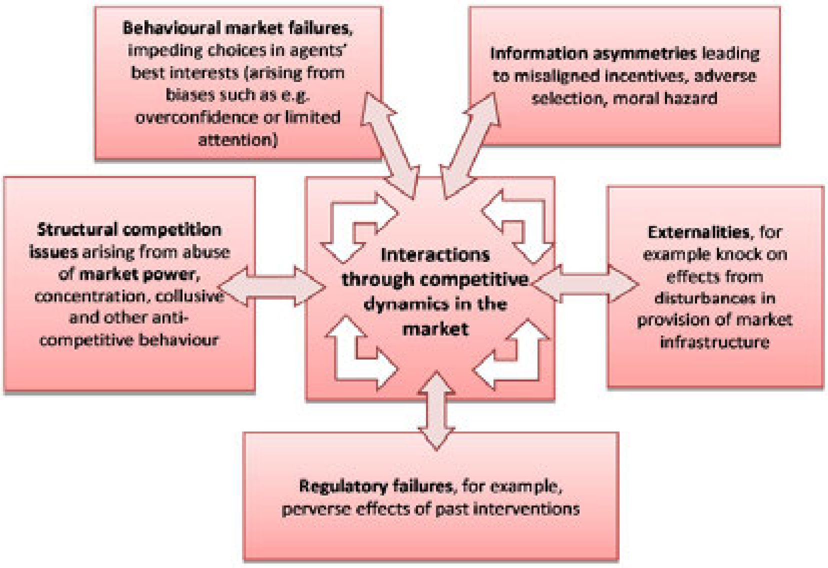
The *Financial Services Act 2012* (UK) established the Financial Conduct Authority (FCA) and gave it a specific competition objective to promote effective competition in the interests of consumers in regulated markets.

In the legislation, matters to which the FCA may have regard in considering the effectiveness of competition in the market include:

- the needs of different consumers who use or may use those services, including their need for information that enables them to make informed choices;
- the ease with which consumers who may wish to use those services, including consumers in areas affected by social or economic deprivation, can access them;
- the ease with which consumers who obtain those services can change the person from whom they obtain them;
- the ease with which new entrants can enter the market; and
- how far competition is encouraging innovation.

The FCA, in implementing its competition mandate, recognises the importance of considering a broad range of factors in assessing competition through its integrated analysis model: see Figure 2.

Figure 2: Interactions between market imperfections



Source: FCA, *Economics for effective regulation*, Occasional Paper No. 13, March 2016, p. 5.

[120] *Financial Services Act 2012* (UK), s1B.

Since the establishment of the competition mandate, the FCA has:

- examined existing regulatory requirements for anti-competitive effects to ensure it does not unduly impede entry and innovation;
- undertaken an extensive program of market analysis (including behavioural studies) to determine the state of competition in various financial markets;
- taken account of competition across policy, supervisory, authorisation and enforcement work, and sought to find pro-competitive solutions to concerns where possible; and
- established programs to assist innovation, including a ‘regulatory sandbox’ for firms to trial innovative ideas.

Having been provided with a mandate to promote competition in 2012, in a separate and additional step in April 2015, the FCA was given powers to enforce competition law concurrently with the Competition and Markets Authority (CMA) for the market sectors it regulates.

351 An explicit broad competition mandate will allow us to:

(a) more formally recognise our existing and future role in promoting and monitoring competition;

(b) directly consider the impact of our regulatory decisions on competition—including considering competition neutrality and reducing unintended barriers to entry and expansion over time;

(c) have a more holistic view of the market sectors we regulate and better understand the root causes of any market-wide problems—including considering both supply-side and demand-side competition issues;

(d) provide a better evidence base for our decision making; and

(e) actively use our regulatory toolbox—including information-gathering powers—to directly examine competition concerns.

352 Without a suitable competition mandate, we are likely to have less capacity to independently collect information or undertake surveillances relating to competition issues underlying poor consumer outcomes and market problems. For example, as part of our mortgage broker remuneration review,[121] the Minister’s specific guidance for ASIC to consider particular matters that related to competition allowed us to examine and highlight competition issues in the mortgage broker industry as part of our report.

More flexible regulatory toolkit

353 The Murray Inquiry also recommended ASIC be provided with a broader toolkit to respond effectively and in a timely way to an emerging risk of significant consumer detriment, through:

[121] ASIC, Report 516 *Review of mortgage broker remuneration* (REP 516), April 2017.

(a) product design and distribution obligations for issuers and distributors of financial products—effectively a 'product governance' framework to strengthen issuer and distributor accountability to ensure that products are designed with consumer needs in mind and are marketed at appropriate sections of the population; and

(b) a product intervention power for ASIC—to enable us to respond to market problems in a flexible, targeted, effective and timely way.

354 The Government has agreed to implement these measures, and, in December 2016, Treasury released a proposals paper, *Design and distribution obligations and product intervention power*, setting out implementation issues for consultation. The Government is still finalising the form that the product design and distribution obligations and intervention power will take.

355 The new product governance obligations will enhance accountability for issuers and distributors of financial products (including banks and insurers) and are aimed at reducing the number of consumers who are sold products that do not meet their needs or are otherwise inappropriate. The obligations will also compel firms to be more consumer-focused when designing and distributing products.

356 The new product intervention power will enhance ASIC's regulatory toolkit by enabling us to 'intervene' by imposing orders that address significant shortcomings in products or conduct that result in consumer detriment. While the exact scope of the power is still to be finalised, the types of intervention ASIC could make might potentially relate to how products are designed and marketed, and the timing and content of disclosure provided.

The relationship between new regulatory tools and competition in financial services

357 We see the product design and distribution obligations, product intervention power and competition mandate as important and interrelated tools for ASIC to help facilitate sustainable competition and address market failures that impact on consumers. For example:

(a) The product design and distribution obligation and product intervention power will work together to address the interests and needs of consumers.

(b) If the design and distribution obligation is in place and being complied with, there will be less need for ASIC to exercise the intervention power.

(c) The competition mandate will give ASIC an additional element in our analysis of market problems, allowing us to consider whether there are competition issues underlying the market problems and poor consumer outcomes we see. Where we find a problem relating to ineffective competition, we may use our product intervention power to address it where appropriate.

358 There is a particularly close link between competition considerations and a product intervention power for ASIC. Providing us with a competition mandate and product intervention powers will enable us to be a more proactive and effective regulator. A competition mandate would allow us to consider and address consumer detriment more broadly, and, where drawn appropriately broadly, we would be able to use the proposed product intervention powers to directly address such market failures, through a specific and targeted intervention.

359 We think that, where there is consumer detriment:

(a) there will often be underlying issues relating to competition working ineffectively or negatively (e.g. excessive supply-driven competition); and

(b) the best and most appropriate interventions will promote competition in the interests of the end users of financial products and services.

Effective regulatory responses: Supply-side responses

360 Whether regulatory responses are delivered by Government through legislation, or by ASIC through our current and future powers, a key focus of regulatory responses to promote effective competition will need to be on addressing supply-side issues that are leading to poorly functioning markets and impeding competition. As set out below, such regulatory responses have been very effective in the past and will continue to be important in markets for financial products and services.

361 In addition to providing a means of addressing structural market issues that are impeding competition, regulation can also have other impacts on the supply side. For example:

(a) Further regulation may be able to address instances of regulatory arbitrage, where the supply side adjusts business models in order to avoid regulation (see paragraphs 364–365).

(b) Regulatory intervention can also promote and overcome any barriers to competition on the supply side (see paragraphs 366–368).

Addressing issues that have an impact on poor consumer outcomes

362 Outcomes for consumers may be poor within markets that are characterised by strong supply-side competition, and weak demand-side competition,

particularly where intermediaries have significant conflicts of interest. For example:

(a) In the absence of genuine demand-side competition, there is always a risk that competition by providers for distribution of their products and services through distributors and other intermediaries will increase costs and end prices because such supply-side competition increases commissions and other selling incentives.

(b) Such situations may also undermine providers' ability to appropriately manage the conduct of their intermediaries for fear of the intermediary moving to another provider.

(c) This, particularly when coupled with conflicted remuneration, makes misconduct or pressure selling more likely, and is likely to lead to poor consumer outcomes.

363 As discussed in Section C, where markets are functioning in this way, one aspect of addressing the problem may be empowering consumers to exert greater demand-side pressure; however, this is unlikely to address such market responses of itself. For example, in our experience, providing additional disclosure has generally not proved effective in addressing these problems. More significant intervention is typically required to make competition and markets function effectively to deliver high quality and cost-effective products and services to consumers.

364 Over the years, supply-side regulatory interventions have been a very important factor in improving the effectiveness of competition in financial markets. Significant examples of such interventions have included significant regulatory reforms to consumer credit and financial advice: see Table 3 in Section A.

Price controls

365 Some of these reforms have involved some element of price control. Generally, we consider competition is a sufficient mechanism to determine a 'fair' price for products and services in the market. In many cases, the interaction of supply and demand—including consumer preferences for a product—will determine the most efficient price and cost for a financial product or service. However, where there are egregious market failures, price controls may be necessary to address such problems.

366 There have been additional market failures in the financial system where the Government (or ASIC) has intervened on price or remuneration to ensure that consumers are not exploited and that the market is transparent, and we think that this has been appropriate. Table 8 outlines examples of such Government intervention in the financial advice, credit and consumer law spaces.

Table 8: Controls on pricing and remuneration

Control	Description
Price controls in payday lending	The payday lending market in Australia provides short-term small amount loans to consumers who may not be able to access credit from mainstream credit providers. The Government has identified small amount or payday loans as a product that holds specific risks of financial detriment or harm to vulnerable consumers. There has been little competition in the market because consumers are likely to take out a loan without considering whether they could get a better deal and will stay with a lender who is providing them with credit. Historically, the cost of small amount loans was very high and well above mainstream consumer lending rates. Due to the high cost of these loans, consumers using this market would fall into an ongoing debt cycle, increasing their reliance on credit for day-to-day living expenses and having repeated roll-overs of their loans leading to a debt spiral. This reduced the consumers' capacity to improve their financial situation, with consequent economic costs including adverse social and health impacts. Specific price controls targeted at the payday lending market include: • a prohibition on 'short-term' loans of $2,000 or less that must be repaid in 15 days or less • a cap on default fees or charges (the credit provider cannot collect more than 200% of the amount loaned if the consumer defaults—that is, fails to pay back the loan); and • a cap on repayments of 20% of a consumer's gross income (this is for consumers who receive 50% of their income through Government social security payments).[122] These caps and the ban on short-term loans do not apply to loans offered by ADIs, or to continuing credit contracts such as credit cards. The cap and price controls are in addition to the general responsible lending obligations for consumer credit preventing consumers from being entered into a loan that is 'unsuitable' to them.

[122] The Government has supported a recommendation from an independent review of the high-cost credit laws in 2016 that the small amount credit contract (SACC) protected earnings amount requirements be extended to all consumers and lowered to 10% of the consumer's net income.

Control	Description
Price controls in consumer leases	Another area where the Government has committed to introducing price controls is the consumer lease market. A consumer lease is a contract for the hire of goods for a fixed term of more than four months, where the consumer has no contractual right or obligation to purchase the goods at the end of the lease term (although in practice most lessors allow the consumer to either retain the goods (or similar goods) at the end of the contract or gift the goods to a third party, nominated by the consumer). Two key findings from ASIC's Report 447 *Cost of consumer leases for household goods* (REP 447), released in September 2015, are: • different lessors charged significantly different amounts for the same goods (price dispersion); and • the same lessor would charge significantly different amounts for the same goods for different customer segments—with significantly higher costs for the most vulnerable consumers (price discrimination). Both price dispersion and price discrimination are considered key indicators of competition failure in the market. Further, these activities disproportionately and negatively affect financially vulnerable consumers. Following an independent review of small amount credit contracts, in 2016 the Government agreed to introduce: • a cap on total payments on a consumer lease equal to the base price of the good plus 4% of that price per month; and • a protected earnings amount requirement for consumer lease providers of 10% of net income for all consumers, equivalent but separate to the requirement for payday loans.
Flex commissions in add-on car insurance	In September 2017, ASIC issued a legislative instrument to prohibit (from late 2018) a form of commission in the car finance market known as flex commissions. Under flex commissions: • the lender gives the car dealer (and other intermediaries) a discretion to set the interest rate within an agreed range (that could be 700 basis points or more); and • the higher the interest rate the larger the commission earned. Following consultation and publication of a Regulation Impact Statement, ASIC decided to prohibit flex commissions because they distort pricing arrangements and are a remuneration structure that mean the interest rate charged to the consumer is not related to their credit rating or the risk of default, but to their financial sophistication, degree of financial literacy and capacity to negotiate to protect their interests. ASIC still allows other forms of commission to be paid to intermediaries.

Addressing regulatory arbitrage

367 Sometimes, an unintended consequence of regulation can be to facilitate arbitrage. For example, where functionally equivalent products and services are subject to different levels of regulation, our experience is that some providers (particularly fringe operators) will structure their business in order to fall into the less intensively regulated space.

368 However, while regulation may inadvertently lead to these kinds of problems, equally, additional more appropriate regulation is likely to be the answer to address regulatory arbitrage.

369 We think that a new product intervention power would better enable ASIC to deal with unintended consequences and take direct action to deal with these problems.

370 Below we outline some examples of regulatory arbitrage that we have seen.

Examples: Regulatory arbitrage

Dealer warranties

During 2016, ASIC released three reports on add-on insurance sold through car dealerships. These reports found systemic problems in this distribution channel, resulting in a market that is failing consumers.

Car dealers also distribute warranties that are functionally similar to insurance products but are typically structured to avoid being classified as insurance so that providers do not need to comply with obligations under the *Insurance Contracts Act 1984* and the Corporations Act.

While our reports did not review the car dealer warranty add-on market, our view is that:

- consumers are likely to experience similar systemic adverse outcomes from the sale of warranties as from other add-on insurance products (given the underlying sales process and commercial drivers are similar to those that have driven poor outcomes for other add-on products); and
- the incentives to offer products that are functionally similar, but unregulated, may increase should reforms be introduced to add-on insurance products regulated under the Corporations Act.

Payday lending

Our experience in the payday lending industry has been that the introduction of the cap on costs (described in Table 8), and other specific obligations, has resulted in a number of lenders attempting to avoid these provisions through specific business models.

Based on this, we strongly advocated for the introduction of anti-avoidance provisions into the National Credit Act, in our submissions to the Government's 2015–16 review of the small amount credit contract laws. The Government has committed to implementing this measure.

Regulation of securities dealers and market participants

The regulatory framework that applies to market participants is substantially different from that which applies to securities dealers, even though market participants and securities dealers play similar roles in our financial markets.

In particular, ASIC does not have the power to make market integrity rules that apply to securities dealers. Market integrity rules impose a range of specific obligations to protect the integrity and efficiency of licensed markets.

From a retail client's perspective, a securities dealer's services may be indistinguishable from those of a market participant (e.g. placing trades or offering managed discretionary account services).

As the market integrity rules do not apply to securities dealers, ASIC has no power to take administrative action against securities dealers through the Markets Disciplinary Panel, depriving ASIC of an important and effective regulatory mechanism.

General versus personal advice distribution models

Under the Corporations Act, 'personal' financial product advice is regulated more intensively than 'general' financial product advice. 'Personal' advice is financial product advice that is given or directed to a person in circumstances where the provider of the advice has considered one or more of the person's objectives, financial situation and needs.

When personal financial product advice is given, a consumer is provided with a range of additional protections, including that the advice provider must comply with the best interests obligation (Corporations Act, s961B(1)) and prohibitions on conflicted remuneration (Corporations Act, Pt 7.7A of Divs 4 and 5 of Pt 7.7A).

Some products are sold under a 'general' or 'no advice' sales model. This places significant responsibility for good purchasing decisions on the consumer, and may risk consumers being sold a product that they do not need.

For example, as part of our examination of add-on insurance sold through car dealers, Report 492 *A market that is failing consumers: The sale of add-on insurance through car dealers* (REP 492), we found that the insurers we studied predominantly sold through a general advice model, although some insurers also used a 'no advice' model where only factual information is provided to the consumer.

The use of these models means that intermediaries (i.e. in this case, the car dealers):

- are under no obligation to ensure the product is suitable or meets the consumer's needs; and
- receive commission payments that could create conflicts of interest.

A general advice model is likely to have adverse outcomes for consumers in the add-on insurance context because it allows car dealers to promote the sale of the products without considering whether the consumer needs cover, and then places the responsibility for poor purchasing decisions on the consumer.

In REP 492, we said that the Murray Inquiry recommendations for product design and distribution obligations and a product intervention power for ASIC would help to address the market-wide failings apparent in the sale of add-on insurance through car dealers.

In August 2017, we released Consultation Paper 294 *The sale of add-on insurance and warranties through caryard intermediaries* (CP 294). This sets out proposals to address the issues we have found in relation to add-on insurance sales, including a deferred sales model that would insert a pause into the sales process.

CP 294 also notes that other regulatory options we have assessed as appropriate may be beyond our current powers (e.g. prohibiting the sale of an add-on product where the consumer cannot reasonably be expected to benefit from it) and that the Government is currently consulting on the form and content of new product intervention powers for ASIC.

We note that the Murray Inquiry recommended that the distinction between personal and general advice be reviewed: see Table 6.

Removing barriers to entry and ongoing contestability

371 Regulation can address issues on the supply side that are creating barriers to entry into the financial markets and/or ongoing contestability, and thus foster increased competition. This is likely to ultimately benefit consumers.

372 As discussed in Section B, we see a particular need for regulation to remove barriers to entry in relation to innovative start-up financial services businesses.

373 Additionally, we see this as an important part of our mandate in relation to small businesses as a key driver of the economy—some of which (although not all) are financial or credit businesses. An important aspect of the ASIC *Small business strategy 2017–2020* is to protect small business through working to level the playing field for small business within our regulatory remit.

374 For example, we receive complaints from small business owners about the unfair competitive advantage that some operators get by engaging in illegal phoenix activity. This has a significant impact across a variety of sectors, and we have a focus on enforcement action against those that are directly involved in, or facilitate, this behaviour.

Effective regulatory responses: Demand-side remedies

375 Demand-side remedies generally fall into three key categories:

(a) *disclosure remedies*—requiring providers to provide consumers with information about products and services that is relevant for consumer decision making;

(b) *shopping-around remedies*—involving a collation of information to facilitate search and comparison or nudges and triggers to encourage shopping around; and

(c) *switching remedies*—to make switching less burdensome or costly or the removal of specific factors that might inhibit switching.[123]

376 As discussed in Section A, addressing information asymmetry through disclosure to consumers has been a key feature of the current regulatory regime. This was on the assumption that consumers, armed with this information, will be empowered to make effective choice: see paragraphs 72–75.

377 ASIC has worked for many years to improve the quality of disclosure. This has included:

(a) developing regulatory guidance on how disclosure documents should be presented, to better assist consumers to locate and understand information they require to make an investment decision;[124] and

(b) encouraging and facilitating digital disclosure documents, to allow consumers to receive documents in more convenient ways, and to encourage the development of more innovative disclosure documents that may be more engaging for consumers.[125]

378 However, it is now recognised that disclosure, while necessary, is not sufficient to facilitate consumers exerting effective demand-side pressure. This is because:

(a) the behavioural biases discussed in Section C, which lead people to rely on beliefs and preferences in decision making, may also mean that people will not read mandated disclosure documents, or inadequately understand or even misunderstand those documents;

(b) people may lack the resources (e.g. financial literacy skills, motivation and time) to read and understand disclosure documents;

(c) the complexity of many financial products may mean that:

[123] A Fletcher, *The role of demand-side remedies in driving effective competition: A review for which?* (PDF 649 KB), Centre for Competition Policy, November 2016.
[124] See, for example, ASIC, Regulatory Guide 228 *Prospectuses: Effective disclosure for retail investors* (RG 228), November 2016.
[125] See ASIC, Regulatory Guide 221 *Facilitating digital financial services disclosures* (RG 221), March 2016.

(i) disclosure for such products is very lengthy and complex, which may make it unrealistic for many people to read and understand it in the time available to them; or

(ii) disclosure for such products is over-simplified or generalised in an attempt to deal with this complexity, which may make people over-confident about their understanding of a product and its risks; and

(d) disclosure alone is unlikely to correct the effect of broader market structures and conflicts that drive product development or distribution practices that result in poor investor outcomes (e.g. conflicted remuneration structures), especially where the interests of issuers and distributors are fundamentally misaligned with those of investors.

Note: For example, behavioural biases can inhibit consumers' ability to exert competitive pressure on prices. Firms can exploit consumer biases by competing on product characteristics that actually shroud rather drive down prices. They may have incentives to create multiple-attribute products and set higher prices in order to confuse buyers, rather than simplifying the information and competing on price to capture market share: see Section C.

379 For choice to deliver real benefits to consumers they need proper access to information, in a form that they can assess and a capacity to act on it.[126]

380 We think that a key avenue for improving consumer outcomes lies in making more data available to consumers in a way that is truly useful to them. This will facilitate both consumers shopping around and, where appropriate, switching.

Access to data

381 Increasing consumers' access to data can help consumers better assess and manage risks, and help them to make better decisions.

382 We are in an era of 'big data', in which businesses are able to collect, store, analyse and use a much greater range of data on consumers—for example, to tailor products to their needs and market the products in a way that will appeal to consumers.

383 Internationally, governments and regulators are increasingly considering what can be done to ensure that this trend can be harnessed to empower consumers, improve their decision making, and drive competition by, for example:

(a) making useful data directly available to consumers; or

(b) requiring product and service providers to make machine-readable data available to third parties, who may then be able to aggregate such data into useful 'choice engines'.

[126] I Harper, P Anderson, S McCluskey & M O'Bryan QC, *Competition policy review*, final report, March 2015, p. 27.

384 The type of data that might be provided includes data that are personal to the consumer (e.g. patterns of past usage of products and services to inform the consumer's choice of a new product or their switching to a new provider) and data that are not personal to any particular consumer but would be informative in assessing the quality and value for money of a provider or goods and services.

Current initiatives in relation to data

385 ASIC supports current initiatives to give consumers greater control over their data, in particular:

(a) the Productivity Commission's inquiry into data availability and use recommendation for a comprehensive right for consumers, including to access data in machine-readable forms or direct that this be transferred to third parties; and

(b) the Government's proposals to implement an open banking regime, to require the banking sector to share product and customer data when requested by the customer.

> Note: As part of the 2017 Federal Budget, the Government announced it would implement an open banking regime in Australia by 2018. The regime will 'require the banking sector to share product and customer data when requested by the customer'. This has commenced with an independent review by Treasury into the most appropriate implementation model for an open banking regime, including privacy and consumer protection considerations.

386 These initiatives may promote competition by:

(a) empowering consumers, or intermediaries (e.g. choice engines), to increase demand-side rivalry;

(b) highlighting new measures of quality (which are particularly important for financial services and products) for firms to differentiate themselves; and/or

(c) potentially reducing barriers to entry for new entrants that incumbent access to existing consumer data may create.

Driving competition through access to private data

387 While the Government's proposed open banking regime (see paragraph 385(a)) is very a useful starting point, we think that there is merit in considering making more data available to Australian investors and financial consumers, particularly in situations of market failure where disclosure is failing to facilitate adequate choice and competition.

388 In addition to providing consumers with access to their own data, we think there can be a public benefit from making some private sector data publicly available, particularly in the financial services industry, due to the inherent complexity of financial products. In particular, key indicators derived from

financial services provider data can provide a more direct and powerful indicator of the quality or value for money of a financial product or service than a detailed comparison of a lengthy disclosure document.

389 For example, rather than relying solely on lengthy individual disclosure of legal and contractual terms, providing transparent data around the broader ‘performance’ of a product or service might facilitate better consumer decision making. In relation to financial markets and services, it is often difficult to find out about performance simply by reading the terms and conditions of a mandated disclosure document. Thus, in the absence of data available in an effective form, consumers often make decisions based on aspects such as brand recognition, which promotes inertia and incumbency.

390 Given the private sector may lack incentives to release this data, or the means to compel third parties to share it, there is a role for regulation to facilitate or mandate these kinds of initiatives.

391 If more data were made publicly available, this might provide an avenue for the creation of ‘choice engines’ to assist consumers. Choice engines, such as decision making or comparison websites, can provide consumers with an interface to more easily compare products and to interpret disclosure information to help them find a product or service that best meets their needs. While there may be some issues in relation to choice engines that are not transparent in relation to the choices they offer consumers (see Sections B and C), where designed responsibly, they can also increase competition between product and service providers by giving consumers potentially greater choice, better quality and competitive prices.

392 There may be particular benefits to providing more data in situations of market failure where competition is not working effectively to produce good consumer outcomes (e.g. where there is evidence of poor investor and financial consumer decision making and outcomes, mis-selling of products, products and services that are objectively poor value for money, and high levels of complaint and dispute).

393 However, the implementation of greater access to data will need to be carefully managed to balance privacy, security, and commercial, consumer protection and liability issues with the overall principle of making more data transparent and accessible. Additionally, this approach may require significant initial costs to develop platforms for providing data, and ongoing costs to maintain and oversee them. Nevertheless, the potential benefits that may be derived from providing more data, including in driving better demand-side competition, may outweigh these considerations.

394 The examples set out below illustrate this approach.

Examples: Current initiatives to give greater access to private data

Where possible, ASIC is seeking to facilitate greater collection and use of recurrent data sets that provide insight into the financial sector, and legal compliance and consumer outcomes.

Financial advisers register

The potential for making available private sector data to support consumers has been highlighted by ASIC's financial advisers register. Launched in March 2015, the new financial advisers register helps people find out where a financial adviser has worked, their qualifications, disciplinary actions, training, membership of professional bodies and on what products they can advise.

Within the first three months, there had been almost 124,000 visits to the register and it continues to be among the most popular content on ASIC's MoneySmart website.

Life insurance claims

In ASIC's Report 498 *Life insurance claims: An industry review* (REP 498), released in October 2016, we identified that, to improve public trust and consumer understanding, there was a clear need for better quality, more transparent and more consistent data on life insurance claims.

ASIC is currently working with APRA on establishing a new public reporting regime for claims data and outcomes in the life insurance industry, which could ultimately allow for meaningful comparisons of insurer performance and with sufficient context to effectively inform consumers.

On 8 May 2017, APRA and ASIC released a discussion paper[127] about the collection of life insurance claims and disputes data, and issued a first round of data requests to life insurers. We are now analysing the data and considering feedback to improve the process.

Internal dispute resolution reporting

The recent *Review of the financial system external dispute resolution framework*, conducted by an independent panel led by Professor Ian Ramsay, recommended that financial service and credit firms that deal with retail clients be required to report standardised information about their internal dispute resolution (IDR) performance on a recurring basis to ASIC, and that to improve transparency ASIC should have power to publish that information.

We have advocated for such a power, including to be able to report complaints about individual firms, given the great majority of consumer complaints are internal, and greater transparency may aid consumer decision making about where they access financial products and services.

[127] APRA, *Towards a transparent public reporting regime for life insurance claims* (PDF 1.43 MB), discussion paper, May 2017.

> The Government has introduced legislation into the Parliament to implement its response to the review. This provides for the establishment of the new Australian Financial Complaints Authority (AFCA) and for a new IDR reporting framework which gives ASIC specific powers to collect, report and publish IDR data, including firm-specific data.

395 Some examples of additional datasets on financial services that might be of benefit to consumer purchasing decisions are set out in Table 9.

Table 9: Additional datasets that might benefit consumer purchasing decisions

Financial service or product	Datasets that might benefit consumers
General insurance	Datasets that might benefit consumers include: • average insurance claims processing times and/or claim payout rates, which could provide better assistance for decision making than long and complex disclosure documents for insurance products; and • natural disaster risk data specific to areas of residence.
Managed investments	Datasets relating to the frequency of managed investment scheme fund distributions might benefit consumers.
Mortgage broking	As part of ASIC's work to review the mortgage broking market to determine the effect of current remuneration structures on the quality of consumer outcomes (REP 516), we identified specific datasets that, if reported publicly, would assist with transparency in this market. These included: • the actual value of remuneration received by aggregators and the potential value if all criteria for remuneration are satisfied; • the average pricing of home loans that brokers obtain on behalf of consumers; • the average pricing of home loans provided by lenders according to each distribution channel; and • the distribution of loans by brokers between lenders to give consumers a better indication of the range of loans that brokers within the network offer. Following the release of REP 516, Treasury consulted with industry on ASIC's findings and recommendations. Representatives from the mortgage industry have recently convened a forum to develop an industry-led response to ASIC's recommendations and will provide a report on progress to ASIC, Treasury and the industry by the end of 2017. The Government has announced that it will take the mortgage industry forum's process into account when finalising its response to ASIC's review.[128]

[128] The Hon Kelly O'Dwyer MP, *ASIC review of mortgage broker remuneration*, media release, 29 August 2017.

Key terms

Term	Meaning in this document
ACCC	Australian Competition and Consumer Commission
ADI	Authorised deposit-taking institution—has the meaning given in s5 of the *Banking Act 1959*
AFS licence	An Australian financial services licence under s913B of the Corporations Act that authorises a person who carries on a financial services business to provide financial services Note: This is a definition contained in s761A.
AFS licensee	A person who holds an AFS licence under s913B of the Corporations Act Note: This is a definition contained in s761A.
ANZ	Australia and New Zealand Banking Group Limited
ASBFEO	Australian Small Business and Family Enterprise Ombudsman
APRA	Australian Prudential Regulation Authority
ASIC	Australian Securities and Investments Commission
ASIC Act	*Australian Securities and Investments Commission Act 2001*
ASX	ASX Limited or the exchange market operated by ASX Limited
ASX 24	The exchange market formerly known as Sydney Futures Exchange, operated by Australian Securities Exchange Limited
ATO	Australian Taxation Office
Australian Consumer Law	Cooperative legislation implemented through the Council of Australian Governments and set out in Sch 2 of the *Competition and Consumer Act 2010*
authorised representative	A person authorised by an AFS licensee, in accordance with s916A or 916B of the Corporations Act, to provide a financial service or services on behalf of the licensee Note: This is a definition contained in s761A.
best interests duty	The duty to act in the best interests of the client when giving personal advice to a client as set out in s961B(1) of the Corporations Act
CBA	Commonwealth Bank of Australia

Term	Meaning in this document
CCI	Consumer credit insurance
CFR	Council of Financial Regulators
Chi-X	Chi-X Australia Pty Limited or the exchange market operated by Chi-X Australia Pty Limited
clearing and settlement (CS) facility licence	An Australian CS facility licence under s842B of the Corporations Act that authorises a person to operate a clearing and settlement facility in Australia
CMA	Competition and Markets Authority (UK)
Corporations Act	*Corporations Act 2001*, including regulations made for the purposes of that Act
Corporations Regulations	Corporations Regulations 2001
CP 294 (for example)	An ASIC consultation paper (in this example numbered 294)
credit licence	An Australian credit licence under s35 of the National Credit Act that authorises a licensee to engage in particular credit activities
credit licensee	A person who holds a credit licence under s35 of the National Credit Act
CSF	Crowd-sourced funding
dark liquidity	Orders that are not pre-trade transparent (i.e. not known to the rest of the market before they match): see paragraph 22 of REP 331 for the full meaning of this term
dark pool/venue	Electronically accessible pools of liquidity that are not pre-trade transparent, including crossing systems and dark venues operated by exchange market operators
DLT	Distributed ledger technology—a specific configuration of technology components that records and tracks information in a ‘distributed’ (as opposed to ‘centralised’) manner
EDR	External dispute resolution
equity market	A market on or through which offers to acquire or dispose of equity market products are made or accepted, the operator of which is an equity market operator
ETF	Exchange-traded fund
FCA	Financial Conduct Authority (UK)

Term	Meaning in this document
FFSP	Foreign financial services provider
fintech	Financial technology
fintech licensing exemption	A conditional licensing exemption provided by ASIC under ASIC Corporations (Concept Validation Licensing Exemption) Instrument 2016/1175 and ASIC Credit (Concept Validation Licensing Exemption) Instrument 2016/1176 to allow eligible businesses to test certain specified products and services for up to 12 months without holding an AFS licence or credit licence
FOFA	Future of financial advice
ICO	Initial coin offering
IDPS	An investor directed portfolio service as defined in Class Order [CO 13/763] *Investor directed portfolio services* or any instrument that amends or replaces that class order
IDPS-like scheme	An investor directed portfolio services-like scheme as defined in Class Order [CO 13/762] *Investor directed portfolio services*, provided through a registered managed investment scheme, or any instrument that amends or replaces that class order
IDR	Internal dispute resolution
INFO 153 (for example)	An ASIC information sheet (in this example numbered 153)
Innovation Hub	ASIC's Innovation Hub exists to foster innovation that could benefit consumers by helping Australian fintech start-ups navigate our regulatory system
IPO	Initial public offering
IT	Information technology
market participant	Has the meaning given in s761A of the Corporations Act
MDP	Markets Disciplinary Panel—ASIC's Markets Disciplinary Panel, through which we exercise our power to issue infringement notices and to accept enforceable undertakings in relation to breaches of the market integrity rules
MoneySmart	ASIC's website for consumers and investors (www.moneysmart.gov.au)
Murray Inquiry	Financial System Inquiry (2014)
National Credit Act	*National Consumer Credit Protection Act 2009*

Term	Meaning in this document
National Credit Code	National Credit Code at Sch 1 to the National Credit Act
OTC	Over the counter
Pt 9.4 (for example)	A part of the Corporations Act (in this example numbered 9.4), unless otherwise specified
RBA	Reserve Bank of Australia
regulatory sandbox	ASIC's regulatory sandbox framework, comprised of three broad options for testing a new product or service without a licence. Those options are: • relying on existing statutory exemptions or flexibility in the law—such as by acting on behalf of an existing licensee; • relying on ASIC's 'fintech licensing exemption' for the testing of certain specified products and services; and • for other services, relying on individual relief from ASIC. More information about each of these options is available in Regulatory Guide 257 *Testing fintech products and services without holding an AFS or credit licence* (RG 257)
regtech	Regulatory technology
REP 240 (for example)	An ASIC report (in this example numbered 240)
RG 148 (for example)	An ASIC regulatory guide (in this example numbered 148)
s961B (for example)	A section of the Corporations Act (in this example numbered 961B), unless otherwise specified
SACC	Small amount credit contract
securities dealer	An entity that is an AFS licensee but is not in itself a market participant and that accesses the market on behalf of its clients through a market participant
SMEs	Small to medium-sized enterprises
Wallis Inquiry	Financial System Inquiry (1997)