

There's more than 30 years of research showing financial consumers have behavioural biases that can lead to poor decisions. Financial providers and banks have known this too, and have designed some products to take advantage of consumer habits rather than benefit them.

Legislation soon to [be introduced to parliament](#) is intended to curb these practices, but credit products are being left out to consumer detriment.

Regulators have relied on two strategies to help consumers with this problem. Disclosure of the nature and prospects of the products providers offer. Also, encouraging consumers to seek financial advice.

Neither of these has worked well. The [Financial System Inquiry in 2014](#) recognised that disclosure hasn't closed the gap in consumer capability. Worse, the providers of these products may have incentives through remuneration which may not serve the customer's interest and only about 25% of financial consumers seek advice.

The [Productivity Commission's report](#) on competition in financial services, illustrates many of these points in arguing for regulation of mortgage brokers. Brokers are supposed to be the customer's agent to scout for and advise on the best mortgage terms and cost. Instead they are remunerated by mortgage providers (like the banks), take commissions and, according to the Productivity Commission, generally cost more than loans directly from a bank.

Bias in financial decision-making

Consumers are [prone to a range of biases](#) which may also impair their financial decisions. For example overconfidence may cause them to ignore new information or hold unrealistic views about how high returns will be.

As we age or as our circumstances change, our tolerance for risk also changes. As we get older our tolerance for risk decreases, while having a higher income increases it. Men are also more risk tolerant than women.

Consumers may also give too much weight to recent events and things they know already and can be unduly influenced by the opinions of friends and family.

This sort of consumer decision-making is no match for providers' knowledge of financial conditions and product features. Banks and other financial service providers have learned from experience, but most of all their own command of consumer behaviour research.

The latter leaves providers able to [design and sell products](#) that benefit from consumers not overcoming mistakes, or at times, exacerbating mistakes.

Helping customers make better choices

In a [bill soon to be before the Australian parliament](#), those selling financial products will have to make a "target market determination". This records and describes the market for a product (those who would buy it). It must also set out any conditions under which the product must be distributed, for example that it can only be sold with advice.

It's designed so that financial products meet the needs and financial situation of the people acquiring them.

There are criminal and civil penalty sanctions for failing to make and ensure products are sold in accordance with a determination. Also, for failure to revise and reissue it, if circumstances change.

Twinned with this requirement are new intervention powers for the Australian Securities and Investments Commission (ASIC). ASIC will be able to make interim rules, effectively prohibiting sales or imposing conditions, if continued sale would result in "significant detriment" to financial consumers.

The purpose of product regulation is clearly to allow ASIC to be more active and reduce [over-reliance on ineffective disclosure](#)

,

[conflicted advice](#)
and drawn out
[dispute resolution](#)

Product regulation is no panacea. This version has a large gap, as credit products (for example credit cards or mortgages) do not require a target market determination. It's not difficult to read the politics of regulation in this omission. There is also a risk that target market determinations will become pro-forma and add to compliance and not to consumer benefit. Although a description of the target market must be in the advertising, it's not clear it must be in formal disclosure, so consumers may never read it.

Product intervention powers apply across investment, insurance and credit products but it will never be easy for ASIC to prove the risk of "significant consumer detriment". Intervention orders also expire in 18 months unless made permanent by parliament.

The regulation of product design and distribution in the spirit of consumer safety has been commonplace (if imperfectly realised) in car, pharmaceuticals and other consumer markets, for decades. There are modest grounds for optimism that in Australia financial product safety might catch on too, but the government needs to include credit products as well.

Dimity Kingsford Smith advised ASIC on product intervention powers policy in 2015 and was the NAB Wealth Customer Advocate from 2015-2017 and is a general member of the FPA.

Authors: Dimity Kingsford Smith, Professor of Law, UNSW

Read more <http://theconversation.com/banks-and-financial-providers-one-step-ahead-of-consumers-who-struggle-with-personal-bias-91228>