

Product Regulation

Strategic Policy

Australian Securities and Investments Commission

11 March 2020

By email

Dear Sir/Madam

Consultation Paper 325 Product design and distribution obligations

Thank you for the opportunity to provide a submission in response to CP 325.

ARCA is the peak industry association for businesses using consumer information for risk and credit management. Our Members include Australia's leading banks, credit unions, finance companies, fintechs, and credit reporting bodies. Collectively, ARCA's Members account for well over 95% of all consumer lending in Australia.

Our comments are directed to the guidance as it applies to credit under the *National Consumer Credit Act* – noting the key differences in such products compared to products regulated under the *Corporations Act*:

- A. while noting ASIC's commentary in the draft regulatory guide that financial products are "inherently complex", credit products do not have many of the features that make Corporations Act products complex, such as investment risk and, for insurance products, the often complicated coverage and exclusion provisions (we have also commented, below, on the assertion that financial products are "inherently complex");
- B. unlike Corporations Act products sold under a 'general advice' or 'no advice' model, the sale of all credit products requires (at least) the credit provider (i.e. 'issuer') to consider whether the product meets the consumer's requirements and objectives.

- C. unlike investment, deposit and insurance products, the credit provider holds the counter-party risk. While a consumer can suffer damages as a result of an unsuitable product, the bulk of the risk sits with the credit provider, not the consumer.

It is therefore important that the application of the design and distribution obligations in the credit market by ASIC allows for a flexible approach that recognises the wide variety of products to which the regime applies and focusses on the key objective of ensuring that financial products are targeted and sold to the right consumers. We consider that the guidance should not impose a prescriptive set of ‘requirements’ that must be followed strictly and without consideration of the underlying product.

On that basis, we welcome ASIC’s general approach to providing principles-based guidance in the draft regulatory guide.

Specific feedback:

We have the following specific feedback:

- i. RG 000.53 makes an unqualified assertion that financial products are “inherently complex” which, we consider, does not give enough recognition to the fact that financial products can be ‘simple’ (even when compared to many other non-financial products and services purchased by a consumer).

While somewhat countered in other parts of the draft regulatory guide, the description of all financial products as “inherently complex” in RG 000.53 does not recognise the importance that product simplification plays in both improving consumer outcomes and, potentially, reducing the regulatory effort required by the licensee to comply with the design and distribution obligation. As such, it could reduce the incentive for product issuers to simplify their products.

Further, the statement fails to unpack the reasons *why* a consumer may perceive that financial products are “complex” (and which leads to consumers feeling that they are making decisions under uncertainty). That is, we would expect that the level of perceived ‘complexity’ is a function of both the product structure and choice architecture (which is within the control of the issuer and/or distributor), the structure of the market within which the product is sold (which is not, generally, within the control of the issuer and/or distributor) and the financial experience and literacy of the consumer.

We recommend that the description of product complexity in RG 000.53 provide a more detailed description of *why* some products may be more complex and better recognise the potential for financial products to be simplified (which would then reduce the regulatory burden of the design and distribution obligations).

- ii. Further to the above, the draft regulatory guide does not recognise the significant regulatory developments that have occurred in recent years that require products to be better suited to consumers’ needs. While the draft regulatory guide describes the limitations of ‘disclosure’ as a regulatory tool (see RG 000.7 – 12), it does not acknowledge the reforms that have impacted the substantive design and sale of products; the most important of which is the unfair contract terms reforms. In addition, there have been more specific reforms such as those relating to credit cards which have made those products ‘better’ and ‘fairer’ (i.e. those changes relating to

the responsible lending assessment, the prohibition of certain fees and requirements on interest charging and payment allocation).

We recommend that the draft regulatory guide recognise the regulatory reforms that have impacted the substantive design and sale of products – where such reforms should be taken into consideration when making the target market determination.

- iii. We note the comment in RG 000.53 and Proposal B2 that “issuers and distributors should not take advantage of behavioural biases or factors that can impede consumers from obtaining products that are consistent with their objective, financial situation and needs”. We are concerned that this statement is not adequately qualified because taken at face value it suggests there is no place for organisations to create “brands identities” and associated marketing and communication messages that are consistent with that brand.

The statement infers that any activity by a licensee that influences a consumer’s decision-making to be based on anything other than a purely rational ‘risk and return’ process could be considered as breaching RG 000.53. We note that, during an ASIC consultation roundtable on 5 March, ASIC commented that they recognised that ‘normal’ consumer behaviour included a mix of economically ‘rational’ and ‘irrational’ choices, and what was important is whether the actions of the licensee take inappropriate advantage of this. Further, ASIC noted that the mere fact that a consumer might be willing to pay a higher price than what was rational on purely economic/financial considerations was not necessarily indicative of a licensee taking inappropriate advantage of a consumer behavioural biases (except for extreme cases such as with insurance products that might have a very low claims ratio).

We recommend that the statement within RG 000.53 be qualified to recognise that issuers and distributors should not take “inappropriate advantage of behavioural biases or factors” - where the issuer and distributor would need to consider when it was ‘inappropriate’ based on guidance provided in the regulatory guide. This could include taking advantage of a consumer’s inherent or situational vulnerability (as described in RG 000.55).

- iv. We recommend that RG 000.70 be updated to state that the “...product design to be driven by features that benefit the *consumers within the target market*”. In its current form, this statement could be read as inferring a requirement to individualise product design.
- v. We note the commentary in RG 000.168 – 169 is not relevant to credit, given the difference in the regulatory regimes. We recommend that this be noted in the regulatory guide.
- vi. A product issuer’s standard product design processes may include a small scale ‘test and learn’ release of a product, where the product may be sold on a limited basis in order to assess the operation of the product in ‘real life’. For example, this could involve distribution to a limited class of consumers (such as employees and their family) or, potentially, to the general public without any advertising or other promotion. Such ‘test and learn’ releases are likely to be more important for smaller

licensees who may not have the organisational experience of larger licensees and need to gather data in other ways.

We recommend that the draft regulatory guide recognise the value of ‘test and learn’ releases of financial products in appropriate circumstances by acknowledging the target market determination may be simplified for those releases (where the learnings from the test and learn release will inform the target market determination when the product is more widely released).

- vii. In the context of Example 1 in RG 000.75 (although, potentially with wider application) we note that many credit card providers will have a process to review a customer’s use of the credit card on a periodic basis to assess whether the product suits the consumer’s needs (noting that this was a recommendation flowing from ASIC’s REP 580). We recommend that the regulatory guide recognise that the target market determination may take into consideration such practices (e.g. those practices will reduce the risk of harm resulting from a consumer purchasing a product that does not suit their needs).
- viii. We note that the section of the draft regulatory guide headed “Who the design and distribution obligations apply to” does not reflect the extension of the design and distribution obligation regime to credit products. We noted in our [submission](#) to the exposure draft of the *Corporations Amendment (Design and Distribution Obligations) Regulations 2019* that, as the design and distribution obligations form part of the Corporations Act, they incorporate terms that are not ordinarily used in respect to credit, and those terms may be inconsistent with equivalent terms used in respect of credit. This includes terms such as ‘retail client’, ‘issue’, ‘dealing’ and ‘financial product advice’. As the regulations have not clarified these matters, we recommend that the regulatory guide should describe how these terms operate with the credit related terms, such as ‘credit activity’, ‘credit service’, ‘credit assistance’.

Further guidance:

Finally, following from the roundtable held by ASIC on 5 March, we note that there may be a need for the following additional, separate guidance and materials from ASIC:

- i. We suggest that ASIC consider whether it could provide further education material and resources in relation to the behavioural economics and consumer research concepts that are embedded in the draft guide. We note that such concepts may require a level of sophistication and expertise in relation to behavioural sciences and consumer research techniques that is not shared by all licensees. Additional educational materials and resources on these topics would assist licensees’ understanding of ASIC’s expectations and improve compliance.
- ii. We note that during the roundtable, a number of attendees sought more specific guidance, including by way of ‘case studies’, on how the design and distribution obligations would apply to specific products and distribution methods. We further note ASIC’s view it was up to individual licensees – who best know and understand their products and distribution methods – to develop their own target market determinations, rather than relying on a ‘case study’ produced by ASIC. We agree with ASIC’s view, however if stakeholders continue to feel that further, specific

guidance is required, we suggest that this be compiled separately to the drafting of this regulatory guide and on an industry-by-industry basis. The development of the additional guidance should, at first instance be developed by industry (which knows and understand its products and distribution channels in more detail than the regulator) and then shared with ASIC for comment.

If you have any questions about this submission, please feel free to contact me or Michael Blyth.

Yours sincerely,

Mike Laing

Chief Executive Officer

Australian Retail Credit Association