7 March 2017

By email: economics.sen@aph.gov.au

Senate Standing Committees on Economics
PO Box 6100
Parliament House
Canberra ACT 2600

Dear Committee Members,

Consumer protection in the banking, insurance and financial sector

The Consumer Action Law Centre (**Consumer Action**) is pleased to provide a submission to the Senate Inquiry into consumer protection in the banking, insurance and financial sector.

We believe there are significant cultural and regulatory changes required in the banking, insurance and financial sector in order to improve outcomes for consumers. But a fairer banking, insurance and financial sector doesn't just benefit consumers. It will enhance confidence and trust in the financial system and ultimately create a more effective financial system for industry and consumers alike.

We have seen an acknowledgement by policy makers in recent years that consumers do not end up with unsuitable products only because of their own limitations, but because of poor or unfair processes by businesses.[1] However, we are still awaiting the legislative reform and enforcement necessary to turn this 'shift in focus' into a reality.

We need to change from consumer protection regulatory system based on disclosure to one focusing on fair treatment of consumers. Implicit in that change is an acceptance that consumers are not necessarily capable of absorbing all the information presented to them and, even if they do, various cognitive limitations and biases limit the ability of people to make rational product choices. It also requires an acceptance that remuneration and banking culture has a strong impact on behaviour and the fair treatment of consumers.

Our further views in response to each of the terms of reference are outlined below.

[1] For example, the Financial System Inquiry Final Report, November 2014, p. xx. Available at: http://fsi.gov.au/files/2014/12/FSI_Final_Report_Consolidated20141210.pdf.

Summary of recommendations

Any failures that are evident in the current laws and regulatory framework

Add-on insurance

1. Introduce delayed opt in sales for add-on insurance. Add-on insurance should only be sold through a delayed opt-in sales model, where the consumer must proactively decide to buy insurance up to a week after taking the car or loan.

2. Ban upfront add-on insurance premiums. Financed upfront premiums should be banned and insurers should move to transparent regular instalment payments instead.

3. Make insurance suitable. Insurers and car dealers should be required to ensure that add-on insurance is only sold to people who will be eligible to make claims and will find it useful.

4. Introduce design and distribution obligations and empower the Australian Securities and Investments Commission (**ASIC**) to make product interventions in relation to financial products, including add-on insurance.

Credit cards

5. Tighten responsible lending obligations for credit cards. Ensure credit cards are only provided to people who can repay the full credit limit within three years.

6. Prohibit credit card limit increase offers. Card issuers shouldn't be able to make unsolicited credit limit increase offers.

7. Standardise and simplify credit card interest calculation.

8. Facilitate online credit card cancellations. Require card issuers to provide online card cancellation and credit limit reduction tools.

9. Increase minimum repayment amounts for credit cards. Help people to pay off their account balance of their card, rather than simply carrying debt month-to-month.

10. Require prominent advertising of credit card interest charges and annual fees. Interest rates and fees should be as prominent as promotional offers.

11. Extend credit card teaser offers. Require 'teaser' offers such as free balance transfers and interest free periods to be offered for a minimum of three years.

Bank fees and charges

12. Restrict fees to the banks' actual costs. Limit credit card late payment and 'over-the-limit' fees, and default and overdrawn account fees, to the direct costs actually incurred by the bank.

13. Ensure that bank fees and charges will not trigger further fees.

14. Provide warnings about bank fees. Provide effective and innovative warnings about fees having regard to behavioural economics principles.

15. Prohibit fees or penalties for visiting a physical bank branch.

16. Prohibit fees for copies of documents in certain circumstances. Consumers should not be charged for hard copies of documents when documents or computer access have been lost due to family violence or natural disaster, or the person receives Centrelink benefits.

17. Prohibit default or similar fees while the bank is considering a hardship arrangement.

Responsible lending

18. Banks should implement best practice in relation to responsible lending, particularly when undertaking loan suitability and affordability assessments.

19. Increase penalties and enforcement action for breaches of responsible lending.

20. Extend the proposed design and distribution obligations, and ASIC product intervention power, to credit.

21. Ban mortgage broker commissions and sales-based payments for bank staff selling home loans.

22. Increase qualification requirements for mortgage brokers and banks' home loan lending staff.

Payday loans and consumer leases

23. Implement the SACC Review recommendations as soon as possible.

24. Introduce a 48 per cent cap on costs charged by all forms of consumer credit, including payday loans and consumer leases.

Any failures that are evident in the enforcement of the current laws and regulatory framework, including those arising from resourcing and administration

25. Introduce an industry funding model for ASIC.

26. Provide ASIC with additional funding that enables it to exercise its enforcement powers effectively to protect consumers and enhance confidence in the market.

27. Strengthen the Australian Credit Licence and Australian Financial Services Licence regimes to enable ASIC to deal more effectively with poor behaviour and misconduct.

28. Increase the maximum penalties that can be imposed for contravening financial services and credit consumer protection laws.

The impact on consumer outcomes of executive and non-executive remuneration, incentive-based commission structures, and fee-for-no-service or recurring fee structures.

29. Require targets for staff to relate to customer outcomes and the appropriateness of products sold, rather than sales.

30. Prohibit conflicted remuneration structures whereby an employee's commissions are forfeited unless they have sold a sufficient number of add-on products (e.g. CCI).

31. Prohibit 'accelerator payments', which encourage staff to intensify their sales activity once they have reached a certain sales volume threshold.

32. Require performance assessments of managers to be based on non-sales metrics, such as how well the corporate aims of the organisation are met.

The culture and chain of responsibility in relation to misconduct within entities within the sector

33. Ensure design and distribution obligations set out a clear chain of responsibility that will not permit distributors to be wilfully blind when issuers fail to identify a target market appropriately or provide inadequate instructions.

The availability and adequacy of redress and compensation to victims of misconduct, including options for a retrospective compensation scheme of last resort

34. Introduce a last chance compensation scheme for victims of misconduct.

35. Integrate the Superannuation Complaints Tribunal and Credit and Investments Ombudsman into the Financial Ombudsman Service.

The availability and adequacy of legal advice and representation for consumers and victims of misconduct, including their standing in the conduct of bankruptcy and insolvency processes

36. Provide additional funding for free legal and financial counselling services to meet the huge demand for assistance

37. Establish a legal service to provide assistance around investment disputes where they cause substantial detriment.

38. Increase the number of co-located free legal services and financially counselling across Australia.

About Consumer Action

Consumer Action Law Centre is an independent, not-for profit consumer organisation based in Melbourne. We work to advance fairness in consumer markets, particularly for disadvantaged and vulnerable consumers, through financial counselling, legal advice and representation, and policy work and campaigns. Delivering assistance services to Victorian consumers, we have a national reach through our deep expertise in consumer law and policy and direct knowledge of the consumer experience of modern markets.

1. Any failures that are evident in the current laws and regulatory framework

It is clear that the current regulatory framework for the banking, insurance and financial sector is not sufficient to deliver fair treatment to consumers. The most significant problems relate to consumers being sold financial products that are not suited to their needs and circumstances. Although the regime should not be expected to prevent all consumer losses, we need to see a shift in focus that strengthens financial firms' accountability.

We have provided further details about a number of key failures that are evident in the current laws and regulatory framework below.

A. Sale of junk insurance

We have been concerned about the sale of 'junk insurance' to consumers for many years. We call it 'junk insurance' because this type of insurance is expensive, bad value and often very difficult to make a claim. Junk insurance, also referred to as 'add-on insurance', is typically sold by a car dealer when you buy a vehicle. It includes Consumer Credit Insurance (**CCI**), Guaranteed Asset Protection (**GAP**) insurance, loan termination ('walkaway') insurance, tyre and rim insurance and mechanical breakdown insurance. Extended and dealer warranties are also sold as add-ons. While 75 per cent of add-on insurance is sold in car yards, the remaining amount is sold by banks, credit unions and finance companies when a consumer takes out a credit card or loan.

ASIC has reported on the clear market failures with add-on insurance, particularly policies sold through car yards. The problems include:[2]

- very poor value products, with an overall claims ratio of just 9%—compared with home insurance at 55% and comprehensive car insurance at 85%;
- insurers paying four times more to car dealers in commissions ($602 million in 2013-15) than to people on their insurance claims ($144 million);

[2] Consumer Action, *Junk Merchants: How Australian are being sold rubbish insurance, and what we can do about it*, December 2015. Available at: http://consumeraction.org.au/junk-merchants-report-how-australians-are-being-sold-rubbish-insurance-and-what-we-can-do-about-it/; Australian Securities and Investments Commission, *REP 470 Buying add-on insurance in car yards: Why it can be hard to say no*, February 2016. Available at: http://asic.gov.au/regulatory-resources/find-a-document/reports/rep-470-buying-add-on-insurance-in-car-yards-why-it-can-be-hard-to-say-no/; Australian Securities and Investments Commission, *REP 471 The sale of life insurance through car dealers: Taking consumers for a ride*, February 2016. Available at: http://asic.gov.au/regulatory-resources/find-a-document/reports/rep-471-the-sale-of-life-insurance-through-car-dealers-taking-consumers-for-a-ride/; Australian Securities and Investments Commission, *REP 492 A market that is failing consumers: The sale of add-on insurance through car dealers*, September 2016. Available at: http://asic.gov.au/regulatory-resources/find-a-document/reports/rep-492-a-market-that-is-failing-consumers-the-sale-of-add-on-insurance-through-car-dealers/.

- car dealer commissions as high as 79%;
- life insurance sold at up to 18 times the cost of term life insurance sold through other channels; and
- insurance sold to people who cannot claim on it—for example, unemployment cover sold to people who were already unemployed.

Consumer Action's website DemandARefund.com has facilitated more than 280 claims for add-on insurance refunds in under a year, totaling over $500,000. DemandARefund claims show big problems with inappropriate sales tactics. Of the people who have claimed refunds:

- 21% did not know they had bought add-on insurance;
- 28% thought the add-on product was mandatory; and
- 31% felt they had been rushed or pressured into buying add-on insurance.

Below are a number of case studies demonstrating these issues in more detail.

Bob's story

Bob bought a new car for $48,774 and got finance through the car dealer. It was his dream car and he was very excited that he had been approved for finance. The car dealer also sold Bob CCI and GAP insurance totalling $19,197. Bob did not receive any Product Disclosure Statements (**PDS**s) for the insurance and did not realise he had bought it. The insurance took Bob's loan from $61,491 to $80,688 and represented 24% of the loan amount. The interest on the insurance would have been $9,999, meaning Bob would have spent $29,195 on insurance.

Mai's story

Mai bought a car at auction and arranged finance onsite. The salesperson told her she had to buy 'lease protection insurance' to be approved for finance, and she was given a PDS for this. However, Mai was in fact sold GAP insurance and was not provided with documentation for it. The GAP insurance was completely useless because Mai had comprehensive insurance with an agreed value that exceeded the amount of her loan, so there was no 'gap' to cover.

Joan's story

Joan was 63 years old and working casually. She had no dependents. She got a personal loan of $12,000 and was sold CCI for unemployment, disability and life costing approximately $3,600. The interest rate on the loan was 27.88%, meaning interest on the insurance would have been $6,117—almost double the premium. Joan would have spent $9,717 on CCI for a $12,000 loan.

We believe some key changes are needed to make improvements to the add-on insurance market. In particular, consumers should only be sold add-on insurance if they opt-in to the purchase. It is hard to decide whether to buy insurance in a high-pressure sales environment. Add-on insurance should only be sold through a delayed opt-in sales model, where the consumer must proactively decide to buy insurance up to a week after taking the car or loan.

We also recommend banning upfront premiums. When you buy add-on insurance with an upfront premium, the insurance is added to the loan and you pay interest on it. This inflates the price and makes it hard for consumers to know what they will really pay. Financed upfront premiums should be banned and insurers should move to transparent regular instalment payments instead. Insurers and car dealers should also be compelled to make sure add-on insurance offers real value and is only sold to people who can claim on it and will find it useful.

The proposed Design and Distribution Obligations (**DADOs**) and ASIC Product Intervention Power (**PIPs**) would also assist with reforming this industry. Further comments in relation to DADOs and PIPs are provided in sections 1D, 2 and 5 below.

Recommendations

1. Introduce delayed opt in sales for add-on insurance. Add-on insurance should only be sold through a delayed opt-in sales model, where the consumer must proactively decide to buy insurance up to a week after taking the car or loan.

2. Ban upfront add-on insurance premiums. Financed upfront premiums should be banned and insurers should move to transparent regular instalment payments instead.

3. Make insurance suitable. Insurers and car dealers should be required to ensure that add-on insurance is only sold to people who will be eligible to make claims and will find it useful.

4. Introduce design and distribution obligations and empower ASIC to make product interventions in relation to financial products, including add-on insurance.

B. Credit cards

Australia's credit card debt is continuing to grow rapidly, and we are headed towards a debt disaster. Australians owe around $32 billion in credit card debt accruing interest. That's an average of around $4,300 per card holder. Australians have more than 16 million credit card accounts with total credit card limits totalling more than $151 billion.[3]

These staggering figures are reflected in our casework experience. Our financial counselling service, National Debt Helpline (Victoria), receives nearly 100 calls per week alone from people struggling with credit card debt. Nearly 50% of callers to our financial counselling service have credit card debts exceeding $10,000. Nearly 10% of our callers have debts exceeding $50,000, and every week we receive at least one call from a person with credit card

[3] Reserve Bank of Australia, *Credit and Charge Card Statistics - C1*, March 2017. Available at: http://www.rba.gov.au/statistics/tables/.

debt exceeding $100,000. It is not uncommon for us to receive calls from people with up to $200,000 owing on their credit cards.[4]

The scale of Australia's credit card industry is well known, and is likely to continue to grow in the short to medium term. The Reserve Bank of Australia (**RBA**) recently identified fee income from credit cards to be the largest earner for major banks, compared to fee income from other banking products.[5]

The four major banks account for around 80 per cent of total outstanding credit card balances,[6] and are failing to compete on price, despite the cost for providing credit actually reducing. The RBA has cut rates by 3.25% since June 2011, but Australian credit card holders have seen no relief in the form of cuts to credit card purchase rates. An analysis of credit card interest rates by CHOICE and Mozo found that if credit card interest rates had moved in line with the RBA cash rate over the last four years, Australian credit card holders would have saved $3.49 billion in interest since mid-2011. Their analysis also found that the average credit card rate is now 11.5 times higher than the cash rate.[7]

Not only are the banks failing to compete on price, but they are failing to lend money responsibly. It is no secret that the responsible lending standards in Australia's credit card market are extremely poor. Unsolicited offers of credit card limit increases also remain common, despite reforms designed to tackle this problem in 2012. Lax responsible lending standards and unsolicited credit offers have had the combined result of many Australians with unsustainable levels of credit card debt.

James' story[8]

James applied for a credit card after a few months at his new job. The credit card provider did not ask him what his purpose was, or ask him to estimate his living expenses. The credit provider asked for his payslips. James was offered a ridiculously high credit limit that far exceed what he was after. He just wanted to start his credit history and have the flexibility of a credit card, plus use the benefits of salary sacrifice at his new job. James had to fight with the credit card provider to reduce the limit as James knew he was on a 12-month work contract and was inexperienced in using credit cards. James did not want to risk it but the credit card provider told him that it was just in case he needed it.

Why does it matter if Australians are drowning in credit card debt? At an acute level, credit card debt is dangerous as it can result in financial hardship, bankruptcy and, in some cases, can place the family home at risk. We note that the number of people contacting us for assistance is likely to be only a small proportion of those struggling with credit card debt. These 'hidden consumers' are generally making minimum monthly repayments or even above, but

[4] Based on data collected from Consumer Action's National Debt Helpline (Victoria) service between 13 July and 7 August 2015.
[5] Wilkins, Kelsy. *Banking fees in Australia*, Reserve Bank of Australia Bulletin, June 2016.
[6] Treasury Ministerial Brief, *Credit Card Interest Rates*, 25 March 2015.
[7] Please see CHOICE's submission to the Inquiry for further details.
[8] Originally published in Consumer Action Law Centre, *Submission to the Inquiry into credit card interest rates*, 10 August 2015. Available at: http://consumeraction.org.au/matters-relating-to-credit-card-interest-rates-senate-standing-committees-on-economics/.

are paying thousands of dollars in interest payments, reducing their income and their ability to pay for day-to-day necessities and other productive expenditure.

Australians battling to make ends meet are effectively cross-subsiding others who pay off their accounts regularly and incur almost no interest. People who are unable to make repayments on time, or overdraw their accounts, pay more fees and interest. This makes them arguably the most profitable customers for the banks, and means they are ultimately paying for the reward points and interest free periods the wealthy enjoy. The banks have failed to implement the changes necessary to save Australians from crippling debt, because the people failing to repay their credit card balances on time are actually the most profitable.

In May 2016, Treasury recommended a number of reforms that addressed some of the issues above.[9] Phase 1 of the proposed reforms, included tightening responsible lending obligations, prohibiting unsolicited credit limit increase offers, allowing online card cancellation and simplifying interest calculation. These reforms were pegged for legislation in the 'near term'. However, we are still waiting for exposure draft legislation to be released for consultation.

Consumer testing of Phase 2 of the proposed reforms, which included requiring improved disclosure of cost, switching cards and expiry of introductory offers, was to commence 'shortly' after the Treasury released its report. However, we are also yet to hear of any behavioural testing being undertaken.

We have provided further commentary in relation to responsible lending in section 1D below.

Recommendations

5. Tighten responsible lending obligations for credit cards. Ensure credit cards are only provided to people who can repay the full credit limit within three years.

6. Prohibit credit card limit increase offers. Card issuers shouldn't be able to make unsolicited credit limit increase offers.

7. Standardise and simplify credit card interest calculation.

8. Facilitate online credit card cancellations. Require card issuers to provide online card cancellation and credit limit reduction tools.

9. Increase minimum repayment amounts for credit cards. Help people to pay off their account balance of their card, rather than simply carrying debt month-to-month.

10. Require prominent advertising of credit card interest charges and annual fees. Interest rates and fees should be as prominent as promotional offers.

[9] Treasury, *Credit cards: improving consumer outcomes and enhancing competition,* May 2016. Available at: http://www.treasury.gov.au/ConsultationsandReviews/Consultations/2016/Credit-card-reforms.

11. Extend credit card teaser offers. Require 'teaser' offers such as free balance transfers and interest free periods to be offered for a minimum of three years.

C. Bank fees and charges

Australians paid nearly $12 billion in bank fees in 2014. This is a growth rate of 2.8 per cent—faster than the consumer price index. Credit card fees are rising fastest, with a 5.9 per cent growth in fees in 2014.[10]

Many bank fees, particularly credit card late fees (some as high as $35), often bear no resemblance to the banks' actual costs. The banks argue that these fees cover their losses, but in fact they are just double dipping. For example, credit card interest rates are already set at very high levels by the banks in order to cover the costs involved with offering unsecured credit.

Bank fees tend to have a harsh and disproportionate impact on lower income Australians. For people who are already struggling with debt, late fees only make the task of repayment more difficult. An example of the disproportionate impact bank fees can have on low-income Australians is set out below.

Example

Credit card late payment fees can range from $9 to $40. For a single mum receiving the Newstart Allowance, a $40 default fee can mean the difference between buying schoolbooks or her kids' lunches. A single mum on Newstart receives only $285.95 per week. A $40 default fee equates to approximately 14% of her weekly income.

Unfortunately, excessive bank fees seem set to continue following a recent High Court decision regarding ANZ's credit card late payment fees.[11] The majority of the High Court held that ANZ was entitled to charge late payment fees of up to $35, even though this amount did not represent a genuine pre-estimate of the ANZ's losses, or the costs actually incurred by ANZ. Apparently these excessive fees protected ANZ's 'legitimate interests', which means ANZ can charge for indirect costs to the overall business like collection costs (even if no collections actually occur). This decision is likely to end the numerous bank fee class actions commenced against other Australian banks, and encourage banks to increase fees.[12]

The High Court decision was argued on the basis that these fees were unlawful contractual penalties. The law of contractual penalties is complex and antiquated. Arguably, it has failed to keep abreast with developments of modern mass-market commerce. In his judgment, Chief

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[10] Wilkins, Kelsey, *Banking Fees in Australia*, June 2015. Available at: http://www.rba.gov.au/publications/bulletin/2015/jun/pdf/bu-0615-5.pdf.
[11] *Paciocco v Australian and New Zealand Banking Group Ltd* [2016] HCA 28.
[12] For example, NAB increased its credit card late payment fee by 80% about the same time it settled a class action relating to these fees: http://consumeraction.org.au/nab-locks-vulnerable-unfair-bank-fees-refunds/.

Justice French noted that “statutory law reform offers more promise than debates about the true reading of English legal history.” We submit that law reform is required to ensure that fees charged by banks reflect the cost and not be used to profit.

Public confidence in banks is low. Australians are extremely sceptical about a sector that posts record profits year after year and yet hits them with dubious charges every time they make the slightest misstep. We need to place some parameters on unreasonable charges and limit the scope for abuse by the banks.

We have outlined our recommendations for law reform in relation to bank fees below.

Recommendations

12. Restrict fees to the banks’ actual costs. Limit credit card late payment and ‘over-the-limit’ fees, and default and overdrawn account fees, to the direct costs actually incurred by the bank.

13. Ensure that bank fees and charges will not trigger further fees.

14. Provide warnings about bank fees. Provide effective and innovative warnings about fees (having regard to behavioural economics principles).

15. Prohibit fees or penalties for visiting a physical bank branch.

16. Prohibit fees for copies of documents in certain circumstances. Consumers should not be charged for hard copies of documents when documents or computer access have been lost due to family violence or natural disaster, or the person receives Centrelink benefits.

17. Prohibit default or similar fees while the bank is considering a hardship arrangement.

D. Responsible lending

Under the *National Consumer Credit Protection Act 2009* (Cth) (**National Credit Act**), lenders are required to assess a loan whether is ‘not unsuitable’ for a consumer before offering credit. As explained in ASIC’s Regulatory Guide 209,[13] a credit contract or consumer lease will be, and must be assessed as, unsuitable where, at the time of the assessment, it is likely that:

- the contract does not meet the consumer’s requirements and objectives; or
- the consumer will be unable to meet their payment obligations, either at all or only with substantial hardship.

[13] Australian Securities and Investments Commission, *RG109 Credit licensing: responsible lending conduct*, November 2014, para 209.3. Available at: http://download.asic.gov.au/media/2243019/rg209-published-5-november-2014.pdf.

In undertaking the assessment, providers must make reasonable inquiries about the consumer's requirements and objectives and their financial situation, and take reasonable steps to verify this information. Banks should be implementing best practice in loan suitability and affordability assessments, but in our experience they are some of the worst offenders in terms of providing loans to people who simply cannot afford pay. We have provided two examples below.

Julia's story

Julia asked the Commonwealth Bank to give her a loan to refinance her existing car loan, and to pay for a rental bond and car registration. The loan was for a total amount of $18,350. At the time she took out the loan, Julia was 19 years old and had only had one previous loan for 7 months. She was a very inexperienced borrower. Julia applied for the CBA loan online and did not receive any independent advice about the loan.

We made a complaint to Commonwealth Bank on Julia's behalf alleging that Commonwealth Bank had failed to lend responsibly to Julia. Julia has been unable to repay her loan without suffering substantial financial hardship. Under Australia's national credit laws, Commonwealth Bank was obligated to assess whether Julia could afford the loan, and verify her financial situation, before giving her the loan.

We have alleged that Commonwealth Bank did not take appropriate steps to verify Julia's financial situation when she applied online for the loan. Commonwealth Bank simply accepted the information provided during the online application process about Julia's expenses, even though her expenses were listed as only $118.90 per week. The Commonwealth Bank were provided with pay slips which demonstrated that her income $431.48 per week (after tax). It is difficult to see how Julia could afford to live on just $118.90 per week, especially given that Julia told us she was paying $100 per week for rent at the time.

Julia's dispute with Commonwealth Bank is ongoing.

Peter and Julie's story

In 2006, Peter and Julie had been separated for at least 6 years. Julie lived in the jointly owned matrimonial home with their two children and Peter lived with his mother. Both were long time customers of the Commonwealth Bank, which held all of their accounts.

Peter ran a modest small business and Julie was in receipt of Centrelink payments. Peter was 59 years old and five years from retirement.

Despite accepting that Peter and Julie lived separately, with a stated combined gross income of $50,000 per year, in March 2006, the Commonwealth Bank provided a Viridian Line of Credit for $50,000. In August 2006, 5 months later, the Commonwealth Bank increased the limit by a further $50,300. In 2007, the Commonwealth Bank then advanced a $25,000 'home loan'. In total, the Commonwealth Bank advanced Peter and Julie $125,300.

The loan applications reveal that Peter and Julie had neither savings nor superannuation. They also reveal that the Commonwealth Bank required no documents (such as bank statements, tax returns, profit and loss statements) whatsoever from Peter to check if his business was profitable, which it was not. The CBA sought no information nor supporting documentation to demonstrate Peter and Julie's capacity to service the loans. It contacted neither of them during the approval process.

In 2015, when the Consumer Action Law Centre raised this case with the Commonwealth Bank, the most it would offer was time for Peter and Julie to sell their property. It saw nothing wrong with its lending. After the Consumer Action Law Centre complained to the Financial Ombudsman Service in 2016, the Ombudsman found that none of the loans should have been made because Peter and Julie could not afford to pay them.

Concerns have been raised in a number of forums about banks' lax responsible lending practices, particularly in relation to credit cards. The banks' own Code Compliance Monitoring Committee (**the CCMC**) recently found significant issues with banks' credit card responsible lending practices.[14] The CCMC identified a number of potential issues regarding:

- banks not making inquiries about a customer's purpose for credit card applications;
- the collection and verification of current customer information when processing applications for credit card limit increases; and
- the assessment of a customer's ability to repay a credit card balance.

The CCMC also found that credit cards account for 68% of applications for unsecured credit, and automated systems are used to process approximately 97% of applications for unsecured credit. Where an automated system is used at some stage of the credit assessment process, 65% of unsecured credit applications are approved. The high use of automated processes is particularly worrying given the banks legal obligations to make reasonable inquiries about consumers' financial situations, and to properly verify this information.

But banks' poor lending behaviour has not been limited to credit cards or relatively small personal or car loans. We have also seen lax lending standards in the home loan market. This was highlighted by ASIC recent enforcement action against Westpac for alleged responsible lending contraventions. On 1 March 2017, ASIC commenced civil penalty proceedings in the Federal Court against Westpac alleging that in the period between December 2011 and March 2015 Westpac failed to properly assess whether borrowers could meet their repayment obligations before entering into home loan contracts.[15] We need only remember the Global Financial Crisis to realise the danger of providing home loans to borrowers who will struggle to make repayments.

[14] Code Compliance Monitoring Committee, *Own Motion Inquiry Provision of Credit*, January 2017. Available at: https://fos.org.au/custom/files/docs/ccmc-provision-of-credit-own-motion-inquiry-report.pdf.
[15] Australian Securities and Investments Commission, *17-048MR ASIC commences civil penalty proceedings against Westpac for breaching home loan responsible lending laws,* 1 March 2017. Available at: http://asic.gov.au/about-asic/media-centre/find-a-media-release/2017-releases/17-048mr-asic-commences-civil-penalty-proceedings-against-westpac-for-breaching-home-loan-responsible-lending-laws/.

Poor lending standards and advice by mortgage brokers are also concerning. These problems were highlighted in CHOICE's shadow shopping report in 2015. An expert panel made a scathing assessment of the advice of 15 mortgage brokers, which represented three of the biggest mortgage broker businesses in Australia. The panel rated 7 brokers as 'poor', with only one broker managing to score a 'good' rating. Problems included a couple who wanted to buy a $600,000 investment property but were advised to take out a $1m loan secured against their home, and a broker pushing his own company's product even while acknowledging that other lenders offered a better loan.[16] ASIC is shortly due to release its own research into the mortgage broking industry, which will provide additional data about the practices of the lenders and their distributors.

We strongly recommend that the proposed DADOs, and ASIC PIP, apply to credit in order to strengthen protections for consumers. Responsible lending offers different, and lesser, protections than the proposed obligations. Increasing the accountability of credit providers and distributors, who have so far failed to design or distribute their products safely, is necessary to save Australia from its looming debt disaster.

The impact of being given an unsuitable loan, whether a mortgage or a credit card, cannot be underestimated. The stress and anxiety of trying to make repayments you simply cannot afford is overwhelming. We have provided further comments in relation to the impact of poor conduct on consumers in section 3 below.

Recommendations

18. Banks should implement best practice in relation to responsible lending, particularly when undertaking loan suitability and affordability assessments.
19. Increase penalties and enforcement action for breaches of responsible lending.
20. Extend the proposed design and distribution obligations, and ASIC product intervention power, to credit.
21. Ban mortgage broker commissions and sales-based payments for bank staff selling home loans.
22. Increase qualification requirements for mortgage brokers and banks' home loan lending staff.

E. Payday loans and consumer leases

Currently, there is no overall obligation that prevents finance companies from designing inherently harmful, high-cost credit products. Two high-cost credit products that we have been concerned about for many years are payday loans and consumer leases.

[16] CHOICE, *Mortgage broker investigation,* May 2015. Available at: https://www.choice.com.au/money/property/buying/articles/mortgage-broker-shadow-shop.

Payday loans are loans of up to $2,000 for a period of less than 12 months. Payday lenders are permitted to charge an upfront 'establishment fee' of 20% of the amount borrowed, plus a monthly fee of 4% of the amount borrowed. Annualised percentage rates for payday loans generally range between 407% and 112.1%.[17] Our small legal practice has received 65 enquiries about payday loans in the past 6 months alone. This does not include calls to our financial counselling service (National Debt Helpline—Victoria) about payday loans.

Perhaps most concerning is the enormous growth of the payday lending industry. In 2015, researchers estimated the payday lending market to be valued at more than $1 billion per annum. This is predicted to grow to $2 billion per annum by 2018. The number of households using payday loans in the last three years increased from 356,097 in 2005 to 643,087 in 2015. In addition, the number of borrowers taking out more than one payday loan the preceding 12 months has grown from 17.2% in 2005 to 38.0% in 2015, meaning we have seen a huge growth in repeat borrowers.[18] An example of repeat borrowing is set out below.

Laura's story[19]

Laura lives in public housing and receives a Centrelink pension. She has a mild intellectual disability and suffers from mental illness. Laura has two young children one of which has a mild intellectual disability. Laura is in severe financial hardship and is due to have her electricity disconnected.

Laura fell into a debt spiral in 2013 and 2014 after she received multiple, successive loans from three different payday lenders. Laura used her Centrelink income to cover the loan repayments and fell into arrears with the rent and energy bills. Laura is currently on a payment plan for her rent after the Department of Housing tried to evict her for failing to pay her rent.

Laura complained to the Energy and Water Ombudsman Victoria about her energy debt. She was too embarrassed to disclose her payday loans so she told them that her Centrelink payments had been reduced. Laura eventually entered into a payment plan with the energy provider, however she fell into arrears for a few weeks during the plan. Consumer Action is currently assisting Laura to resolve her dispute.

Consumer leases are a type of 'rent to buy' arrangement, but the catch is that despite paying huge amounts for basic goods and vehicles, the lessee actually has no contractual right to own the goods. There is no cap on the fees charged by consumer lease providers, unlike payday lenders and other credit providers. Lease providers are also not required to advertise the total rental amount or retail price (or an effective interest rate). Consumer leases can cost

[17] Comparison rate calculations completed using RiCalc software assuming maximum permitted fees and charges, and fortnightly repayments. 407.6% comparison rate calculated using a 30 day loan of $200 with total repayments of $248. 112.1% comparison rate calculated using a 12 month loan of $1,000 with total repayments of $1,680.

[18] Digital Finance Analytics, *The stressed finance landscape data analysis,* October 2015. Available at: http://consumeraction.org.au/wp-content/uploads/2015/10/The-Stressed-Financial-Landscape-Data-Analysis-DFA1.pdf.

[19] Originally published in Consumer Action Law Centre, *Small amount credit contract review submission,* October 2015. Available at: http://consumeraction.org.au/review-of-the-small-amount-credit-contract-laws-submission/.

at least twice the retail price, usually three times and sometimes more. The cost of a consumer lease is usually advertised as a low 'per week' amount, but lease providers do not disclose the total rental amount or retail price in advertisements.

Hilary's story[20]

We were contacted by Hilary after she had entered into a number of consumer leases. Hilary's income is sourced through a disability support pension and a modest wage earned working part time. Hilary has an intellectual disability, and experiences difficulties learning, reading and spelling. Hilary says has no assets other than some essential household items.

Hilary entered into her first consumer lease for a mattress, bedroom suite, and cabinet in March 2013. The total payments under the lease would have been more than $8,900. The cash price of the goods was less than $3,000. Hilary entered into her second consumer lease with the same provider for a washing machine in October 2013. Total payments under the lease to amounted to more than $2,300. The cash price for the washing machine was less than $800.

Hilary was also required to purchase 'add on' insurance. We are instructed that Hilary did not know what the insurance was when she entered the lease agreements. Hilary says that she thought she would own the goods at the end of the leases, although this was not the case.

These products are targeted at people who have difficulty accessing mainstream finance, and do not have enough money to pay for the upfront cost of essential goods or cover emergency expenses. There is no question that high cost payday loans and consumer leases are not suitable for these groups. In general, they have little to no discretionary income and are at significant risk of falling into a debt spiral. The marketing of these products is often confusing (and potentially misleading). These advertisements are designed to appear as though the clients are getting a bargain, but in actual fact they are being charged an exorbitant amount.

The current responsible lending obligations apply only at the point of sale, and do not require credit providers to design and target their products appropriately. One of the challenges for a regulator in enforcing the responsible lending laws with respect to products targeted at these vulnerable groups is that the misconduct is rarely reported to the regulator. Vulnerable people often do not want to be involved in regulator action as there are a range of life circumstances that can act as a barrier.

In 2015, the Government established a review into payday loans and consumer leases (**the SACC Review**). The panel provided the final report to Government on 3 March 2016, with a number of much-needed recommendations for reform including:

- imposing a cap on the total amount of payday loan repayments to 10 per cent of the consumer's net (that is, after tax) income;
- requiring equal repayments over the life of the loan;

[20] Ibid.

- banning unsolicited payday loan offers to current or previous consumers;
- imposing a cost cap for consumer leases of 4 per cent of the base price of the rented goods per month (up to 28 months);
- prohibiting unsolicited selling of consumer leases of household goods; and
- introducing anti-avoidance provisions.[21]

The recommendations above were accepted by the Government on 28 November 2016, but have not yet been legislated. Australia's most vulnerable and disadvantaged are continuing to be ripped-off by these products, and we cannot afford to wait any longer for reform. We strongly recommend that the above reforms are enacted as soon as possible. We also recommend moving towards a 48 per cent cap on costs for payday loans and consumer leases, which is the cost cap for all other forms of consumer credit. We can see no justification for exempting these predatory lenders from the cost caps that other lending businesses must abide by.

Recommendations

23. Implement the SACC Review recommendations as soon as possible.

24. Introduce a 48 per cent cap on costs charged by all forms of consumer credit, including payday loans and consumer leases.

2. Any failures that are evident in the enforcement of the current laws and regulatory framework, including those arising from resourcing and administration

The failures in the enforcement of the current laws and regulatory framework has been a result of inadequate resourcing, in conjunction with insufficient penalties and exemptions that allow financial firms to take advantage of regulatory loopholes.

We are very supportive of the excellent enforcement work that ASIC undertakes, but we believe ASIC requires additional resources and powers to ensure that it can tackle the challenges ahead. We support recent moves to introduce an industry funding model for ASIC. Currently, reliance on yearly funding results in peaks and troughs, making it arguably more difficult for ASIC to plan how they will allocate their resources long-term and to be responsive to market needs. An industry-funding model would provide ASIC with much needed funding stability.

The industry funding model would also ensure that those industries that cost the most to regulate contribute appropriately to the regulator's funding.[22] It seems only appropriate that participants contribute an amount to ASIC's funding that corresponds with their costs of regulation. This will also hopefully encourage high risk participants to improve industry

[21] The Hon Kelly O'Dwyer MP, *Government response to the final report of the review of the small amount credit contract laws*, 28 November 2016. Available at: http://kmo.ministers.treasury.gov.au/media-release/105-2016/.
[22] CHOICE and Consumer Action Law Centre, *Proposed industry funding model for the Australian Securities and Investments Commission - joint submission*, December 2016. Available at: http://consumeraction.org.au/proposed-industry-funding-model-australian-securities-investments-commission-proposals-paper/.

standards to drive down the cost of regulation. We suggest the indexation be included in cost recovery processes as a standard approach.

In terms of the amount of ASIC funding, it needs to be at a level that enables it to be a proactive regulator that responds promptly to evidence of misconduct. Additional funding is required to enable ASIC to enhance its enforcement activities and financial literacy and outreach work, and to take on cases that test the law and challenge large players in the market, such as the banks. It is imperative that ASIC be provided with a level of funding that enables it to exercise its enforcement powers effectively to protect consumers and enhance confidence in the market. ASIC must also be able to offer remuneration comparable to the private sector in order to attract and retain experienced staff.

We have previously voiced our support for strengthening the Australian Credit Licence and Australian Financial Services Licence regimes so that ASIC can deal more effectively with poor behaviour and misconduct.[23] The licensing regimes enable ASIC to act as a 'gatekeeper' to the industry, and it is imperative that these powers are strengthened in order to keep unscrupulous traders from entering the market and being legitimised by holding a licence. We also strongly support the introduction of DADOs and PIPs.[24] The DADOs will improve issuer and distributor accountability, product design and marketing, while ASIC's PIP will enable the regulator to respond to significant risks of consumer harm before actual losses occur.

ASIC also requires the resources and powers to effectively enforce the DADOs, and use the proposed PIP. We recommend that the ASIC Enforcement Review Taskforce give particular attention to ASIC having the full suite of regulatory tools and powers available to enforce compliance with the new obligations.

Finally, we strongly support increases to the maximum penalties that can be imposed for contravening financial services and credit consumer protection laws. Penalties must be set at a level to act as a credible deterrent against misconduct, and not just be factored in as simply the cost of doing business. Penalties must be increased substantially, but the regulator must be able to disgorge profits associated with unlawful conduct. In our view, penalties for breaches of responsible lending in particular need to be increased, as the refund of interest, fees and charges hasn't been enough to change industry practice.

Recommendations

25. Introduce an industry funding model for ASIC.
26. Provide ASIC with additional funding that enables it to exercise its enforcement powers effectively to protect consumers and enhance confidence in the market.

[23] *Financial System Inquiry Final Report*, November 2014, Recommendation 29. Available at: http://fsi.gov.au/files/2014/12/FSI_Final_Report_Consolidated20141210.pdf.
[24] For more information, see Treasury, *Design and Distribution and Product Intervention Power Proposals Paper*, December 2016. Available at: http://www.treasury.gov.au/ConsultationsandReviews/Consultations/2016/Design-and-distribution-obligations-and-product-intervention-power.

27. Strengthen the Australian Credit Licence and Australian Financial Services Licence regimes to enable ASIC to deal more effectively with poor behaviour and misconduct.

28. Increase the maximum penalties that can be imposed for contravening financial services and credit consumer protection laws.

3. The impact of misconduct in the sector on victims and on consumers

The impact of misconduct in the sector can cause a range of financial and non-financial losses for victims and on consumers more generally. Misconduct impacts the affected consumer and their family, the community generally and the reputation of the financial services and credit industries. When losses occur, the impact is generally very substantial.[25]

The impact of uncompensated loss was the subject of research commissioned by ASIC's Consumer Advisory Panel and reported in ASIC Report 240 in 2011.[26] This research reported on the experiences of 29 consumers affected by losses caused by misconduct in the financial services sector. Some of the research's key findings included:

- 17% of the group were living below the poverty line and had either lost their home or were perilously close to losing it;
- a further 27% were experiencing a significant decline in living standards to the point where they were now 'living frugally'. Many suffered from long -term depression;
- affected consumers draw more on community resources than would otherwise be the case; and
- one of the most significant impacts of these investors' losses is the damage to their confidence in the financial system.

The impact of general over-indebtedness is also significant. At one level, significant debt can lead to, and exacerbate, the financial marginalisation of disadvantaged consumers. At an acute level, excessive debt is dangerous for some individual consumers as it can result in financial hardship, bankruptcy and, in some cases, can place the family home at risk. At a generic level, the level of debt of Australian consumers as a whole is cause for some concern in relation to macro social policy objectives and the stability of the financial system generally.

For those with the most acute problems with debt, it seriously harms their lives. It can cause, amongst other things, family breakdown, violence, crime and deterioration in health (including mental health).[27] Researchers at Ohio State University also found that people who reported higher levels of stress about their debt showed higher levels of physical impairment and also

[25] Consumer Action Law Centre et. al., *Inquiry into scrutiny of financial advice – joint submission,* May 2015. Available at: http://consumeraction.org.au/wp-content/uploads/2015/05/Joint-consumer-submission-Last-Resort-Compensation-Scheme-05052015.pdf.
[26] Australian Securities and Investments Commission and Susan Bell Research, *REP 240: Compensation for retail investors: the social impact of monetary loss*, May 2011. Available at: http://asic.gov.au/regulatory-resources/find-a-document/reports/rep-240-compensation-for-retail-investors-the-social-impact-of-monetary-loss/
[27] Financial and Consumer Rights Council Inc., *Submission to the House Standing Committee on Economics, Finance and Public Administration: Inquiry into Home Loan Lending Practices and Processes*, August 2007, p. 3.

reported worse health than those with lower levels of debt.[28] Another study of the health effects of debt by BioMed Central (**BMC**) found that 'individuals with unmet loan payments had suicidal thoughts and suffered from depression more often than those without such problems. Unpaid financial obligations were also related to poorer subjective health assessments and health-related behaviour.'[29]

Significant indebtedness can also have a long-term impact on a person's capacity to provide for housing, health, education and retirement.[30] These are serious and profound impacts, and taking appropriate steps (including regulation) to minimise these impacts should be a priority for policy makers. Credit cards are particularly harmful for low-income earners and those who have limited impulse control.

Clearly the impact of misconduct and irresponsible lending can be devastating for victims, but it can also affect the financial sector more broadly. There are significant implications for community trust and confidence in the financial sector. We agree with the Murray Financial System Inquiry, which stated that "confidence and trust in the system are essential ingredients in building an efficient, resilient and fair financial system that facilitates economic growth and meets the financial needs of Australians".[31]

4. The impact on consumer outcomes of executive and non-executive remuneration, incentive-based commission structures, and fee-for-no-service or recurring fee structures.

It is clear that there is a sales culture rather than service culture in our banking industry. We see commissions and targets for product sales, but no incentives for after-sales service or complaints handling.

We need the culture of Australian retail banking to shift away from a hard-sell approach and towards a service focus. Incentivised sales targets (or 'conflicted remuneration') are a clear impediment to that goal. Bank staff themselves have provided examples of a 'target-based, sales-driven culture where their perception is that the imperative is not customer service per se but to sell.'[32]

The risk of harm created by conflicted remuneration was acknowledged during the Future of Financial Advice (**FOFA**) reforms process. Unfortunately, the FOFA ban on conflicted remuneration has so many exemptions that we question whether it has had any significant impact on the overall sales cultures of Australian banks.

Despite the FOFA reforms, conflicted remuneration arrangements are still permitted for the following products (among other exemptions):

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[28] Science Daily, *High credit card debt may be bad for your health study suggests,* March 2000. Available at: https://www.sciencedaily.com/releases/2000/03/000306075256.htm.

[29] Turunen, Elina and Hiilama, Heikki, *Health effects of indebtedness – a systematic review,* April 2014. Available at: https://bmcpublichealth.biomedcentral.com/articles/10.1186/1471-2458-14-489.

[30] Ministerial Council on Consumer Affairs, *Responsible lending practices in relation to consumer credit cards,* Consultation Regulatory Impact Statement, August 2008, 15.

[31] *Financial System Inquiry Final Report*, November 2014, p. xv. Available at: http://fsi.gov.au/files/2014/12/FSI_Final_Report_Consolidated20141210.pdf.

[32] Stephen Sedgwick AO, *Retail Remuneration Review – Issues Paper*, 17 January 2017. Available at: http://retailbankingremreview.com.au/wp-content/uploads/2017/01/Issues-Paper_Retail-banking-remuneration-review.pdf.

- credit products (e.g. mortgages and credit cards)
- basic deposit products (e.g. bank deposit)
- non-cash payment products
- general insurance products
- consumer credit insurance (CCI)

A number of international studies have identified a strong correlation between target-based sales incentives and consumer harm.[33] In early 2016 two major UK banks – the Royal Bank of Scotland (RBS) and NatWest – scrapped cash bonuses for branch staff offering credit cards, loans and mortgages, in clear recognition of the harm such incentives can cause.[34]

Conflicted remuneration ultimately distorts the behaviour of banking staff and encourages the cross-selling of products people don't want or need. Selling products is elevated above considerations of the well-being of customers. This can lead to Australians suffering significant financial harm. A typical example of a product mis-sold via cross-selling is consumer credit insurance (**CCI**). The claims ratio for CCI is only 5%, indicating the product has minimal value for most Australians who purchase it. As set out in section 1A above, 28% of claimants on our DemandARefund.com site indicated that they believed the CCI was mandatory for them to obtain the loan or credit card, and 21% were unaware that they had even purchased the CCI.

Neil's story

Neil was working shift work on a casual basis when he got a car loan. He was told he would only be approved for the loan if he bought a warranty and consumer credit insurance. The consumer credit insurance premiums were $1,775. The salesperson also told him that he would be able to claim on consumer credit insurance if he got no shift work. He made a claim but it was rejected because he hadn't lost his job. This cover was unsuitable to him because of his employment status.

To improve confidence and trust in our banks, we need to ensure that the imperative for bank staff is service rather than sales. Bank staff should be rewarded for providing advice, products and services that genuinely meet their customers' needs and offer them a positive benefit. We have outlined our recommendations for reform below.

Recommendations

29. Require targets for staff to relate to customer outcomes and the appropriateness of products sold, rather than sales.

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[33] A summary of this research is available in Consumer Action Law Centre's submission to the *Retail Banking Review - Terms of Reference* at pages 3-5: http://retailbankingremreview.com.au/wp-content/uploads/2016/10/Consumer-Action-Law-Centre-Submission.pdf.

[34] Boyce, Lee. *NatWest/RBS scrap bonus incentives for staff members pushing products in branch to help 'rebuild customer trust'*, This Is Money.Co.Uk, 20 November 2015. Available at: http://www.thisismoney.co.uk/money/saving/article-3326750/NatWest-RBS-scrap-bonus-incentives-staff-members-pushing-products-branch-help-rebuild-customer-trust.html.

30. Prohibit conflicted remuneration structures whereby an employee's commissions are forfeited unless they have sold a sufficient number of add-on products (e.g. CCI).

31. Prohibit 'accelerator payments', which encourage staff to intensify their sales activity once they have reached a certain sales volume threshold.

32. Require performance assessments of managers to be based on non-sales metrics, such as how well the corporate aims of the organisation are met.

5. The culture and chain of responsibility in relation to misconduct within entities within the sector

As set out above, we strongly support the implementation of DADOs, which we believe will significantly improve the culture and chain of responsibility in relation to misconduct in the sector.[35]

Under the proposed DADOs, issuers will be required to:

- identify appropriate target and non-target markets for their products;
- select distribution channels that are likely to result in products being marketed to the identified target market; and
- review arrangements with reasonable frequency to ensure arrangements continue to be appropriate.

In addition, distributors of financial products will be required to:

- put in place reasonable controls to ensure products are distributed in accordance with the issuer's expectations; and
- comply with reasonable requests for information from the issuer related to the product review.

The above obligations will ensure that product suitability is considered throughout the design, distribution and post-sale process. It will also ensure that distributors remain accountable to issuers, and issuers remain accountable to the regulator for the distribution channels they select.

However, it should be clear that the proposed obligations will not permit distributors to be wilfully blind when issuers fail to identify a target market appropriately or provide inadequate instructions. There will need to be a clear chain of responsibility that ensures distributors can't simply turn a blind eye and wipe their hands clean when they ought to have been aware of breaches by the issuer.

[35] For more information, see Treasury, *Design and Distribution and Product Intervention Power Proposals Paper*, December 2016. Available at: http://www.treasury.gov.au/ConsultationsandReviews/Consultations/2016/Design-and-distribution-obligations-and-product-intervention-power.

Recommendations

33. Ensure design and distribution obligations set out a clear chain of responsibility that will not permit distributors to be wilfully blind when issuers fail to identify a target market appropriately or provide inadequate instructions.

6. The availability and adequacy of redress and compensation to victims of misconduct, including options for a retrospective compensation scheme of last resort

Currently, many consumers are able to seek redress through external dispute resolution services such as the Credit Industry Ombudsman (**CIO**) and the Financial Ombudsman Service (**FOS**). These services offer free, fair and accessible dispute resolution services to consumers who are unable to resolve a dispute directly with a financial services or credit provider. Ombudsman services, in our view, have been one of the greatest advances in consumer protection and redress in the last 30 years.

However, there are high levels of uncompensated loss in the financial services and credit sectors, with statistics from FOS that 23.3 per cent of determinations in the investments and advice jurisdiction remain unpaid.[36] CIO has also stated that a last resort compensation scheme is crucial if consumers are to be compensated for their losses in circumstances where:

- the provider has ceased operating and does not have the resources to pay the compensation awarded; and
- the complaint was not covered under a professional indemnity insurance policy.[37]

Currently, not all credit providers are even required to have a professional indemnity insurance policy. Unless a licensee provides credit assistance, it is merely required to have 'adequate compensation requirements'. We understand that licensees are required to verify their compensation arrangements at the time they apply for their licence, which tends to be a multiple of their average expected loan or lease amount. However, ongoing compliance is only monitored by way of the annual compliance certificate, in which the credit provider self-certifies that they are compliant. The requirement for 'adequate compensation requirements' is therefore meaningless from a consumer compensation perspective, as the regulator may not even discover compensation arrangements are inadequate until after the business becomes insolvent.

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[36] Financial Ombudsman Service, *Unpaid determinations update*, February 2017. Available at: https://fos.org.au/fos-circular-28-home/fos-news/unpaid-determinations-update/.
[37] Credit Ombudsman Service, *Submission - Economics References Committee Inquiry: Scrutiny of Financial Advice*, 2014. Available at: http://www.cio.org.au/assets/1212423/Submission%20-%20Economics%20References%20Committee%20Inquiry%20-%20Scrutiny%20of%20Financial%20Advice.pdf

Carol's story[38]

In early 2012, Carol approached a 'rent-to-buy' caryard to trade in her old car and purchase a larger car. At the time, Carol was living in emergency accommodation and supporting three children. She had limited experience with complex transactions. Due to misrepresentations by staff members, Carol believed that she was buying a car under finance. She traded-in her old vehicle as part of the deal. However, the financial services provider (**FSP**) claimed that the agreement was for short-term rental only. At the end of 2012, the FSP repossessed the new car. The FSP sold both her new car and her old car. Carol lodged a dispute with FOS.

In 2014, FOS made a determination in favour of Carol, finding that the FSP had engaged in misleading or deceptive conduct, irresponsible lending and inappropriate debt collection. Carol was awarded over $10,000 in compensation. The FSP did not pay Carol. Having lost both the new and old cars, Carol was left with no car and no compensation. At the end of 2015, FOS obtained an order for specific performance of the tripartite contract between it, the FSP and Carol in the Magistrates' Court of Victoria in respect of a number of unpaid determinations, including Carol's. The total order against the FSP was for over $50,000. The FSP is insolvent and did not pay.

In Victoria, the Motor Car Traders Guarantee Fund may pay compensation to a consumer as a result of a motor car trader's failure to satisfy a court order. In Consumer Action's view, the FSP met the definition of a 'motor car trader' under the Victorian legislation. Consumer Action assisted Carol to make a claim to the Motor Car Traders Guarantee Fund.

The Fund refused the claim on three grounds:

- The FSP was not a Motor Car Trader under the Act.
- The loss did not arise from a failure to satisfy a Court Order, but rather the FSP's breach of its contract with FOS.
- The Court Order arose from the provision of credit not motor car trading.

Carol remains uncompensated.

We consider that a last chance compensation scheme is necessary, particularly in markets which are dominated by many small players. The last chance compensation scheme should be industry funded, to provide an incentive for good conduct and reduce Government spending. However, it may be appropriate for the Government to make a small contribution to the establishment of a such a scheme, given the wider benefit to the community in reduced calls on social security, health and other welfare services as a result of uncompensated losses. We suggest that the scheme be limited to compensating retail clients only, and that awards of compensation be appropriately tiered and capped.

[38] Consumer Action Law Centre et. al., *Review of the Financial System Dispute Resolution Framework – joint submission*, October 2016. Available at: http://consumeraction.org.au/wp-content/uploads/2016/10/EDR-Review-Joint-consumer-submission-1.pdf.

We have welcomed the Ramsay Review into External Dispute Resolution being given an extended terms of reference to include the making of recommendations about the establishment, merits and design of a compensation scheme of last resort as well as the merits and issues involved in providing access to redress for past disputes. To be effective and go some way to restoring community trust and confidence in the finance sector, it is essential that losses caused by misconduct that remain uncompensated are included in the scope of any scheme.

In terms of the structure of the external dispute resolution framework, our primary position remains that the best framework for dispute resolution in the financial system is a single industry ombudsman scheme for all disputes, including superannuation disputes. In our view, the best way to achieve this is to integrate the Superannuation Complaints Tribunal and CIO into FOS, rather than creating two new schemes.

We have made further comments about access to justice for consumers below.

Recommendations

34. Introduce a last chance compensation scheme for victims of misconduct.

35. Integrate the Superannuation Complaints Tribunal and Credit and Investments Ombudsman into Financial Ombudsman Service.

7. The availability and adequacy of legal advice and representation for consumers and victims of misconduct, including their standing in the conduct of bankruptcy and insolvency processes

Overall, the availability of legal advice and representation for low-income consumers who have been impacted by misconduct is inadequate. We provide free legal advice and financial counselling services to thousands of Victorians each year, many of whom have been impacted by misconduct in the financial services and credit industries. However, there are simply not enough free legal and financial counselling services to meet the huge demand for assistance.

The recipients of free legal assistance typically face a number of barriers to accessing the civil justice system, and if left unresolved, can deepen and complicate existing problems. While access to external dispute resolution services such as CIO and FOS have certainly improved access to justice, there are many instances where consumers still need guidance and representation in order to get fair outcomes. The Productivity Commission, in its Access to Justice Inquiry Report,[39] recognised this and found that there was a role for government in assisting the most vulnerable to uphold their legal rights and resolve disputes. The Commission acknowledged that there is a need for additional funding for the legal assistance sector, as not providing legal assistance can be a false economy as the costs of unresolved

[39] Productivity Commission, *Access to Justice Arrangements*, December 2014. Available at: http://www.pc.gov.au/inquiries/completed/access-justice/report.

problems are often appear in other areas of government spending, including health care, housing and child protection.[40]

In 2011, the report *Consumer Credit Legal Services in Australia* recommended specialist consumer credit legal services be available in every state and Territory in Australia, and that these be integrated with financial counselling services. We have strongly advocated for co-located free legal services and financially counselling across Australia, which we believe is a far more efficient use of resources than a referral process.

There are no free legal services for legal disputes relating to investment losses. Most free legal assistance services only provide advice in relation to very low-income and disadvantaged consumers, meaning many Australians who are affected by investment losses miss out. As we saw with financial advice scandals, many people have had their lives ruined, lost their homes, or lost their retirement savings, but did not qualify for free legal assistance. Many were also precluded from seeking redress from external dispute resolution services such as CIO and FOS due to current compensation caps that would not cover their losses. The Inquiry should note this assistance gap, and recommend funding a legal service to provide assistance around investment disputes where they cause substantial detriment.

Recommendations

36. Provide additional funding for free legal and financial counselling services to meet the huge demand for assistance
37. Establish a legal service to provide assistance around investment disputes where they cause substantial detriment.
38. Increase the number of co-located free legal services and financially counselling across Australia.

8. The social impacts of consumer protection failures in the sector, including through increased reliance of victims on community and government services.

Please refer to section 3 above.

9. Options to support the prioritisation of consumer protection and associated practices within the sector

Please refer to the recommendations made in sections 1 to 8 above.

[40] For more information, see Consumer Action Law Centre, *Priorities for 2017-18 Budget – submission*, January 2017. Available at: http://consumeraction.org.au/wp-content/uploads/2017/01/20170119-Budget-Submission-201718.pdf.

Please contact Katherine Temple, Senior Policy Officer on 03 9670 5088 or at katherine@consumeraction.org.au if you have any questions about our comments on the review.

Yours sincerely

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