Cutting the Red Tape: effective consumer regulation – a discussion primer

While industry and consumer interests may disagree on the level, and type, of regulation that is necessary, there would be broad agreement that ineffective regulation is detrimental to consumers and business.

The session will consider:

- What factors impact on the level of effectiveness of consumer protection regulation?
- What can be done to improve the effectiveness of regulation?

Introduction

Language is a powerful thing – terms such as “family values” and “unAustralian” say much more than their literal meanings. While the term “red tape” has been understood to refer to unnecessary paperwork or regulation, the business lobby has been successful in morphing the meaning to suggest any regulation that places restrictions on business. In fact, the business lobby has been so successful in creating concern over “red tape” that government now seems to be afraid that any regulation at all is red tape – witness arbitrary policies such as “one law in, one law out”.

While there will never be full agreement about whether some regulation is unnecessary (real “red tape”), I would like to focus this session on the importance of ensuring what regulation we have is effective. If regulation does not achieve the purpose it was designed to achieve, problems continue for consumers, and business can easily claim “red tape”. Regulatory failure often leads to calls for more regulation, and this is not ideal for consumers or business. However, I suggest that sometimes the blame should be placed at the feet of business who often lobby for “lightest touch” regulation, which sometimes means less effective regulation!

I could imagine – although I’m not familiar with taxation law – that when tax laws are changed to address evasion or avoidance, proposed changes would be “tested” against a variety of methods that parties might use to avoid compliance with the new regulation, and that consideration would be given to whether in practice the new regulation was adequate to bring about the desired changes. Issues that I assume would be considered include the level of penalties, the risk of being caught, whether compliance with the laws can be adequately monitored, and whether the benefits of avoiding the law are greater than any incentives to comply. What might be effective in particular circumstances may depend on whether the regulation was targeting the practices of large companies, small business or individual taxpayers.

.

This conference isn't about taxation law, but just as there are taxpayers (and lawyers and accountants) who are determined to find ways around tax regulation –it is the same in the consumer regulatory environment. There are particular companies or industries that will generally comply, those that will work hard to find ways not to comply (and lawyers that help them) and those that fall somewhere in the middle. But I also use the taxation story to suggest that when it comes to consumer regulation, we don't put the same effort into ensuring that the regulation we have is the most effective.

Consumer regulation is more complex, and unlike compliance with tax laws that can be measured in dollars and cents, it can be very difficult to quantify the benefits of regulation or the detriment of no regulation. While there have been some successful regulatory outcomes from consumer/industry consultation, it is often the case that less effective regulation can be the outcome of government seeking a compromise between consumer and industry interests. For example while it may be clear that stronger regulation is required in a particular area (for example to prevent conflicts of interest), protections are introduced that rely primarily on disclosure as it is seen as "lighter-touch". Ironically, industry then cites the paperwork required for disclosure, and complains about "red tape".

A clear example of a choice between simple and effective regulation, and more complex regulation is that of finance broker regulation. The problems arising from the use of credit intermediaries are significant, and the fact that the intermediaries claim to be agents of the consumer (while they take commissions from lenders) makes it difficult for consumers to seek redress when something goes wrong. It was the view of the consumer representatives that the major concerns would be addressed if the law simply stated that brokers were the agents of the lenders (not the consumers). Of course the credit industry was not prepared to take responsibility for the conduct of those who were selling their products, and we expect the resulting legislation to be much more complex than our simple proposal. While we are eager for the new regulatory scheme to be introduced, we imagine that licensing and paperwork requirements will be identified by some in the industry as more "red tape"!

What should consumer regulation achieve?

From the consumers' point of view, consumer regulation should:

- Prevent, or reduce, the practice/s that are causing harm to consumers; and
- Enable the individual consumer to seek redress.

These two aims are often inter-related, for example an accessible forum for redress can increase the likelihood that a consumer will complain, thereby increasing the likelihood that the regulator will be informed about legislative breaches.

Choosing the right tools for the job

There is no "one size fits all" for consumer regulation. The toolbox contains many tools including:

- legislation,
- co-regulatory approaches such as enforceable codes,
- licensing,

- criminal penalties,
- civil penalties,
- innovative approaches such as unfair contract terms legislation and the ability for consumer groups to lodge “super complaints”; and
- a range of options for consumers seeking redress such as tribunals and dispute schemes.

The most appropriate tools will depend on a range of factors including:

- the type of industry (large or small businesses, culture of industry, other regulation of that industry);
- the regulator (whether the regulator is likely to have the resources, and give the issue priority);
- the availability of services to assist the particular consumers;
- the type of problem (is the problem caused by the structure of the industry?);
- consumer factors (for example those using pay day lenders are less likely to seek redress than consumers of other products).

Examples of current regulation

The following is an example of some of the strengths and weaknesses of some current consumer regulation.

<u>Cartel behaviour</u>
This is an area where there is legislation to prohibit the behaviour, and a regulator that is prepared to take action, but where there is general agreement that the penalties available have little deterrence due to the significant profits involved.

<u>Telecommunications</u>
This area of consumer services and contracts is regarded as one where the regulation is weak. While consumer representatives have input to the Codes of Conduct, sign-up to the Codes is not compulsory. Even where there is sign-up, it is up to the regulator to enforce a breach. Weakness is the result of a number of factors including a bad statutory structure and a weak regulator. The Victorian unfair contract terms regulation – rather than specific industry regulation - has probably been the most effective impetus for fairer contracts in this market.

<u>Code of Banking Practice</u>
This has been reasonably successful in changing industry conduct in relation to a number of issues raised by consumer groups. Sign-up is voluntary, but few banks have not signed up. The Code is enforceable because it is a condition of the contracts between signatory banks and their customers. The industry has generally accepted the need to comply, and the Code is actively interpreted by the industry dispute resolution scheme (in relation to general individual complaints) and by the Code Monitoring Committee (in relation to complaints under the Code). Banks are reluctant to accept interpretations of their credit assessment obligations under the Code, but there are effective forums where these issues can be debated.

<u>Insurance</u>
Some years ago, insurers routinely denied 10% or so of car accident claims on the basis that the claimant was 10% at fault – the amount was too small for a consumer to

fight through the Courts or tribunals. However, caseworkers saw this practice virtually cease “overnight” when the Insurance Ombudsman Scheme was established. This is an example of a change in practices that can be brought about simply by providing improved access to dispute resolution.

Uniform Consumer Credit Code

The weaknesses in this legislation have been well documented. The legislation has not kept up with changes in the lending industry, for example no mention is made of intermediaries or brokers. Lenders have been able to avoid the Code, or parts of it, by using a variety of loopholes, for example business purpose declarations or wording loans as consumer leases. The development of industry ADR schemes for many financial services has left those consumers who are most vulnerable, those who borrow from finance companies and pay day lenders, with regulation that lacks teeth.

A particular example of Code failure relates to repossession provisions. Appropriate notice is required to be given to a consumer prior to repossession, and failure to do so is an offence. However, to our knowledge there have been no prosecutions under the Code for this or any other breach. It is not clear whether failure gives the consumers any rights, so the goods are sold, and the company is not prosecuted. This provides little incentive for a lender to comply.

Debt Collection

The laws that apply to debt collection are very broad, and generally prohibit “undue harassment and coercion”. In recent years the ACCC and ASIC have produced a guideline for debt collectors. The guideline itself is not enforceable, although it is based on a range of regulatory provisions that could apply to debt collection.

While we continue to believe that a guideline is inadequate, it has allowed some flexibility – it was updated recently to take into account some recent practices of concern. It appears it has also been used broadly by industry to train, and guide, staff.

A recent Supreme Court case that found that a debt collector had engaged in unconscionable conduct should had had a more significant impact on industry practices. However, research by ASIC found that ‘the effect of *Collection House v Taylor* on collection practices is poorly recognised within the debt collection industry’. Whether this legal precedent really changes industry practices may rely on the role of the regulator in clarifying what the case means to the industry.

The experience with debt collection issues illustrates the problem with broad regulation, where legal precedents are few. Industry and consumers need some guidance – but guidelines are just that, and if industry merely needs a small amount of assistance they may be effective, but they will not alone bring about changes in industry conduct.

Auditing Regulation for Effectiveness

Prior to the implementation of regulation, much effort is placed on analysing the costs and benefits, particularly to business, but there is often inadequate focus on whether the regulation is structured to achieve the best outcomes for consumers – which is ultimately about preventing costs to consumers and thus to the economy as a whole.

As costs to consumers can be harder to quantify, they are often discounted or forgotten in regulatory gate-keeper processes (even though the reason for the proposed regulation is meant to be about preventing harm to consumers).

For example, using the conflict of interest example again, a disclosure regime might be assessed as imposing less cost that stronger and more restrictive regulation as it doesn't limit the types of products offered, or commission structures and relationships entered into, so doesn't affect the market too much. But if it does not actually stop the harm to consumers, it is still imposing costs on business – passed on to consumers - but for little benefit! The better cost-benefit outcome may have been stronger regulation, which might have limited some developments in the market but actually led to real benefits for consumers, meaning the benefits of the regulation might outweigh the costs.

The following could be applied to an analysis of current regulation – but should also be applied in the early stages of development. Are there other suggestions for questions that could be asked?

- Are the penalties, and risks of being caught, great enough to outweigh the benefits of non-compliance? Note that changing penalties for conduct that is already regulated or prohibited is not actually "increasing red tape" – it merely changes the consequences of engaging in conduct where the ground rules are already set.and business should already be complying.
- Does the regulator have the resources to allocate to enforcing the regulation?
- Are there loop-holes? It may be necessary to run through a range of possible scenarios against the legislation to identify them.
- Are there alternate approaches that can address the problems before they occur? (Unfair contract terms regulation is an example of this)
- Are the provisions too general, and do they need to be interpreted (in legislation or guidelines) for particular industries/products?
- Are there gaps in the regime? An otherwise effective regime can fail due to one weakness, such as lack of accessible dispute resolution, lack of an active regulator, lack of processes to identify systemic issues, or lack of processes to address systemic issues.

Carolyn Bond
co-CEO
Consumer Action Law Centre

www.consumeraction.org.au

15th March 2007