Treasury has finally responded to the Financial Services Inquiry (also known as the Murray Inquiry), releasing two proposals to make the Australian Securities and Investments Commission (ASIC) “a more proactive regulator”.

But it is unclear that these proposals will lead to better outcomes for consumers. There a several holes in them, not least that they put the emphasis on the issuers of financial products to choose the “right” customers for their products.

It is questionable whether those who lost out from the sale of unsuitable products by the likes of Storm Financial and Comminsure would be any better off had these proposals been in place.

Further, these proposals fail to adopt successful consumer protections used in similar product categories, and there are lots of questions about how the “right” consumer is determined.

The proposals

The first proposal is to require the issuer of a financial product to ensure those products are targeted only at the “right” people. For example, the right person for a high growth investment product might have a high tolerance for risk and be many years from retirement.

The second proposal would give ASIC the power to temporarily intervene when a product is launched that has a risk of causing significant financial or emotional cost.

The idea is that a product issuer should state who the product is suitable for. An issuer should state who is the ‘target market.’ They would have to consider the needs of their consumers - their ability to understand the product, and whether and how they might benefit. The issuer might be an insurance company who is liable to pay out a claim, while the distributor or seller is the person who sells insurance.

Meanwhile the seller should have controls to ensure the product is sold only to the right consumers, and the issuer should select sales channels and marketing strategies suitable only for that market.

If the product is not suitable for certain consumers then the product must be designated inappropriate for that “non-target” market. Unemployment insurance, for example, often excludes the self employed. The self-employed, then, would be a “non-target” market for this kind of financial product.

None of this would apply to ordinary shares or consumer credit products but would apply to margin loans, managed investments, insurance and others. It would also not apply if the product were sold by someone giving personal financial advice, as that person is already subject to a “best interests” duty towards the client.

There is a lot missing

The main issue with the proposals is that it is unclear how to differentiate between consumers in a way that is meaningful for both those selling the products and those buying them.

How is the individual consumer to know who the target market for a particular product is and whether he or she as an individual falls within that target market?

There are differences between an obligation to assess whether a product is suitable for a particular individual such as consumer credit, and indicating whether a product is generally suitable for a class of persons who may have some similar characteristics.

Issuers are tasked with assessing the risk that their product will not reach the wrong target market, and whether consumers will be able to understand complex products sold via that channel.

Issuers have to consider the needs of the class of consumers in the target market, their ability to understand the product, the nature of the product, and benefits to a consumer. All of this would

take into account the characteristics of the target class of consumers – proximity to retirement, income, wealth, financial literacy and access to financial information.

But in what way do the issuers make these judgements, and are they the appropriate parties to do it? Further, there are several suitability tests used in similar products that are not included.

The key thing tested when it comes to applying for consumer credit is the capacity to pay, or, more accurately, the capacity to repay. On the other side is the capacity to bear a loss. It may not matter to some classes of consumers if their investments result in losses, but it will be critical to others.

If a person cannot pay for a type of insurance without, say, dipping into superannuation funds, should it be sold to him? If a person stands to lose the (modest) family house or retirement funds if she invests in a high risk product, should it be sold to her or to those, who with her, form the target market?

Marketing by class or category has been with us for a long time. We now have big data and individual access to data about ourselves. So it must be possible to fashion a better way to ensure individuals receive the product must suitable for their individual circumstances.

Gail Pearson is on the Executive Committee of the Consumers' Federation of Australia. She is the President of the International Association of Consumer Law.

Read more http://theconversation.com/there-are-a-few-gaping-holes-in-the-proposals-to-beef-up-asic-70408