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Senior Manager, Financial Services Group
Australian Securities and Investments Commission
Level 7, 120 Collins Street
Melbourne VIC 3000
email: product.regulation@asic.gov.au

Dear Senior Manager,

I am the Principal of Benchmark Analytics, a public policy consultancy specialising in banking and finance regulation. I was formerly a Policy Director at the Australian Bankers' Association (ABA).

I believe further information and analysis is needed to justify using the Product Intervention Power (PIP) and there is a benefit in having Parliament give further guidance to ASIC, particularly in relation to better defining the word 'significant' in the term 'significant detriment'.

Cigno and BHFS are private businesses that compete against other lenders. Their business model entails financial risks and there is no information provided that indicates how profitable or otherwise are the businesses.

The Government and RBA are currently encouraging Australian businesses to take more entrepreneurial risk, invest, and employ more people. ASIC's regulatory interventions represent risk to businesses.

By potentially altering the revenue and costs of a legally compliant financial product, misuse or non-rigorous use of the PIP will undermine the Government and RBA message of encouraging risk taking.

Non-rigorous use of the PIP will also contribute to regulatory burden as financial firms will need to examine ASIC's use of the power and take advice on whether ASIC's intervention has implications for their own business operations.

As such, ASIC should only use the power when there is very strong evidence to prove 'consumer detriment'. In my view, the consultation paper has not provided that evidence.

Missing information

Consultation Paper 330 presents four case studies to prove the intervention order is necessary. Like other lenders, Cigno and BHFS can be considered to have two cohorts of customers: (a) those that repay their loan in accordance with the contract; and (b) those that default. Both these groups are relevant to the consideration of 'significant detriment'.

ASIC presents only case studies of defaulting customers, not non-defaulting customers. ASIC does not provide information on (i) average costs across both customer cohorts; (ii) default rates; or (iii) actual numbers of customers that fall into these categories. As such, even in the cohort of defaulting customers, we do not know if the case studies paint a typical picture or atypical.

Another problem of the case studies is that the information presented is inconsistent. Only one of the case studies provides measurable income information (disability support pension). Only one gives demographic information (single mother). Only one case study details the loan's purpose (medical supplies).

This raises a question as to what guidelines are used to select case studies and the minimum details that should be included. Without knowing the guidelines and whether those guidelines have been accurately applied in these case studies, it is difficult to know what weight to place on them.

'Vulnerable' consumers – legal uncertainty

ASIC should be cautious in using the word 'vulnerable' in arguing for using the product intervention power. The word does not appear in the legislation. The Act refers to 'retail' consumers.

It is a word which is ill defined, politically-charged and used by activists. It means different things to different people.

For example, people with jobs are 'vulnerable' to an economic downturn and loss of their income, and their savings if they cannot access social security. Retirees that have saved up for their retirement are 'vulnerable' to making poor decisions and losing a large part of their savings. Just about everyone has vulnerabilities - it conjures up strong emotions but is not well enough defined.

It can refer to people who are at risk of making bad decisions because they are suffering emotional problems, or they have low intelligence.

The discussion paper hints that ASIC views people receiving a Centrelink payment as 'vulnerable' but this is not stated clearly in the document or explained. If ASIC is going to use the term, then it should be clearly defined so that it does not result in legal uncertainty.

Do payday lenders prey on the vulnerable?

A further point is worth making. It is often said that payday lenders 'prey' on the vulnerable. That concept (insult) does not capture the reality of the payday lending business model.

Payday lenders market products to people receiving social security payments because they have a highly stable form of regular income. Stable income is the opposite of vulnerable.

While social security income is typically very low, lenders manage that risk by issuing small loans. It is the stability of the income that attracts lenders, not the fact their incomes are low. Cigno says it only arranges these types of loans for amounts under \$1000. This contrasts with other lenders that have incentives to maximise loan size.

Significant detriment test

The Corporations Act 2001 authorises ASIC to make a product intervention order if it identifies a product that is available to retail consumers which has or will likely result in 'significant detriment' to those customers.

In detailing the matters to be taken into consideration when considering 'significant detriment', the Act requires ASIC to show 'actual or potential' financial loss to retail clients resulting from the product.

However, in paragraph 23 of the consultation paper, ASIC notes the continuing credit contracts and services agreement are high cost 'relative' to the loan amount. The original loan amount is not a sound benchmark to draw a conclusion of 'significant detriment' (although it is useful in considering the net benefit of the product).

In my view, ASIC's use of the term 'relative to the loan amount' is inconsistent with Act's instruction to show 'actual or potential' financial loss that is significant.

The price of bananas may rise from \$2 per kilo to \$10 (due to a cyclone), resulting in a new price that is 500% higher relative to the old price. But the materiality of this potential detriment on household budgets will depend on the number of bananas purchased and the extent (proportion) to which this expenditure accounts for household income or expenditure.

A more instructive benchmark to assess actual losses is that of the individual's total income or total expenditure over a suitable timeframe, such as 6-12 months.

Case study 3: Client C

Of the four case studies in Consultation Paper 330, only one included measurable income information. Client C apparently receives a 'Centrelink disability support pension'. According to the Government's Services Australia website, the fortnightly payment for a single person on this pension is \$944, or \$1,423 for a couple¹, excluding any rent subsidies or in-kind benefits.

The consultation paper notes, Client C received a Cigno arranged loan of \$250 and was then charged default fees of \$180 for multiple defaults (including change of payment fees). The default

¹ <https://www.servicesaustralia.gov.au/individuals/services/centrelink/disability-support-pension/how-much-you-can-get/payment-rates>

fees represent 0.7% of estimated annual income, with total fees accounting around 1.6% of annual income.

Even these estimates are overstated for the purposes of assessing ASIC's proposed product intervention orders.

To accurately assess the significance of Cigno default charges and total fees, the fees should be net of the likely default and other fees charged if ASIC's product intervention order had been in place. This latter analytical step is important because ASIC is not proposing to abolish the product, just subject it to a price cap.

Comparable fees for breaches

An alternative means of assessing 'significant detriment' is to compare the fees and charges used by Government agencies.

Comparing Cigno and BHFS charges with standard Government agency charges is useful because it can be assumed that Government agency charges broadly reflect a community standard of a failure (default) to meet a legal requirement and presumably they have been set so as not to cause significant detriment to Australian citizens.

Here are some common examples:

- The minimum parking infringement in NSW is \$114 (per offence).
- Unauthorised stopping in a disabled spot is a fine of \$572 (per offence)².
- The minimum fine for driving with an expired license in NSW, \$572 (per offence).³
- One large local council in NSW imposes a minimum fine for dumping of rubbish of \$500 (per offence).⁴
- The ATO charges a minimum of \$222⁵ for late lodgment of tax returns or statements (per offence).
- ASIC applies a \$340 fee for companies that are one month late in paying their annual review fee, exceeding the actual review fee of \$270. ASIC applies a \$340 fine if a company is more than a month late in lodging a change of details notification.⁶

² <https://www.rms.nsw.gov.au/documents/roads/safety-rules/demerits-parking.pdf>

³ <https://www.rms.nsw.gov.au/documents/roads/safety-rules/demerits-general.pdf>

⁴ <https://www.cityofparramatta.nsw.gov.au/living-communityclean-up/illegal-dumping#:~:text=Illegal%20dumping%20costs%20our%20community,%24500%20and%20up%20to%20%24250%2C000.>

⁵ <https://www.ato.gov.au/general/interest-and-penalties/penalties/>

⁶ <https://asic.gov.au/for-business/payments-fees-and-invoices/asic-fees/#LateFees>

None of these Government charges will vary based on the person's level of income or assets. There is typically very limited access – if any - to a free appeals tribunal, equivalent to the Australian Financial Complaints Authority (AFCA)⁷.

The average total default fees as specified in the case studies is \$491, reflecting multiple defaults over an average what appears to be about two months of defaulting. However, to accurately assess the significance of the average default fee of Cigno and BHFS, then the \$491 needs to be adjusted to net out the default fees that could potentially be charged if the product intervention order had been in place.

Only then can you get an idea of what potential savings that defaulting customers will have from the intervention order. An assessment of how the intervention order is likely to impact non-defaulting customers should also be considered in the analysis.

Financial System Inquiry – origins of the PIP

The origin of the PIP was Recommendation 22 in the Financial System Inquiry (FSI) chaired by David Murray. In arguing for the new power, the final report noted:

This power should be used as a last resort or pre-emptive measure where there is risk of significant detriment to a class of consumers. This power would enable intervention without a demonstrated or suspected breach of the law. Given the potential significant commercial impact of this power, the regulator should be held to a high level of accountability for its use.

This power would allow the regulator to intervene to require or impose:

- *Amendments to marketing and disclosure materials.*
- *Warnings to consumers, and labelling or terminology changes.*
- *Distribution restrictions.*
- *Product banning.*

This power is not intended to address problems with pricing of retail financial products, where consumers might be paying more than expected for a particular product or where a large number of consumers have incurred a small detriment.⁸

Parliament better placed to take this issue forward

In my view, ASIC should not proceed with the proposed product intervention order. Parliament should give further guidance to ASIC in how to accurately interpret 'significant' in the term

⁷ <https://www.afca.org.au/>

⁸ <https://treasury.gov.au/sites/default/files/2019-03/p2014-FSI-01Final-Report.pdf>, page 206

‘significant detriment’, particularly given the wise advice of the FSI that the regulator should be held to high accountability for use of the PIP.

In the meantime, ASIC should ensure there is appropriate disclosure of all relevant product features and give guidance on its Money Smart website as needed.

I hope these comments assist in finalising the proposed action under the PIP.

Regards,

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