

Product Design and Distribution
Obligations, Consultation Paper 325

Legal Aid NSW submission to the
Australian Securities & Investments
Commission

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Legal Aid 
NEW SOUTH WALES

About Legal Aid NSW

The Legal Aid Commission of New South Wales (**Legal Aid NSW**) is an independent statutory body established under the *Legal Aid Commission Act 1979* (NSW). We provide legal services across New South Wales through a state-wide network of 24 offices and 221 regular outreach locations, with a particular focus on the needs of people who are socially and economically disadvantaged.

We assist with legal problems through a comprehensive suite of services across criminal, family and civil law. Our services range from legal information, education, advice, minor assistance, dispute resolution and duty services, through to an extensive litigation practice. We work in partnership with private lawyers who receive funding from Legal Aid NSW to represent legally aided clients.

We also work in close partnership with LawAccess NSW, community legal centres, the Aboriginal Legal Service (NSW/ACT) Limited and pro bono legal services. Our community partnerships include 29 Women's Domestic Violence Court Advocacy Services.

The Legal Aid NSW Civil Law Division focuses on legal problems that impact

most on disadvantaged communities, such as credit, debt, housing, employment, social security and access to essential social services.

The Civil Law Service for Aboriginal Communities provides legal advice and assistance to Aboriginal people and communities in regional and remote communities in NSW.

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Introduction

Legal Aid NSW welcomes the opportunity to provide a submission to the Australian Securities and Investments Commission (**ASIC**) on its proposed guidance on the design and distribution obligations in part 7.8A of the *Corporations Act 2001* (Cth), which are set out in the Consultation Paper, and the draft Regulatory Guide 000 Product design and distribution obligations (the **Regulatory Guide**).

Our comments are limited to those areas where Legal Aid NSW has particular expertise.

B1Q1 Is our guidance on a robust product governance framework useful? What additional matters, if any, do you think are important in ensuring that a product governance framework will be effective and support compliance with the design and distribution obligations?

We consider that the guidance provided by ASIC on the proposed product governance framework is instructive. We outline additional considerations for ASIC below.

Costs of implementation should be supported by financial services

In our view, the cost of implementing a product governance framework should not be passed onto consumers. The Treasury's Financial Services Inquiry (the **FSI**) acknowledged that:

firms that already invest in customer-focused business practices and procedures would not be required to change their operations significantly...[and] costs involved in changing practices should be low...firms would be likely to benefit from long-term savings through increased customer retention and avoid further regulatory costs.¹

Given the low costs of implementation anticipated by the FSI and the expected long-term benefits for financial services and credit providers, we consider that the Regulatory Guide should include guidance that the costs of compliance with the design and distribution obligations should not be passed onto consumers.

Documentation of product governance framework

ASIC's guidance encourages issuers and distributors to document their product governance framework, stating "*documentation helps issuers and distributors demonstrate whether or not they are complying with the design and distribution obligations*".²

In our view, ASIC should also encourage issuers and distributors to publish their product governance framework so that it is accessible to consumers and consumer advocates,

¹ The Treasury, *Financial System Inquiry: Final Report* (November 2014), 194.

² ASIC, *Consultation Paper 325 Product design and distribution obligations* (December 2019), 4.

the regulator and other interested organisations, such as product review and testing companies.

Product approval system

The Regulatory Guide details the expectation that the product design stage will involve “robust testing of the product, and the systems that will support it, to check it will function as intended” and “determining how consumer outcomes will be measured and monitored when designing the product.”³

We suggest that the Regulatory Guide also provide examples of best practice product approval systems, particularly in relation to monitoring and measuring consumer outcomes.

B2Q1 Is our guidance on the consumer-centric approach issuers and distributors should take to deliver good consumer outcomes useful?

Yes, we consider that ASIC’s guidance on the consumer-centric approach that issuers and distributors should take to deliver good consumer outcomes is useful.

Legal Aid NSW is particularly supportive of ASIC’s position that issuers and distributors should consider consumer vulnerabilities in product design and distribution. This is a welcome recognition that vulnerability can be proactively factored into all stages of the consumer experience, rather than only when difficulties arise.⁴ This is particularly important as the risk of vulnerability at some stage of life is high, given “common, unavoidable and unpredictable life events such as illness, job loss, financial shocks, the death of a loved one and natural disaster.”⁵

We suggest that the Regulatory Guide include a definition of consumer vulnerability or common vulnerability considerations.

ASIC’s current definition of vulnerability is:

Any consumer can experience vulnerability as a result of a number of factors, including:

- the actions of the market or individual providers, e.g. being targeted by products that are inappropriate for a particular consumer, or being given inadequate or overly complex documentation
- experiencing specific life events or temporary difficulties, e.g. an accident or sudden illness, relationship breakdown, family violence, job loss, having a baby or the death of a family member
- personal or social characteristics that can affect a person’s ability to manage financial interactions, e.g. speaking a language other than English, having different cultural assumptions or attitudes about money, or experiencing cognitive or behavioural impairments due to intellectual disability, mental illness, chronic health problems or age.⁶

³ ASIC Regulatory Guide 000, *Product design and distribution obligations* (December 2019), 000.45.

⁴ Emma O Neill, ‘Exploring Regulatory Approaches to Consumer Vulnerability: A Report for the Australian Energy Regulator’, *Consumer Policy Research Centre* (2019).

⁵ Ibid.

⁶ ASIC, *Corporate Plan 2019-23: Focus 2019-20*, (August 2019)

We consider this definition could be broadened to include people experiencing structural disadvantage, and people in regional, rural and remote areas.

C1Q1 Do you agree with our approach to guidance on the form and content of a target market determination? If not, why not?

ASIC's guidance about the form and content of a target market determination is useful.

The Regulatory Guide notes that the "target market determination must be made publicly available".⁷ ASIC's guidance should also encourage issuers to provide the target market determination to consumers if they request it, and store it in easily accessible formats such as on issuers' websites and in hard copy in issuers' branches.

C2Q1 Is our guidance on the approach to identifying the target market for new products and continuing products useful?

Yes, Legal Aid NSW considers that ASIC's guidance on the approach to identifying the target market for new products and continuing products is useful. However, we consider that ASIC's guidance about existing or continuing products at Regulatory Guide paragraph 000.69 could be strengthened.

A number of products that fall into the category of "existing products" have been harmful to our clients. The following case study provides an example of a product targeted at a group including our client, in circumstances where the product does not suit the client's objectives, financial situation and needs because it leads to further financial hardship.

Case Study: Small amount credit contracts targeted at vulnerable consumers

Kylie is a 48-year-old Aboriginal woman who lives in a remote community. She works on a part-time basis at a local community organisation and receives minimal Newstart and Carer payments from Centrelink. At the time Kylie started using small amount credit contracts (SACC) loans she had a number of other debts including a \$10,000 loan for which she was on a hardship arrangement, a credit card debt of \$2,000 and a debt of \$3,700 following a car accident.

Kylie struggles to manage her limited income and regularly borrows money from SACC providers to make ends meet. In the past two years, Kylie has had eight loans from two SACC providers, ranging in amounts from \$100 to \$1,900. On three occasions our client was granted a third loan in a 90-day period. The lender has been unable to demonstrate how they rebutted the presumptions of unsuitability.

In Kylie's circumstances, the SACC was not a suitable financial product and caused her further financial hardship.

⁷ ASIC Regulatory Guide 000, *Product design and distribution obligations* (December 2019), 000.59.

Issuers of existing products are in a strong position to articulate their target market determination based on how consumers have been using their products to date. We consider that the Regulatory Guide should be amended to encourage issuers to analyse data from their existing customer base when identifying the target market for existing products. This could include examining:

- the proportion of consumers who default, pay the minimum amount, live in rural, regional or remote areas, receive social security payments etc.
- consumer complaints, systemic issues in internal dispute resolution and external dispute resolution complaints and outcomes
- regulatory action, such as litigation and enforceable undertakings.

C3Q1 Do you have any comments on our approach to guidance on identifying and describing the target market?

C3Q2 Do you have any comments on the following examples, which we have used in our guidance to illustrate key principles set out in RG 000.66–RG 000.89:

- (a) Example 1: Credit cards;
- (b) Example 2: Reverse mortgages;
- (c) Example 3: Cash options in superannuation;
- (d) Example 4: Consumer credit insurance;
- (e) Example 5: Low-value products; and
- (f) Example 6: Basic banking products?

C3Q3 what additional matters, if any, do you consider to be relevant?

In our view, ASIC’s use of examples to show key principles is effective. We suggest that ASIC could also consider using de-identified case studies showing real life examples of consumer experiences,⁸ to provide practical examples in this section.

Case studies could also be useful to demonstrate what a target market determination should generally look like. We suggest that ASIC consider including a case study involving a consumer lease product, as an example of a product that is often not suitable for many of the consumers who use it.

⁸ Case studies could be drawn from the experiences of clients of Legal Aid NSW and similar organisations or ASIC’s complaints data.

Case Study: Consumer leases

Cindy is a young Aboriginal woman and a single mother to four children. Cindy was referred to Legal Aid NSW by a community organisation after she sought assistance with food and energy vouchers. Cindy believed that her housing provider had been overcharging her on rent because she had such large deductions from her Centrelink benefit. After talking to Cindy about her circumstances it became clear that she was renting four household items. Cindy had signed up with two different rental providers and had already completed payment for rental contracts for an additional three household items. Cindy did not realise how much of her Centrelink benefit had been paid towards her consumer lease contracts.

Cindy is in receipt of Centrelink benefits that amount to \$650 per fortnight. Cindy's rent is \$260, with an additional \$211 per fortnight deducted for her consumer lease contracts. This left Cindy with \$179 per fortnight to pay for electricity, food, transport and other expenses for her and her four children. Legal Aid NSW assisted Cindy to cancel her consumer lease payments.

ASIC could also consider including an example of insurance products with exclusions that result in the product being unsuitable for many consumers. This is illustrated by the following case study.

Case Study: Small amount credit contracts targeted at vulnerable consumers

Legal Aid NSW assisted a client whose property on the South Coast of NSW suffered extensive damage as a result of the bushfires. Our client had a home and contents insurance policy with a large insurance company. Our client had been paying premiums for many years, and believed that her property and contents were all covered in the event of a fire. The fire that came through destroyed a water tank on her property worth several thousand dollars. The insurance company said that the policy did not cover the tank, as a section of the product disclosure statement excluded 'any property as a result of scorching or melting'.

In our view, this case study shows that a more consumer-centric approach, encouraged by the design and distribution obligations, would have resulted in our client entering into a policy which suited her needs. Alternatively, such guidance may lead to the market developing insurance products which better suit the needs of people living in rural and remote areas, and those prone to natural disasters.

C5Q1 Do you agree that consumer understanding of a product does not necessarily equate to the product being likely to be consistent with the likely objectives, financial situation and needs of consumers in the target market? If not, why not?

Yes, Legal Aid NSW agrees that a target market should not be predominately based on consumer understanding of the product. We support the requirement for an issuer to objectively assess whether a financial product is likely to be consistent with the likely objectives, financial situation and needs of a class of consumers.

We agree with the Banking Royal Commission's observation that consumers are often not able to make well informed choices between financial products.⁹ Many financial products are complex and can be difficult for consumers to understand without specific independent advice, which is often not readily available.

Australia also has a diverse population, and we do not consider that there is a common consumer understanding across the community, particularly given the regional differences in exposure and access to financial and credit products. Consumer knowledge varies across population, location, individual, education level and exposure to such information previously, and cannot be said to be universal.

When a target market determination does refer to consumer understanding, Legal Aid NSW supports the requirement for an issuer to consider how consumer understanding of a particular product will be assessed as part of its reasonable steps obligation.¹⁰

We agree with the factors as set out in the Regulatory Guide at 000.107-000.121, however we suggest that ASIC could provide further specific guidance about how a distributor should assess consumer understanding.

C6Q2 Is our guidance on the role of describing a negative target market adequate and useful? If not, please explain why, giving examples.

Yes, we agree that the guidance on the role of describing a negative target market is adequate and useful.

C9Q1 Do you have any comments on our guidance on settling appropriate review triggers and maximum review periods?

We support ASIC's guidance on review triggers, and an approach that requires issuers and distributors to adapt and respond quickly to changes impacting on the suitability of the target market.

We consider that ASIC should also continue to monitor compliance with the product design and distribution obligations.

⁹ Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry (Final Report February 2019), 2.

¹⁰ ASIC Regulatory Guide 000, *Product design and distribution obligations* (December 2019), 000.80.

C10Q3 In addition to the information set out at RG 000.139, are there other types of information an issuer should collect from distributors? If so, please describe the type of information you think would be relevant.

We suggest that ASIC clarify that complaints data should include data obtained from both internal dispute resolution and external dispute resolution complaints.¹¹ We also suggest that ASIC clarify that consumer feedback should include feedback from consumer advocate organisations.¹²

C11Q1 Do you consider our guidance on the types of information issuers should have regard to (described at RG 000.143) to be useful? If not, why not?

Yes, we consider the guidance to be useful.

C11Q2 In addition to the data sources described in draft RG 000 at RG 000.143(a) – RG 000.143(d), are there other sources of information that you think an issuer should take into account in reviewing a target market determination?

We consider that issuers should also take into account data and complaints provided from consumer advocates in reviewing a target market determination.

C12Q1 Are there any additional factors that issuers should consider? If yes, please provide details.

We refer to ASIC's guidance that one of the factors relevant for issuers in determining whether a 'significant dealing' has occurred outside of the target market is "*the actual or potential harm to consumers, including the amount of any monetary loss, resulting from consumers who are not in the target market acquiring the product*".¹³

We note that a relatively small financial loss can have a significant negative impact on some consumers, such as those on low incomes or experiencing vulnerability, due to the absence of financial buffers. This can lead to issues such as financial stress and housing instability. We consider that the Regulatory Guide should reflect this and note that a small amount of monetary loss does not necessarily mean that consumer harm has not been significant.

¹¹ ASIC Regulatory Guide 000, *Product design and distribution obligations* (December 2019), 000.139(a).

¹² ASIC Regulatory Guide 000, *Product design and distribution obligations* (December 2019), 000.139(b).

¹³ ASIC Regulatory Guide 000, *Product design and distribution obligations* (December 2019), 000.148.

We also recommend that issuers consider whether a particular class of consumers has been affected, and the actual or potential harm to that particular class of consumer, in determining whether a ‘significant dealing’ has occurred.

D1Q1 Do you agree with the factors listed in Table 5 of draft RG 000 that we will take into account when considering whether a distributor has met the reasonable steps obligation? If not, why not?

D1Q2 What additional factors, if any, do you consider should be included in Table 5 of draft RG 000?

We agree with the factors listed and do not suggest any additional factors at this time.

D2Q1 Do you have any comments on our proposed guidance for distributors in Example 14 of draft RG 000?

We agree that if an insurer assesses that it is likely that a consumer is no longer in the target market for an insurance policy, this should not result in an insurer automatically declining to offer a renewal of the policy without contacting the consumer. This will prevent situations from arising where an insurance policy is cancelled, leaving a consumer uninsured without their knowledge.

We agree with a non-prescriptive approach to guidance on how an insurer should go about the ‘reasonable steps’ obligation, and that it may differ from case to case.

D3Q2 What data do you consider would help distributors reasonably conclude that a consumer is reasonably likely to be in the target market for a financial product?

We note that as part of the product design stage, distributors are required to determine how consumer outcomes will be measured and monitored given the obligation to carry out reviews.¹⁴ We suggest that data gathered as part of that measuring and monitoring process may help distributors to reasonably conclude that a consumer is reasonably likely to be in the target market for a financial product.

D3Q4 Do you have any comments on our proposed guidance on how a distributor can reduce the likelihood of leaving a consumer with the impression that their personal circumstances have been considered?

We suggest that distributors could directly and simply tell consumers that their individual circumstances have not been taken into account.

¹⁴ ASIC Regulatory Guide 000, *Product design and distribution obligations* (December 2019), 000.45(c).

In providing any information to consumers, distributors should also consider if their communication style is accessible and appropriate. Some examples of how distributors can make information more accessible is by using plain English or easy English, and providing consumers with an opportunity to get independent advice.

D4Q1 Do you have any comments on our proposed guidance on the content of the reasonable step's obligation in these circumstances?

We agree that the reasonable steps that a distributor should take when selling a financial product to consumers who are outside the target market for the product depends on the circumstances of interaction, the nature and degree of harm that may result, and the steps that can be taken to mitigate harm. We consider that the example at Regulatory Guide paragraph 000.173 clearly illustrates the substance of the obligation where its apparent that a product is unsuitable.

We agree that distributors should be required to assess the effectiveness of their reasonable steps on an ongoing basis.¹⁵ We also agree that it is helpful for distributors to keep records about interactions with customers outside the target market. Such records would also be useful to identify systemic issues which could be relayed to ASIC or the Australian Financial Complaints Authority (AFCA). Where systemic issues or significant dealings are identified and indicate a systems failure, we agree that this may indicate that the reasonable steps obligation has not been complied with.

We support the examples listed at Regulatory Guide paragraph 000.190. We suggest that a credit example would also be helpful, such as a case study regarding a small amount credit contract, consumer lease or fringe lending. In our casework experience, consumers experiencing vulnerability often use these products, which can lead to further financial detriment.

Case Study: Buy now, pay later (fringe lending)

Janette is 63 years old and is unable to work due her anxiety and depression. Janette's sole income source is the Newstart payment from Centrelink.

In early 2016, Janette was approached unsolicited by a company to have her home cladded for \$23,657. To pay for the cladding, Janette was offered a \$17,580 "no interest" loan. In approving the loan, the financial firm was aware that Janette was not working but approved the loan based on her ability to pay previous debts with them. The financial firm obtained one months' worth of bank statements to verify the Janette's financial circumstances.

Around six months later, Janette sought advice from Legal Aid NSW due to her severe financial hardship. In addition to the debt for the cladding, Janette had a \$180,000 home loan and \$22,500 in credit card debt.

Janette saw a financial counsellor who estimated that Janette was in deficit of \$1,142 per fortnight. Janette was forgoing food to pay her bills. Legal Aid NSW was ultimately

¹⁵ ASIC Regulatory Guide 000, Product design and distribution obligations (December 2019), 000.174).

able to negotiate a hardship arrangement for the cladding loan, however we consider that the product was not suitable for Janette given her financial circumstances.

D4Q2 Are there any specific methods that you consider our guidance should identify for distributors seeking to meet the reasonable steps obligation in the context of interacting with consumers who are outside the target market for a financial product?

We suggest that the Regulatory Guide should include examples of how online sellers of financial and credit products may discharge their obligations to take reasonable steps when interacting with consumers outside the target market for a financial product.

This is particularly important given that many online sales take place without the assistance of human sales representatives. In situations such as those described in the case study below, it is unclear at which point in the sales process the distributor would become aware that the customer is outside the target market. We are concerned that if a distributor obtains relevant data after the sale is completed, there is a risk that the reasonable steps obligation and the protection it provides to consumers, will be ineffective.

Case Study: Vulnerable consumer obtains unsuitable loan through self-service kiosk

Our client has been intermittently homeless for the last five years. She has been diagnosed with borderline personality disorder, depression, anxiety and receives the Disability Support Pension. She cares for a child with multiple disabilities. She has multiple debts and is regularly contacted by debt collectors.

Our client applied for a small amount credit contract with high interest fees and charges, through a self-serve kiosk at a Tobacco Store. The kiosk benchmarked her expenses when assessing her income and she was able to access the loan. Ms Atkins had several debts with utility and credit providers, as well as a No Interest Loan Scheme loan.

D6Q1 Do you have any comments on proposed guidance for using information gathered for the purpose of meeting responsible lending obligations in order to assist a distributor to form a reasonable view of whether consumer is reasonably likely to be in target market for a financial product?

We agree with ASIC's guidance regarding the interaction between responsible lending obligations and the design and distribution obligations.

D6Q2 - Are there any other further issues you consider are raised by the interaction of the two regimes that should be dealt with in our guidance?

We agree that the Regulatory Guide should acknowledge that the responsible lending obligations and design and distribution obligations are complementary and serve different purposes, as set out in Regulatory Guide paragraphs 000.185 - 000.187.

We suggest that ASIC consider including a further example in the Regulatory Guide at paragraph 000.186, to illustrate how the design and distribution obligations will work concurrently with responsible lending obligations, such as in circumstances like those set out in the following case study about timeshare providers.

Case Study: Timeshare arrangements

Mr and Mrs Collins are in their late 50s. Mr Collins works and earns a modest income. Mrs Collins does not work. They have no savings and are repaying their home loan. They have never travelled overseas but would like to.

While on the Gold Coast on holiday, they are approached on the street by a timeshare representative and offered the chance to win a prize via a “scratchie”. They win and they are told that to collect the prize, they need to go to an information seminar at a nearby luxury hotel. They go to hotel and watch a presentation about becoming a member of a holiday club that allows them to holiday in Australia and overseas for the rest of their lives.

Mr and Mrs Collins are moved around to various tables and speak with a number of people about membership of the club and its advantages. They are discouraged from leaving the venue. The sales representatives provide limited information about the cost of membership or whether Mr and Mrs Collins can afford it.

After hours of being exposed to high pressure sales tactics, Mr and Mrs Collins feel they have no choice but to agree to sign up for club membership in order to be able to leave. They are asked for information about their income and assets and sign numerous documents, including a credit contract from a credit provider linked to the timeshare provider.

Once they have time to read the documents and do some online research, they become aware that they entered into a credit contract that they cannot afford and that will result in them repaying \$44,000 over a 20-year period. Furthermore, timeshare does not suit how they would like to travel.

We suggest that ASIC should also consider providing guidance to consumers on their rights and remedies under the design and distribution obligations and responsible lending obligations, for example, through ASIC’s Moneysmart website.

E1Q1 Do you agree with the factors that we will take into account when considering whether to provide an exemption from, or modification to the design and distribution obligations. If not, why not?

We agree with ASIC's guidance. We consider that it is useful for ASIC to be clear about the factors it will consider when deciding whether to exercise its relief powers. In our view, ASIC should also consider consulting with the consumer sector and other relevant stakeholders, when considering whether to exercise its relief powers.

To ensure that exemptions do not become a loophole for avoiding compliance, we suggest that ASIC ensure its assessment is rigorous and subject to review.

E1Q2 Are there any additional factors that you consider we should take into account?

We suggest that ASIC also take into account any existing information it has regarding the general business practices and compliance history for the company seeking the exemption.

E2Q2 Do you agree with our proposed approach to providing relief from design and distribution obligations when disclosure relief has been granted? If not, why not?

We agree with ASIC's approach.