



**Submission by the**

**Financial Rights Legal Centre**

**Senate Economic References Committee**

**Inquiry into Consumer Protections in the Banking,  
Insurance and Financial Sector**

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**March 2017**

## About the Financial Rights Legal Centre

The Financial Rights Legal Centre is a community legal centre that specialises in helping consumer's understand and enforce their financial rights, especially low income and otherwise marginalised or vulnerable consumers. We provide free and independent financial counselling, legal advice and representation to individuals about a broad range of financial issues. Financial Rights operates the Credit & Debt Hotline, which helps NSW consumers experiencing financial difficulties. We also operate the Insurance Law Service which provides advice nationally to consumers about insurance claims and debts to insurance companies. Financial Rights took over 25,000 calls for advice or assistance during the 2015/2016 financial year.

Financial Rights also conducts research and collects data from our extensive contact with consumers and the legal consumer protection framework to lobby for changes to law and industry practice for the benefit of consumers. We also provide extensive web-based resources, other education resources, workshops, presentations and media comment.

This submission is an example of how CLCs utilise the expertise gained from their client work and help give voice to their clients' experiences to contribute to improving laws and legal processes and prevent some problems from arising altogether.

For Financial Rights Legal Centre submissions and publications go to  
[www.financialrights.org.au/submission/](http://www.financialrights.org.au/submission/) or [www.financialrights.org.au/publication/](http://www.financialrights.org.au/publication/)

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Credit & Debt Hotline 1800 007 007  
Insurance Law Service 1300 663 464  
Aboriginal Advice Service 1800 808 488

Monday – Friday 9.30am-4.30pm

## Introduction

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Thank you for the opportunity to provide input into consumer protections in the banking, insurance and financial services sector. The Financial Rights Legal Centre (**Financial Rights**) regularly provides significant input into parliamentary inquiry's and reviews into the financial services sector drawing on our experience working with consumers.

As the committee would be aware there have been a large number of reviews and subsequent reforms over the last half decade seeking to investigate and address issues in the financial services sector. Among others, these include:

- the 2012 Future of Financial Advice (**FOFA**) reforms<sup>1</sup> involving a prospective ban on conflicted remuneration structures and volume based payment, in relation to distribution of and advice and a duty of financial advisers to act in the best interests of their clients, subject to a 'reasonable steps' qualification. Further amendments were passed in March 2016.
- 2014's Financial System Inquiry (**FSI**) including recommendations on lifting the standards of financial advice including by introducing minimum professional, ethical and education standards and ensuring remuneration structures in life insurance do not adversely affect the quality of advice consumers receive;
- the Senate Economics References Committee Scrutiny of Financial Advice (**SOFA**) Inquiry 2014-2016 including additional terms of reference on the life insurance industry (2 March 2016)<sup>2</sup>
- the Association of Financial Advisers and the Financial Services Council (**FSC**) 2014 independent Trowbridge Review. The final Trowbridge Report<sup>3</sup> made significant recommendations on adviser remuneration; licensee remuneration; quality of advice; and other insurer practices. The report, has led to a number of reforms, many of which are the basis of the yet to be implemented *Corporations Amendment (Life Insurance Remuneration Arrangements) Bill*<sup>4</sup>
- 2015-16's Review of Small Amount Credit Contracts and subsequent Government Response;

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<sup>1</sup> Including amongst other inquiries the Parliamentary Joint Committee on Corporations and Financial Services inquiry into the Corporations Amendment (Future of Financial Advice) Bill 2011 and the Parliamentary Joint Committee on Corporations and Financial Services inquiry into the Corporations Amendment (Further Future of Financial Advice Measures) Bill 2011 both of which made specific recommendations about the need to monitor the quality of advice about the sale of risk insurance.

<sup>2</sup>[http://www.aph.gov.au/Parliamentary\\_Business/Committees/Senate/Economics/Scrutiny\\_of\\_Financial\\_Advice](http://www.aph.gov.au/Parliamentary_Business/Committees/Senate/Economics/Scrutiny_of_Financial_Advice)

<sup>3</sup> John Trowbridge, March 2015, Review of Retail Life Insurance Advice: Final Report, [http://www.fsc.org.au/downloads/file/MediaReleaseFile/FinalReport-ReviewofRetailLifeInsuranceAdvice-FinalCopy\(CLEAN\).pdf](http://www.fsc.org.au/downloads/file/MediaReleaseFile/FinalReport-ReviewofRetailLifeInsuranceAdvice-FinalCopy(CLEAN).pdf)

<sup>4</sup> [http://www.aph.gov.au/Parliamentary\\_Business/Bills\\_Legislation/Bills\\_Search\\_Results/Result?bId=r56](http://www.aph.gov.au/Parliamentary_Business/Bills_Legislation/Bills_Search_Results/Result?bId=r56)  
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- 2015 Senate Economics References Committee inquiry into Credit Cards with its report title Interest Rates and Informed Choice in the Australian Credit Card Market and subsequent Treasury consultation paper Credit Cards: Improving Consumer Outcomes And Enhancing Competition.
- A series of parliamentary inquiries into the Insurance Sector including the current Life Insurance Inquiry and General Insurance Inquiry.

Financial Rights has provided significant input into all these inquiries with large numbers of case studies relaying the lived experiences of financially vulnerable consumers and their interaction with the financial services sector.

Financial Rights intends with this submission to provide some of those lived experiences and our suggestions for the failures in the current regulatory framework drawing upon our 30 years of advice and case work experience and expertise.

We provide input on the following terms of reference:

- a. any failures that are evident in the current laws and regulatory framework, and enforcement of the current laws and regulatory framework, including those arising from resourcing and administration; (NB: Term of Reference b “the impact of misconduct in the sector on victims and on consumer” is integrated into our response to Term of Reference a) **(at page 18)**
- c. the impact of consumer outcomes of incentive-based commission structures **(at page 119)**
- e. (ii) 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 (NB Term of Reference e.i. is also integrated into our response to Term of Reference a.) **(at page 121)**

## Executive Summary

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Financial Rights has worked with vulnerable consumers of banking, insurance and finance services for 30 years, providing expert advice, information, casework assistance and education.

We believe that a number of regulatory reforms in the financial services sector in the past decade – including the introduction of compulsory external dispute resolution and the responsible lending – have greatly improved and strengthened the consumer protection framework and are generally serving Australian consumers well.

There are however a great number of problems, gaps and failures with the current consumer protection regime that have tremendous consequences upon those experiencing financial stress and hardship. The raft of scandals that have beset the financial services sector recently are indicative of these problems but Financial Rights works daily with financially vulnerable Australians caught out and frustrated by the plethora of minor and major loopholes and regulatory gaps, as well as poor service resulting from a profit driven culture.

While there have been many numerous government inquiries (FOSA, FSI, SOFA, the Ramsay Review), industry inquiries (Trowbridge Report, Enright Review, Khoury Review) and a number of planned reforms (SACC, Credit Cards, Remuneration) there still remains fundamental issues that remain unresolved and require reform.

We have drawn upon our frontline experience of working with consumers to identify the key failures and gaps in the regulatory framework and subsequently put forward our recommendations on what needs to be done to fill those gaps and fix the system.

In banking and credit Financial Rights believes there is much to be done improve and reform the consumer protection framework, from closing off loopholes and reigning in poor practices in the responsible lending and financial hardship space to ensuring better practices in relation to card cancellations, direct debit cancellations and charging of fees.

With respect to the insurance sector Financial Rights believes that the industry is at least 20 years behind the banking sector in terms of addressing basic consumer issues be it in claims handling, mis-selling, unfair contract terms, disclosure problems and the creation of problem products and business models. Financial Rights strongly believes that there needs to be a fundamental shift in the regulation of the insurance industry to one based upon the concepts of suitability (the insurance equivalent of responsible lending in the banking and credit sector) and the standard cover model. While Financial Rights details a litany of specific reforms required to better protect insurance policyholders and consumers in general, we strongly believe a total re-think in Australia's regulatory approach to insurance is justified and well overdue.

Financial Rights also identifies failures in the current legal and regulatory framework that apply to the financial services sector as a whole (for example, external dispute resolution) as well as the gaps in the current law that allow some financial services and products to slip

through and be left unregulated (eg debt management firms and no interest payment services) despite producing significant harm to consumers.

Our submission is long and detailed with a large number of recommendations but feel that it is important to provide a full and comprehensive picture of the failures and gaps in our legal and regulatory framework that impact upon the lives of millions of Australian consumers

## Recommendations

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### General consumer protections in financial services

#### Applying consumer protection powers to financial products

1. The ASIC Act should be amended to explicitly apply its consumer protections to financial products.

#### Design and Distribution Obligations and Product Intervention Powers

2. The current Treasury proposal for design and distribution obligations and product intervention powers should be introduced and strengthened to include
  - a. regulated and unregulated credit products;
  - b. distributors who do not receive a benefit from issuers of products; and
  - c. ASIC intervention powers be allowed to continue until ASIC or the Government decides to cease the intervention.

#### Dispute Resolution and Complaints Framework

3. There should be a single industry ombudsman scheme for all disputes in the financial system, including superannuation disputes. The SCT and CIO should be integrated into FOS and
  - a. adopt the FOS model;
  - b. include life insurance;
  - c. be required to implement findings of systemic issues investigations;
  - d. consider disputes (in limited circumstances) after a court judgment has been entered; and
  - e. have its compensation caps increased.
4. ASIC should be appropriately resourced to undertake increased oversight of industry ombudsman schemes.
5. ASIC should be able to give directions to the new ombudsman schemes to remedy any failure to comply with the Benchmarks for Industry-based Customer Dispute Resolution.
6. ASIC should have greater oversight of Internal Dispute Schemes, publish details of non-compliance or poor performance, including identifying financial service providers and ensure that IDR reporting regimes are required to have clear and consistent terminology across all financial service providers to ensure the data is comparable.
7. An industry-funded compensation scheme of last resort should be introduced. The compensation scheme should:
  - a. apply to all financial services providers, including credit licensees and operators of managed investment schemes;

- b. only accept claims from retail clients (consumer claims) and operate as a last resort scheme, that is, only be available for claims after all avenues have been exhausted, including a relevant award from an EDR scheme or a court and professional indemnity insurance;
- c. not require an ombudsman scheme to enforce its determination in court as a precondition to compensating an affected consumer; however, after the scheme has compensated the affected consumer, the scheme should be able to recover from the financial service provider on a subrogated basis;
- d. involve people with relevant industry and consumer experience in its governance, based on the existing industry ombudsman model;
- e. award compensation at levels aligned with EDR caps that are reviewed and increased over time;
- f. be retrospective in application; and
- g. be funded by industry, through a levy imposed by the government.

### **Debt Management Firms**

- 8. A seamless regulatory framework should be introduced for debt management firms. All debt management firms should be required to hold a relevant licence, have minimum required standards such as a fit and proper person test and maintain membership of an ASIC-approved industry ombudsman scheme.

### **No Interest Payment Service**

- 9. All No Interest Payment Services should be regulated under the National Credit Code (NCC)<sup>5</sup>, should be required to hold a relevant licence and maintain membership of an ASIC-approved industry ombudsman scheme.

### **Insolvency: Bankruptcy and Part IX Debt Agreements**

- 10. Part IX of the *Bankruptcy Act* should be repealed.

### **Self Regulation: Financial Services Sector Codes of Practice**

- 11. The Government should work with industry organisations administering Codes of Practice to ensure that each Code's Standards are lifted and subsequently approved by ASIC in accordance with RG 183.
- 12. The ABA should improve their Code of Practice to meet the standards set by ASIC RG 183 and seek approval from ASIC for their Code. If the ABA chooses not to seek approval of its code in accordance with ASIC RG183, the Government should intervene to ensure that this takes place.

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<sup>5</sup> The National Credit Code forms a schedule to the National Consumer Credit Protection Act 2009 and applied to all consumer lending and lending for investment in residential real estate.

13. Government should identify those parts of the banking sector not covered by the Code of Banking Practice and ensure that minimum standards apply to all finance providers in the banking, finance and credit sectors.
14. The ICA should implement a fully independent, complete review of the General Code of Practice with fully transparent and open public consultation. The ICA should also improve their Code of Practice to meet the standards set by ASIC RG 183 and seek approval from ASIC for their Code. If the ICA chooses not to seek approval of its code in accordance with ASIC RG183, the Government should intervene to ensure that this takes place.
15. The Government needs to ensure that the FSC follow through on commitments to improve standards in relation to advisers, problem products such as funeral insurance and CCI, sales practices, medical definitions and mental health obligations. The Government must ensure that the FSC improve their Code of Practice to meet the standards set by ASIC RG 183 and seek approval from ASIC for their Code. If the FSC chooses in 18 months not to seek approval of its code in accordance with ASIC RG183, the Government should intervene to ensure that this takes place.
16. We recommend that the Government ensures that the superannuation sector develop a Code of Practice that works symbiotically with the Life Insurance Code of Practice and that this new Code be approved with ASIC in accordance with RG 183
17. The Government should review the *Superannuation (Resolution of Complaints) Act 1993* with an eye to improving consumer protections and improving consumer outcomes relating to claims handling.
18. The Government should ensure that NIBA, MFAA and COBA review and improve their Codes of Practice to meet the standards set by ASIC RG 183 and seek approval from ASIC for their Codes. If these organisation choose not to seek approval of their coded in accordance with ASIC RG183, the Government should intervene to ensure that this takes place.

## General and Life Insurance Sectors

### Sales practices, advertising and marketing

19. An appropriately formulated and monitored delay regime including an opt-in days after the sale of the loan initiated by the consumer should be introduced.
20. The exemptions for life insurance under the anti-hawking rules to prevent unsolicited sales should be removed.
21. ASIC and APRA should establish a consistent public reporting regime requiring insurers to fully and transparently publicise their claims pay-out ratios, as occurs in the UK, as well as claims handling timeframes and dispute levels across all policy types. Data should be made available on an industry and individual insurer basis.
22. The government should implement an individual suitability test for insurance products at point of sale.

23. ASIC should review 2012's RG 234 *Advertising products and advice services including credit: Good practice guidance* to tighten the rules around life insurance (and general insurance) marketing claims.

### **Insurance Claims Handling**

As recommended in ASIC Report 498, Financial Rights recommends that:

24. ASIC establish, with APRA, a new public reporting regime for life insurance industry claims data and claims outcomes and that this data be made accessible and available to all consumers at point of sale and renewal. ASIC should also ensure that this data is fully transparent including attaching insurer names to the claim rates.
25. The Government should strengthen the legal framework covering claims handling including the removal of the exemption of 'handling insurance claims' from the conduct provisions of the Corporations legislation and that more significant penalties for misconduct in relation to insurance claims handling be introduced in ASIC's penalty powers.
26. The consumer dispute resolution framework for claims handling be strengthened under the Government response to the current Ramsay review by ensuring better and more effective consideration of issues of fairness to supplement the existing jurisdiction and giving better access to consumers with complaints about delays in claims handling and ensure better remedies when these complaints are found in favour of the consumer.
27. ASIC undertake targeted follow-up reviews on areas of concern, including for individual insurers with high decline, withdrawal and dispute rates, as well as review life insurance sold directly to consumers without personal advice.
28. The insurance sector comply with ASIC's expectation that it undertake an immediate review of the currency and appropriateness of policy definitions; examine and ensure advertising and representations about the cover align with the definitions and the policy, and report any discrepancies to ASIC; ensure that claims timeframes are consistent with industry standards and expected claims timeframes are adequately communicated to policyholders; and ensure that incentives and performance measurements for claims handling staff and management do not conflict with the obligation to assess each claim on its merit. The results of this should be report by ASIC in the lead up to the first review of the newly introduced Code.
29. The Government consider legislative reform to impose strict time limits on life insurers to decide claims.
30. The Federal and State Governments through the Council of Australian Governments should develop uniform private investigator licensing regulations with an enforceable code of conduct.
31. The Federal and State Governments through the Council of Australian Governments should develop uniform surveillance and listening devices laws that provide for strong consumer protections including stricter protections for members of the public; greater certainty to consumers and businesses; technological neutrality to ensure that all (known and developing) forms of surveillance be captured; and removal of "participant

“monitoring” exceptions (found in Qld, Vic, and NT), i.e. outlaw the recording by one party to a private conversation or activity without the consent of other parties.

#### Unfair contract terms, standard cover and standard terms

32. The exemption for insurance products under the UCT regime should be removed.
33. Remove subsection 35(2) of the *Insurance Contracts Act* – that is, the standard cover “get out of jail” clause.
34. Introduce a complimentary suitability requirement.
35. Introduce marketing obligations to draw the insured’s attention to product elements that stray from standard cover, and
36. Introduce a default cover regime requiring insurers to carry standard cover products and placing the consumer in this default cover unless they explicitly choose different cover.
37. Ensure that the general product design and distribution requirement also applies to insurance, noting that the government has recently released a proposal paper on design and distribution obligations on issuers and distributors of financial products and a product intervention power for ASIC.<sup>6</sup>
38. Remove section 15 of the *Insurance Contracts Act* which currently excludes the operation of other laws which, for example, provide for judicial review of a contract on the grounds of harshness or unconscionability or relief from the consequences of misrepresentation.
39. The Government should step in to mandate minimum standard medical definitions for inclusion in life insurance policies to be reviewed and regularly updated by *independent* medical specialists.
40. Policy reform should be implemented, as recommended by ASIC, to allow upgrades of existing life insurance policies on a portfolio basis to more current definitions, where this is beneficial to policyholders, allowing any premium impact to be spread across the portfolio.

#### Insurance Disclosure

41. Section 75 of the *Insurance Contracts Act 1984* should be amended to require insurers to provide written reasons for why premiums were increased on request in writing from a policy holder. These reasons should include any increased risk factor that the insurer has become aware of.
42. Alternatively, if legislative change is not feasible, the General Insurance Code of Practice should be amended to include a requirement for the insurer’s IDR team to provide reasons for significant premium increases after a request in writing by the policy holder.

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<sup>6</sup> Treasury, Design and Distribution Obligations and Product Intervention Power, Proposals Paper, Dec 2016  
<http://www.treasury.gov.au/~/media/Treasury/Consultations%20and%20Reviews/Consultations/2016/Design%20and%20distribution%20obligations/Key%20Documents/PDF/Design-and-distribution-obligations.ashx>

43. Change FOS Terms of Reference to allow disputes about the level of a premium if there has been an unfavourable change to an insurance policy (or if the insured has recently undertaken mitigation strategies on their home which have not resulted in a reasonable reduction of premiums) and the insurer's IDR response has failed to include adequate reasons for the change.
44. Insurers should be required to provide component pricing of premiums.
45. Government should establish a clearinghouse website (or any alternative government supported measure) to ensure data consistency and reliability of natural hazard mapping and modelling.
46. Improve the ICA's Building Resilience Rating Tool
47. Insurers (including life insurers) should provide the previous year's premium on the annual renewal notice including
  - the price of the new policy if the consumer renews;
  - any difference between the new price and the old price; and
  - the reasons for any change.
48. Insurers should provide more meaningful information regarding the risks of replacing insurance products, the design of which should be informed by peer-reviewed behavioural research.
49. Insurers should provide premium hardship options under every policy they provide and provide this information on the renewal notice.

### **Insurance Reporting**

50. The Federal Government should introduce insurance reporting regulations to bolster consumer and privacy protections.

## **Banking and Credit Sector**

### **Comprehensive Credit Reporting**

51. Mandatory credit reporting should not be implemented or considered.
52. An independent review should be conducted into the effectiveness of the new credit reporting laws after 5 years commencing in March 2019.
53. The Office of the Australian Information Commissioner should be funded appropriately to deal with increased consumer data privacy concerns
54. Regulators must ensure that credit reporting agencies enable access to a free credit report to all Australians once every twelve months (and in some additional circumstances) and that access to these free credit reports is as easy as getting a paid report.
55. Credit reporting agencies should be policed to ensure that they are meeting the requirements regarding the use of consumers' personal information for marketing, the

content of free reports, and the timeframes in which reports must be provided to consumer.

56. Lenders who are reporting RHI to any credit reporting agency should be obligated under Privacy Law to notify a consumer by way of their regular statements what numeric code has been submitted to the credit reporting agency for the previous repayment cycle, what that Code means and if relevant, how they can avoid any negative information being listed in future. Where statements are sent less regularly than monthly, timely notification should be given by alternative means.
57. Any new laws relating to data should be included in the Privacy Act. A separate new Act should not be considered.
58. Any proposal for a new data sharing regime should involve a comprehensive review of Australia's privacy laws with appropriate additions to ensure adequate privacy laws for the protection of all Australians.
59. A review of data quality protections are required given the serious systemic issue with accuracy already identified

### **Financial Hardship**

60. The *National Credit Act* should be amended to give small business and individual investor banking customers the same rights as those currently provided to consumers of regulated credit under the NCC, including acceptance of a broadly defined hardship notice; flexible hardship repayment arrangement options, stays of enforcement and a right to go to EDR.
61. Either the a new industry EDR scheme, or FOS, should provide small business with monetary limits and compensation caps that are higher than the current arrangements, and that are subject to regular indexation.

### **Sales Incentives and Bundling Add-ons**

If the financial services industry does not effectively self-regulate to resolve the issues listed below (in the current Code of Banking Practice Review and other Codes of Practice), the Federal Government must enact legislative reforms which:

62. include commitments that arise from the current Independent Review of Product Sales Commission and Product Based Payments;
63. institute suitability requirements with respect to all sales within banks and other financial service providers, at minimum requiring that consumers are left no worse-off from switching to another product or purchasing the additional product;
64. introduce a mandatory delay of at least 4 days between the sale of the primary product and the sale of the add-ons;
65. allow the promotion of products but prohibit the completion of a sales transaction until the consumer takes a step to opt-in. That is, the consumer would have to call the salesperson themselves (after the mandatory delay) and say that they want to buy the product

66. commit banks and all third party financial service sellers to tell a customer that they can buy the add-on product elsewhere and be given information on how to shop around.
67. prohibit the sale of add-on products via an 'opt-out' mechanism, such as where the contracts have a pre-ticked box saying that the consumer agrees to buy the add-on unless they say otherwise.
68. require banks and all financial service providers to review the cover offered by add-on products on a regular basis, to assess whether it meets the needs of the consumers who are buying.
69. require banks and all financial service providers to review their sales practices for add-on products on a regular basis, to ensure they assist consumers provide informed consent in respect of both the cost and the cover offered

### **Credit Cards**

Legislative reform should mandate the financial services sector to:

70. assess all credit card applications on the basis that the customer has the capacity to pay the account out in full within three years if it has been fully drawn to its designated credit limit;
71. not offer unsolicited credit card limit increases by phone, face to face or any other way;
72. increase minimum repayment amounts on all new accounts;
73. if the credit card is being obtained to purchase goods in a linked credit transaction, the limit for the credit card cannot exceed the price of the goods.
74. ask all consumers the credit limit they are seeking and not approve a limit above that requested
75. provide a right to cancel a credit card and reduce their credit limit in writing and an easy to use automated process on online banking and phone banking
76. provide consumers with notification of how much credit they have used at no cost.
77. Legislative reform should commit the banking industry to undertake not to offer low interest/interest free honeymoon period on cards including on balance transfers; or alternatively
  - a. provide consumers with timely electronic notification of balance transfer expiry periods;
  - b. not offer honeymoon periods for periods of less than 12 months; provide regular disclosure of how much should be repaid per month to pay off the debt within the honeymoon period;
  - c. require consumers to close the original account from which the balance was transferred.

## Cancelling Direct Debits

78. Government should examine ways to ensure that banks commit to providing ways for a customer to cancel a direct debit via both phone banking and online banking.
79. Despite the views expressed in the Khoury review, consideration should be given introduction of the payment of a fine in addition to reimbursement of any actual loss incurred as a result of a debit overdrawing a consumers account, if a bank has not implemented a direct debit when instructed do so.
80. A prohibition on fees being charged to stop a direct debit or recurring payment on their own credit or debit card account.
81. Ensure that consumers can cancel recurring payments on credit cards without requiring the customer to contact the debit user.
82. Require that banks not set a timeframe for reporting unauthorised transactions and other transactions that may qualify for a chargeback that is more than seven days less than the timeframe set by card providers

## Fees and Charges

Financial Rights recommends that the Government address consumer concerns with excessive fee charging. The Government should commit banks to:

83. Examine their fees structures to address the extent to which any of their fees are regressive;
84. Limit the charging of fees for breaches of terms and conditions or default to a maximum of the direct costs incurred as a result of the breach;
85. Ensure bank fees and charge will not trigger further fees;
86. Provide consumers a warning that a fee will be imposed if a particular transaction goes ahead, and if a particular service will incur a fee both when the customer opts into the service and when the fee is incurred;
87. When a bank offers services through physical branches, not charge fees for face to face interaction with branch staff or penalties for going into a branch;
88. Not charge for providing a document under this Code in the following circumstances:
  - i. Where documents or computer access have been lost due to family violence or natural disaster;
  - ii. The customer has a low income with Centrelink benefits as their main source of income.
89. Financial Rights notes that recommendations in other sections of this submission are also relevant including:
  - a. Not charging customers default fees while the bank is considering a hardship arrangement
  - b. Account suitability.

## Responsible Lending

90. Government should implement the recommendations of the Parliamentary Joint Committee on Corporations and Financial Services' Report on *Impairment of Customer Loans*

## Refunding Lender's Mortgage Insurance

The Government should ensure that:

91. only the actual cost of the LMI to the bank is paid by the consumer;
92. banks pass on any rebate they are entitled to receive on LMI to the customer who has paid the premium in the event of a refinance;
93. bank provide clear information to customers about how and when a rebate may be claimed as apart of the documents provided when getting the loan; and
94. a key fact sheet is provided to better explain this product to consumers.

## Small Amount Credit Contracts and Consumer Leases

95. All small amount credit contracts and consumer leases should be subject to a 48 per cent cap.

## Mortgage Brokers

96. The government should take urgent action to expose and address conflicts of interest driving poor behavior in the mortgage broking market;
97. The responsible lending provisions of the *National Credit Act* should be enhanced to improve the standards of advice provided by credit assistants (brokers);
98. The design and distribution obligations and product intervention powers currently being consulted on by Government should include credit products within its purview.

## Exemptions in NCCPA for Point-of-Sale Vendors

99. Apply the Credit Act without modification to POS retailers. Where a POS retailer is engaging in credit activities, by performing or undertaking functions regulated by the Credit Act, they would be required to either: a) hold an ACL; or b) be appointed as a credit representative of a licensee.
100. POS retailers engaging in credit activities should have to be a member of a recognised external dispute resolution scheme.

## The impact of consumer outcomes of incentive-based commission structures

### Remuneration

101. The *Corporations Amendment (Life Insurance Remunerations Arrangements) Bill (2015)* needs to be passed as soon as possible without amendment.
102. The Federal Government needs to set a clear date for the removal of all commissions in life insurance advice, starting by phasing out up-front commissions shown to lead to the worst consumer outcomes.

## **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**

### **Legal advice and financial counselling for banking consumers**

103. The Federal Government should develop an ongoing and sustainable, industry-contributed model for free and independent financial counselling and legal advice to vulnerable consumers with credit and debt problems.

### **Legal services for insurance consumers**

104. The Federal Government should support independent and free legal assistance for vulnerable consumers subject with insurance problems through the development of an ongoing, sustainable funding for the national ILS including the AAS.

### **Legal advice for financial advice consumers**

105. Financial Rights recommends that Government needs to fund a Financial Advice Assistance Service pilot to provide casework assistance to consumers affected by poor financial planning advice.

## 1. Failures that are evident in the current laws and regulatory framework and enforcement

Financial Rights has drawn upon our 30 years of working with consumers to identify the key failures and gaps that currently exist in the regulatory framework and put forward our recommendations on what needs to be done to fill those gaps. We break down the areas into the following categories and sub categories:

### General Consumer Protections in Financial Services (page 20)

Financial Rights identifies failures in the current legal and regulatory framework that apply to the financial services sector as a whole (for example, external dispute resolution (**EDR**)) as well as the gaps in the current law that allow some financial services and products to slip through and be left unregulated (eg debt management firms and no interest payment services) despite producing significant harm to consumers.

- Applying consumer protections to financial products ([page 20](#))
- Design and Distribution Obligations and Product Intervention Powers ([page 21](#))
- Dispute Resolution and Complaints Framework ([page 24](#))
  - Strengthen and enhance EDR by increasing jurisdiction
  - Regulatory oversight by ASIC
  - Last Resort Compensation Scheme
  - Superannuation Complaints
- Debt Management Firms ([page 26](#))
- No Interest Payment Services ([page 28](#))
- Insolvency: Bankruptcy and Part IX Debt Agreements ([page 30](#))
- Self-regulation: Financial Services Sector Codes of Practice ([page 32](#))
  - The Code of Banking Practice
  - The General Insurance Code of Practice
  - The Life Insurance Code of Practice
  - A potential Group Insurance Code of Practice
  - Insurance Brokers Code of Practice, MFAA Code of Practice and Customer Owned Banking Code of Practice

### General and Life Insurance sector ([page 41](#))

Through our extensive case work on the Insurance Law Service, Financial Rights identifies the key failings in the insurance legal framework and argues for the need to shift insurance regulation to a suitability and standard cover model as well as recommending specific reforms to address particular consumer harms.

- Insurance sales practices advertising and marketing ([page 48](#))
  - Poor and aggressive sales practices
  - Add-on sales practices through third parties (car yards etc)
  - Sale of consumer credit insurance and other insurance products through banks
  - Direct insurance and suitability obligations
  - Advertising and marketing
- Insurance Claims Handling ([page 48](#))

- Surveillance and Investigations
- Unfair Contract Terms, Standard Cover and Standard Terms (**page 54**)
  - Unfair Contract Terms
  - Standard Cover
  - Standard Terms and Default Cover
  - Standard Medical Definitions
- Insurance Disclosure (**page 64**)
  - Premium transparency and contestability
  - Disclosure of Component Pricing
  - Previous year's annual premium
- Insurance Reporting (**page 74**)

### **Banking and Credit Sector (page 77)**

Financial Rights has been the NSW answer point for the National Debt Helpline for over 10 years. We offer financial counselling as well as legal advice and casework to over 16,000 consumers each year, most of whom are having difficulty with one or more credit products. This experience enables us to identify the key failings in the banking and credit legal protection frameworks and recommend specific reforms to address particular consumer harms.

- Comprehensive Credit Reporting (**page 77**)
  - Proposals to increase Data Availability
  - RHI & Hardship
- Financial Hardship (**page 83**)
  - Inadequate compliance with NCC (RHI & Hardship)
  - Consumers not covered by NCC (small business & investors)
- Sales Incentives and Bundling Add-ons (**page 90**)
- Credit Cards (**page 94**)
  - Responsible Lending
  - Honeymoon offers
- Cancelling direct debits (**page 99**)
  - Savings and transaction accounts
  - Credit Schemes (Visa and Mastercard)
- Fees & Charges (**page 101**)
  - Current fees and charges
  - Innovative services generate yet more fees
- Responsible Lending (**page 105**)
  - Loan practices: Impairment of Customer Loans Reports
  - RG209 & compliance
- Refunding Lenders Mortgage Insurance (**page 107**)
- Mortgage Brokers (**page 112**)
- Small Amount Credit Contracts and Consumer Leases (**page 108**)
- Exemptions in NCCPA for Point-of-Sale Vendors (**page 114**)

## General consumer protections in financial services

### Applying consumer protection powers to financial products

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Financial products and services are explicitly excluded from provisions of the Australian Consumer Law (**ACL**) by section 131A of the *Competition and Consumer Act 2010* (Cth). Consumer protection for financial services (and indirectly, conduct related to financial products) is provided by Part 2 Division 2 of the *Australian Securities and Investment Commission Act* (**ASIC Act**) which mirrors a number of **ACL** provisions.<sup>7</sup> The current review into the **ACL** is examining the issue of whether the application of these protections should be expanded to explicitly capture financial products.

It is Financial Rights view that the current consumer protections under Part 2, Division 2 of the **ASIC Act** apply largely to financial services but not to financial products. Section 12BAB defines the “meaning of a financial service” when someone

- (a) *Provide[s] financial product advice ...; or*
- (b) *deal[s] in a financial product ...; or*
- (c) *make[s] a market for a financial product ...; or*
- (d) *operate[s] a registered scheme; or*
- (e) *provide[s] a custodial or depository service ...; or*
- (f) *operate[s] a financial market ... or clearing and settlement facility ...; or*
- (g) *provide[s] a service (not being the operation of a derivative trade repository) that is otherwise supplied in relation to a financial product (other than an Australian carbon credit unit or an eligible international emissions unit); or*
- (h) *engage[s] in conduct of a kind prescribed in regulations made for the purposes of this paragraph.*

As this definition indicates, financial services relate to financial products but it is far from clear as to the interaction. Financial products are defined under Section 12BAA as

*a facility through which, or through the acquisition of which, a person does one or more of the following:*

- (a) *makes a financial investment ...;*
- (b) *manages financial risk ...;*
- (c) *makes non-cash payments*

Given the limited and indirect nature of the application of consumer protections for financial services, consumers are left open to exploitation when purchasing a financial products and are left with less rights to protect them than when purchasing other goods or services.

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<sup>7</sup> The **ACL** review further notes that consumer protection for financial services is provided by Part 2 Division 2 of the **ASIC Act** which mirrors a number of **ACL** provisions, with the *National Consumer Protection Credit Act 2009* (Cth) and *Corporations Act 2001* (Cth) also providing some protection.

The ACL interim report notes that some key ACL protections that have not been carried over to apply to financial products and services including:

- consumer guarantees
- unsolicited consumer agreements
- single pricing, and
- proof of transaction.

One element that does not transfer over from the ACL to a financial product, for example, is the fit for purpose regime. Under the consumer guarantee, products and services must be fit for purpose – that is be fit for the purpose the business told you it would be fit for and for any purpose that you made known to the business before purchasing. The equivalent section under the *ASIC Act* is section 12ED where there is an implied warranty that the financial services supplied will be “reasonably fit for that purpose ....”

Financial products are not all subject to this same consumer protection under the *ASIC Act* or ACL. Some financial products such as all credit contracts are subject to the suitability regime under the *National Credit Act*. Insurance products, however, are not subject to any suitability or fit for purpose test.

Even as applied to financial services section 12ED remains limited in scope as it doesn't impose a positive obligation on the financial service provider to look into the personal circumstances of the consumer.

This situation needs to be clarified and amended to ensure that consumers receive equal protections in their consumption of non-financial goods and services and financial goods and services. Financial Rights notes that the fit for purpose regime has not been listed as one of the elements that need clarity under the *ASIC Act*. We recommend that every single consumer protection applying to goods and services generally be applied to financial goods (products) and services under the *ASIC Act*.

Applying the fit for purpose (or product suitability) regime to financial products would be transformative and ensure less exploitation of consumers in the financial services sector.

## Recommendation

That the *ASIC Act* be amended to explicitly apply its consumer protections to financial products.

## Design and Distribution Obligations and Product Intervention Powers

Financial Rights notes that the Financial Services Inquiry recommended the introduction of a targeted, principles-based product design and distribution obligation<sup>8</sup> which has subsequently

<sup>8</sup> Financial System Inquiry, December 2014, Recommendation 21, available at: <http://fsi.gov.au/publications/final-report/chapter-4/accountability/>

been supported by Government.<sup>9</sup> Treasury has now released a proposals paper for public consultation.<sup>10</sup> The introduction of a design and distribution obligation and product intervention powers is an important part of a suite of new regulations aimed at the financial services sector including Future of Finance Advice reforms, a proposed tightening up of Small Amount Credit Contract regulations, a review of Credit Card regulations and others.

The current Treasury proposal paper refers to the general movement away from simply relying on disclosure as the key consumer protection in the financial services space:

*The FSI outlined the limitations of relying on disclosure as the main form of consumer protection for financial consumers. Over time, disclosure has been supplemented by other forms of protections aimed at making firms more directly accountable. For example, in the Future of Financial Advice (FOFA) reforms, there was a shift from requiring financial advisers to disclose conflicted remuneration (such as, commissions) to banning these remuneration structures (subject to specific exemptions). Implementation of the measures proposed in this paper would extend the approach of supplementing disclosure as the main form of consumer protection more broadly throughout the financial product lifecycle.<sup>11</sup>*

Financial Rights commends the government for the introduction of a design and distribution obligation and product intervention powers and fully supports this shift to make financial service providers more accountable. However we feel that this current proposal needs to be extended and the government needs to take more steps to build accountability into the financial services sector.

Further detail will be provided in a joint consumer representative submission on the proposals paper however it is worth noting here a small number of key points.

Under the proposal, design and distribution obligations and product intervention powers will apply to financial products made available to retail clients including insurance products, investment products, margin loans and derivatives. The obligations would however not apply to credit products or ordinary shares. Financial Rights strongly believes that this needs to be reconsidered and that they need to apply to both regulated and unregulated credit products. This is because:

- a. responsible lending obligations do not provide the full gamut of protections that a design and distribution obligation will provide:

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<sup>9</sup> Improving Australia's financial system: Government response to the Financial System Inquiry "The Government agrees to create a targeted and principles-based financial product design and distribution obligation. Implementation of this recommendation will be subject to detailed consultation with stakeholders to ensure that the scope of the obligation enhances consumer protection without placing an undue burden on industry."

[http://www.treasury.gov.au/~/media/Treasury/Publications%20and%20Media/Publications/2015/Government%20response%20to%20the%20Financial%20System%20Inquiry/Downloads/PDF/Government\\_response\\_to\\_FSI\\_2015.ashx](http://www.treasury.gov.au/~/media/Treasury/Publications%20and%20Media/Publications/2015/Government%20response%20to%20the%20Financial%20System%20Inquiry/Downloads/PDF/Government_response_to_FSI_2015.ashx)

<sup>10</sup> Design and Distribution Obligations and Product Intervention Power, Proposals Paper, 2016  
<https://www.treasury.gov.au/~/media/Treasury/Consultations%20and%20Reviews/Consultations/2016/Design%20and%20distribution%20obligations/Key%20Documents/PDF/Design-and-distribution-obligations.ashx>

<sup>11</sup> Ibid p.3

- a. design and distribution obligations apply during product design, responsible lending applies only at the point of sale;
- b. the regulator needs to intervene before the harm can take place, which is the whole point of the design and distribution obligation. Carving credit out will lead significant regulatory arbitrage with banks capitalising on this loophole;
- c. responsible lending has a weak “not unsuitable” standard, design and distribution obligations ensure that products are designed to be safe and suitable;
- d. design and distribution obligations will require agreement on how a product is distributed with controls in place. With responsible lending obligations there are fewer oversight controls.
- e. There is no evidence to date that unsuitability requirements has prevented the creation and sale of harmful credit products.

- b. financial services providers are designing harmful products and targeting vulnerable people, eg funeral insurance being targeted at indigenous communities and pay day loans and consumer leases targeted at those who can least afford the products.
- c. Unregulated credit products such as pawn broking and non-interest payments services such as Certegy Ezi Pay and AfterPay are not subject to responsible lending laws nor the requirement to be a member of an EDR scheme.

Financial Rights also supports expanding the proposal in the following way:

- Distributors who do not receive a benefit from issuers of products should also be covered, and
- Australian Securities and Investments Commission (**ASIC**) interventions should not be limited to an initial duration of 18 months but should continue until ASIC or the Government decides otherwise.

If these recommendations to strengthen the proposal are supported this would go a long way to ensure that the most vulnerable of Australian consumers are protected from the worst excesses of financial service providers.

However as mentioned above Financial Rights supports the need for further consumer protection measures to reign in financial service providers further. This submission goes into great detail into what these are with respect to banking, insurance and other financial service products more specifically but generally speaking, a move to strengthened suitability obligations on financial service providers is essential.

## Recommendations

That the current Treasury proposal for design and distribution obligations and product intervention powers be introduced and strengthened to include

- a. regulated and unregulated credit products;
- b. distributors who do not receive a benefit from issuers of products; and
- c. ASIC intervention powers be allowed to continue until ASIC or the Government decides to cease the intervention.

## Dispute Resolution and Complaints Framework

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### Strengthen and enhance EDR by increasing jurisdiction

Financial Rights notes that the Ramsay Review into the EDR and complaints schemes is currently in its final stages and will be producing a final report soon

Financial Rights strongly supports Draft Recommendation 1 that moving to a single industry ombudsman scheme for all financial, credit and investment disputes will have substantial benefits for consumers relative to the status quo. Our full position with respect to the current Ramsay Review recommendations can be found in the joint consumer submission.<sup>12</sup> We feel that it is worth highlighting below in this submission a number of the key issues relating to gaps in the current laws and regulatory framework that need to be addressed to bolster consumer protections. Other issues brought up in this review relating to for example, Debt Management Firms, will be addressed elsewhere in this submission.

### Regulatory oversight by ASIC

We believe that ASIC needs to have more oversight of the ombudsman schemes and:

- should be able to give directions to the new ombudsman schemes to remedy any failure to comply with the Benchmarks for Industry-based Customer Dispute Resolution
- should be appropriately resourced to undertake increased oversight of industry ombudsman schemes; and
- should have an enhanced role in responding to complaints about poor Internal Dispute Resolution (IDR)

With respect to the first point, ASIC, for example, has recommended in its recent *Report 498 Life Insurance claims: An industry review*<sup>13</sup> that the coverage of life insurance claims by dispute resolution schemes should be considered as part of the Ramsay Review including a need to:

- (a) ensure better and more effective consideration of issues of fairness to supplement the existing jurisdiction; and
- (b) give better access to consumers with complaints about delays in claims handling and ensure better remedies when these complaints are found in favour of the consumer.

This could be more easily implemented if ASIC had greater oversight powers. We also recommend that ASIC publicly name Financial Services Providers including life insurers where complaints and systemic issues are raised by recognised consumer groups or by a sufficient number of consumers.

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<sup>12</sup> <http://financialrights.org.au/wp-content/uploads/2017/03/Joint-Consumer-Submission-EDR-Review-Interim-Report.pdf>

<sup>13</sup> <http://download.asic.gov.au/media/4042220/rep498-published-12-october-2016a.pdf>

## Superannuation complaints

Financial Rights also notes that, along with other consumer advocates, we have argued for the creation of one EDR scheme covering all financial institutions including life insurers, effectively merging the Financial Ombudsman Service (**FOS**), the Credit and Investments Ombudsman (**CIO**) and Superannuation Complaints Tribunal (**SCT**).

Financial Rights has had ongoing concerns about the structure, funding and operation of the SCT, the venue where a significant number of life insurance complaints turn. The SCT is significantly underfunded, is inflexible, complex and is unable to provide legal advice to applicants (as detailed in the Joint Consumer Submission to the Ramsay Review<sup>14</sup>). This has led to significant and unacceptable delays for justice. As at April 2016, the SCT had a complaints backlog of at least 1,500 cases, with some complaints dating back to 2012. This has disastrous implications for consumers waiting on a determination, and significantly impairs its effectiveness as dispute resolution forum.

## Last resort compensation scheme

A last resort compensation scheme is essential to ensure that vulnerable consumers who suffer loss from misconduct are actually compensated. The scheme would make funds available to those cases where compensation remains unpaid, misconduct by a financial advisor has been proven and the guilty party can't pay up because they've gone under and their professional indemnity insurance won't cover the compensation amount.

The Interim Report of the Ramsay Review stated that

*Where consumers are denied compensation due to a financial firm's lack of resources, it has a negative impact on both the individual consumer and the broader financial system. In circumstances where the market is currently unable to provide a solution to this problem, the Panel is of the view that there is considerable merit in introducing an industry-funded compensation scheme of last resort.<sup>15</sup>*

A last resort compensation scheme is effectively the missing piece of the financial services regulatory architecture and should be introduced as soon as possible.

## Recommendations

There should be a single industry ombudsman scheme for all disputes in the financial system, including superannuation disputes. The SCT and CIO should be integrated into FOS and

- f. adopt the FOS model;
- g. include life insurance;
- h. be required to implement findings of systemic issues investigations;

<sup>14</sup>

[http://www.treasury.gov.au/~/media/Treasury/Consultations%20and%20Reviews/Consultations/2016/Review%20of%20the%20financial%20system%20external%20dispute%20resolution%20framework/Submissions/PDF/Joint\\_Consumer\\_Groups.ashx](http://www.treasury.gov.au/~/media/Treasury/Consultations%20and%20Reviews/Consultations/2016/Review%20of%20the%20financial%20system%20external%20dispute%20resolution%20framework/Submissions/PDF/Joint_Consumer_Groups.ashx)

<sup>15</sup> Op cit. p. 23

- i. consider disputes (in limited circumstances) after a court judgment has been entered; and
- j. have its compensation caps increased.

ASIC should be appropriately resourced to undertake increased oversight of industry ombudsman schemes.

ASIC should be able to give directions to the new ombudsman schemes to remedy any failure to comply with the Benchmarks for Industry-based Customer Dispute Resolution.

ASIC should have greater oversight of Internal Dispute Schemes, publish details of non-compliance or poor performance, including identifying financial service providers and ensure that IDR reporting regimes are required to have clear and consistent terminology across all financial service providers to ensure the data is comparable.

An industry-funded compensation scheme of last resort should be introduced. The compensation scheme should:

- h. apply to all financial services providers, including credit licensees and operators of managed investment schemes;
- i. only accept claims from retail clients (consumer claims) and operate as a last resort scheme, that is, only be available for claims after all avenues have been exhausted, including a relevant award from an EDR scheme or a court and professional indemnity insurance;
- j. not require an ombudsman scheme to enforce its determination in court as a precondition to compensating an affected consumer; however, after the scheme has compensated the affected consumer, the scheme should be able to recover from the financial service provider on a subrogated basis;
- k. involve people with relevant industry and consumer experience in its governance, based on the existing industry ombudsman model;
- l. award compensation at levels aligned with EDR caps that are reviewed and increased over time;
- m. be retrospective in application; and
- n. be funded by industry, through a levy imposed by the government.

## Debt Management Firms

Financial Rights has seen a proliferation in the last few years of consumer complaints against new financial businesses known as Debt Management Firms. In our view these types of businesses prey on and exploit on the most vulnerable consumers in Australia.

These businesses can be categorised in the following four groups:

1. Debt negotiators: claim they can negotiate with creditors to settle debts for a lesser amount, but often suggest high risk strategies to improve their 'bargaining position';
2. Credit file "repair" services: offer to 'clean' clients' credit files by pressuring creditors to have default listings removed;
3. Debt agreement brokers/referrers: act as intermediaries for debt agreement administrators under part IX of the Bankruptcy Act and
4. Budgeting services or debt payment services: arrange for wages to be paid into an account created and controlled by the company, from which bills are paid on the consumers' behalf.

These businesses have a number of common elements including:

- targeting consumers experiencing financial stress, particularly low-income Australians;
- they fail to provide clear explanations of fees and charges during the initial contact with consumers
- they charge high up-front and on-going fees for 'services' and
- they suggest high cost 'solutions' to debt problems that are not in the consumer's best interests, potentially leaving them in a worse financial position than before, even when there is a free dispute resolution service available to the consumer.

Debt management firms operate under a business model that is inherently unfair. They depend on a class of consumers that cannot access, or are not aware of, alternative services to meet their needs, and they are based on charging ongoing fees to consumers who are often ill placed to afford them and the fees are significantly disproportionate to the cost of providing the service.

Debt management firms can charge large fees and cause significant consumer detriment, but consumers have limited access to justice. Although the fees charged by some providers are very high and disproportionate to the service provided, this may not itself be unlawful.

Importantly, for the purpose of this inquiry, none of the above businesses are subject to specific regulation of their activities.

The businesses currently do not currently fall within the meaning of 'financial services' or 'financial products' as defined the ASIC Act or the relevant provisions of the Corporation Act. This means they cannot be licensed by ASIC, are not required to be members of EDR schemes, are not required to provide any information on their activities nor are subject to regular audits. Even if they were to be licenced the laws currently in place do not necessarily address the business models that these firms use.

These businesses do however fall within the consumer protection provisions of the ACL but the ACL protections have so far proven to be inadequate to protect vulnerable consumers. There are also significant difficulties in applying the consumer guarantees to new and emerging services such as those provided by debt management firms. For example, how does a consumer or regulator know whether a new and emerging service is "fit for any specified purpose" when there is nothing to compare that new service to and there are no standards set for what is essentially a useless service.

Some of the activities of debt management firms may or may not be regulated by the *National Credit Act*, the *Bankruptcy Act* and the *Privacy Act*. What is clear however is that there is no uniform regulatory framework applying to the activities of debt management firms in Australia and they are not required to hold a credit or AFS licence administered by ASIC.

There are also significant complexities and difficulties for consumers (be it individually or collectively) to pursue any action against any debt management firms or any other new and emerging financial businesses. Firstly it is difficult to work out whether a business needs to be licenced as an Australian Financial Services Licensee, secondly actually pursuing this requires Supreme Court action which is costly and complex and thirdly the rescission provisions under s. 925A of the *Corporations Act* and the interpretation they have been given by the courts have proven difficult for consumers to get their fees returned or receive declaratory relief.

If debt management firms and other new and emerging financial businesses were required to be licensed there would be greater scope for ASIC to gather information, conduct regular risk-based audits for compliance and ensure that these unfair businesses are subject to an EDR scheme.

Financial Rights notes that the Ramsay Review has drafted the following recommendation:

*Debt management firms should be required to be a member of an industry ombudsman scheme. One mechanism to ensure access to EDR is a requirement for debt management firms to be licensed.<sup>16</sup>*

We strongly support with this recommendation.

## Recommendation

A seamless regulatory framework should be introduced for debt management firms. All debt management firms should be required to hold a relevant licence, have minimum required standards such as a fit and proper person test and maintain membership of an ASIC-approved industry ombudsman scheme.

## No Interest Payment Service

Recently Financial Rights has seen the rise of a number of financial service products such as Certegy Ezi-Pay and AfterPay, which purport to offer no interest financing. Increasingly, we are seeing products, such as solar panels, being sold using this type of finance. The catch is often that while the finance company claims not to charge interest, the interest may be built into the loan amount because the cash price of the goods may be different if the consumer paid in a lump sum versus if they paid over time. The model hides the cost of finance as merchants

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<sup>16</sup> Review of the financial system external dispute resolution and complaints framework, Interim Report, p. 26

are charged extra fees for providing this credit “service”<sup>17</sup> Even, if this is not the case, it is arguable an entity offering such products should be required to be licensed, a member of an EDR scheme or required to undertake an assessment as to the suitability of the no interest payment service to prevent the proliferation of such arrangements to a consumers harm.

The consumer loses valuable consumer protections by using this type of arrangement including the responsible lending provisions of the *National Consumer Credit Protection Act 2009*. Whilst there are still some protections in the ACL there is no access to free EDR.

Many of these entities purport to have access and reporting requirements to a person’s credit report but are not members of an EDR scheme. They often have high default fees, and appear to rely on defaults as a means of recouping their costs and producing profit. A business model that profits and relies on default is fundamentally unconscionable and should be discouraged.

The following is a recent example of a client that had a dispute with a “No Interest Payment Service”.

### Case Study – Bill’s story

Bill is over 70 years old and his only source of income is the aged/carer’s pension. In 2013, he purchased and paid for solar panels to cover the roof of his home which cost \$5,000 after the solar panel rebate.

In July 2016, a Solar Panel salesman approached his house uninvited selling solar panels. Bill told the salesman he already had solar panels but the salesman said you can always use more. Two days later, the salesman returned with an agreement and information on how Bill could fund the purchase.

The salesman told Bill there was sufficient space on the roof of his shed to put more panels and that the savings he would make on his electricity bill would cover the cost - \$8,500. Bill was told:

- a) Instead of paying \$120 a month to the electricity company, pay \$99 a fortnight for the solar panels and you will save.
- b) The “No Interest Payment Service” will give you an interest free loan to pay for the panels. They will direct debit the money from your account.

After 3 months Bill had only saved \$30 on his electricity bills and he could not afford the fortnightly repayments for the new solar panels.

Financial Rights contacted No Interest Payment Service and alerted them to the fact that, among other things:

- a) The value of the solar panels was around \$5,000 not \$8,500 and as the cash price was less than the amount Bill had to repay, No Interest Payment Service must be regulated by the *National Consumer Credit Protection Act 2009*. No Interest Payment

<sup>17</sup> For example, see <http://www.afr.com/business/banking-and-finance/former-macquarie-manager-katherine-mcconnell-looks-to-shake-up-energy-finance-20161007-grxl2x> and <http://www.fcrc.org.au/member-news/afterpay-what-you-need-to-know>

Service continued to deny they are regulated by the Act and do not carry out any responsible lending assessments prior to advancing funds.

- b) Bill was never told the company supplying the solar panels was not a Clean Energy Council Member which meant he would not get the solar panel rebate; and
- c) No Interest Payment Service breached consumer law when they failed to outline to our client his cooling off rights.

The No Interest Payment Service agreed they breached consumer law by failing to outline our client's cooling off rights but denied they are regulated by the *National Consumer Credit Protection Act* and refused to comment on the allegations made.

No Interest Payment Service released our client from the contract, refunded the amounts he paid to date (\$900) and allowed our client to retain the solar panels. However, it is likely many other consumers have entered similar arrangements

## Recommendation

All No Interest Payment Services should be regulated under the National Credit Code (**NCC**)<sup>18</sup>, should be required to hold a relevant licence and maintain membership of an ASIC-approved industry ombudsman scheme.

## Insolvency: Bankruptcy and Part IX Debt Agreements

As a community legal centre which provides both legal advice and financial counselling to the public, we receive many calls about personal bankruptcy and other insolvency options under the *Bankruptcy Act*. Those calls range from people who are contemplating bankruptcy as a solution to insurmountable debt to those who are made bankrupt by their creditors and those who have already become bankrupt, in some cases without their knowledge or understanding of the process.

The Government has over the last two years worked to reform the insolvency rules as a part of its National Innovation & Science Agenda. The April 2016 National Innovation & Science Agenda proposals paper, outlines measures that the government wanted to act upon including:

1. reducing the current default bankruptcy period from three years to one year
2. introducing a 'safe harbour' for directors from personal liability for insolvent trading if they appoint a restructuring adviser to develop a turnaround plan for the company

The *Insolvency Law Reform Act 2016* was introduced last year and will commence this year. To give full effect to the new *Insolvency Law Reform Act 2016* the government have developed a number of legislative instruments to sit alongside it including the *Insolvency Practice Rules*.

<sup>18</sup> The *National Credit Code* forms a schedule to the *National Consumer Credit Protection Act 2009* and applied to all consumer lending and lending for investment in residential real estate.

While we generally support the reforms with some amendments outlined in our submission, our key concern remains with Part IX Debt Agreements and Debt Agreement Administrators as referred to above under Debt Management Firms.

A Part IX Debt Agreement (**Debt Agreement**) is a formal, supposedly “low cost” alternative to bankruptcy under the Bankruptcy Act introduced in 1996. Although it is considered an alternative to bankruptcy, many of the consequences are the same. The potential advantages and risks involved with Debt Agreements are complex and difficult for most debtors to weigh up effectively. While there may be advantages of entering a Debt Agreement for debtors with an asset such as a home to protect, a large proportion of people entering Debt Agreements are not in this position.

When Debt Agreements were introduced it was not envisaged they would be promoted and administered by commercial operators. Debt Agreements are sold by private administrators (and unregulated Debt Management Firm acting as brokers or introducers) with a view to making a profit from consumers whose essential problem is that they are already in serious financial difficulty and cannot meet their commitments to existing creditors.

Consumers usually focus on catch phrases like “freeze your interest”, “make one easy payment” and even “government backed” and don’t realise the implications until they are well into the process of signing up. This means that rather than approaching such agreements with careful consideration, many consumer are induced to sign up for Debt Agreements who would not otherwise consider a formal alternative to bankruptcy, or bankruptcy itself. In other cases, debtors enter a Debt Agreement when they would have been far better off simply going bankrupt and, in some cases, end up bankrupt anyway after a long drawn out process of trying to pay in accordance with a Debt Agreement and then defaulting.

The business model makes its profit by diverting some of the limited funds available to pay existing creditors to the Debt Agreement administrator. While this may have some net benefit for the community (but not necessarily the debtor) if every debtor who entered a Debt Agreement would have otherwise gone bankrupt, Financial Rights’ experience, however, suggests that this is far from reality (many Financial Rights’ clients, for example, do not appear to have even been insolvent at the point of entering a Debt Agreement).

Other problems in the industry which have arisen in the wake of the enactment of Part IX include:

- Misleading conduct - debtors believe they are consolidating their debts and/or do not appreciate that they are committing an act of bankruptcy;
- Debtors are not advised of alternatives, such as direct negotiation with their creditors, bankruptcy, or assistance with the previous options from free financial counselling agencies;
- Debtors are placed in Debt Agreements they cannot afford;
- Debt Management Firms and Debt Agreement administrators charge upfront fees that are payable prior to the agreement being voted on, with some debtor’s paying multiple up front fees and no solution guaranteed;

- Debtors are advised to stop making payments pending the consideration of a Debt Agreement proposal by creditors, leading to ballooning debts as a result of compounding interest; and
- Debt Agreements are getting longer with many debtors in Debt Agreements for 4-5 years when most commonly they would have been discharged from bankruptcy after 3 years. Worse, many consumers fail to complete their Debt Agreements and may end up bankrupt in any event, with the whole cumulative process lasting many, many years.

Debt Agreements have been growing faster than any other form of bankruptcy. This growth has been fairly consistent and independent of other economic trends and financial stress indicators including bankruptcies. We submit that this growth is entirely due to the inherent conflict of interest in the promotion of these agreements by for profit entities under the guise of disinterested advice. While there have been a number of reviews and improvements made to Debt Agreements the problems remain. Financial Rights believes that with the reforms of the *Bankruptcy Act*, the time has come to repeal Part IX of the *Bankruptcy Act*.

## Recommendation

Part IX of the *Bankruptcy Act* should be repealed.

## Self Regulation: Financial Services Sector Codes of Practice

A number of self-regulatory codes of practice have been developed in the financial services sector including:

- the Australian Bankers' Association (**ABA**) with its Code of Banking Practice
- the Customer Owned Banking Association (**COBA**) with its Customer Owned Banking Code of Practice;
- the Financial Planning Association of Australia (**FPAA**) with its FPA Code of Professional Practice
- the FSC with its recently launched Life Insurance Code of Practice;
- the Insurance Council of Australia (**ICA**) with its General Insurance Code of Practice;
- the Mortgage & Finance Association of Australia (**MFAA**) with its MFAA Code of Practice;
- the National Insurance Brokers Association (**NIBA**) with its Insurance Brokers Code of Practice.

In addition to this is a planned Group Insurance Code of Practice currently being developed by Superannuation Working Group, established by ASFA, FSC, AIST, IFF and ISA, subsequent to the development of the Life Insurance Code

Furthermore there is an ePayments Code<sup>19</sup> regulating consumer electronic payments, including ATM, EFTPOS and credit card transactions, online payments, internet and mobile

<sup>19</sup> <http://asic.gov.au/for-consumers/codes-of-practice/epayments-code/>

banking, and BPAY. This Code is notable for being administered by ASIC who monitors the subscribers' compliance and reviews the code regularly.

Codes of Practice are enforceable rules setting out an industry's commitment to minimum service standards for consumers. An industry association is however not required to seek ASIC approval of its code, but may choose to do so.

It is notable that no financial service sector code of practice has been approved in accordance with the ASIC's *Regulatory Guidance 183*<sup>20</sup> nor do they oversee any of the code's operations and administration.

Financial Rights<sup>21</sup> recently wrote to six financial services sector associations administering codes to request that they seek ASIC approval in accordance with ASIC RG 183.

We argued that registration would increase public confidence in the financial services sector, ensure that the Codes meet best practice standards and send a strong signal to consumers that the Codes are something they can have confidence in. Registration would also demonstrate that the financial services sector proactively responds to identified and emerging consumer issues and that the Codes work to deliver substantial benefits to consumers.

Code registration would also mean that:

- investigative or enforcement action can be undertaken if misrepresentations are made about a code;
- ASIC can monitor the Codes based on issues raised by consumers, EDR schemes or industry consultations;
- there is greater certainty that consumer concerns and independent review recommendations will be taken seriously and more likely implemented – rather than what can occur now which is that some recommendations for change are watered down or rejected outright;
- consumers can have confidence that there is specific government/ASIC oversight of the Codes and their ongoing development;
- each segment of the financial services sector would be making a public statement that it is strong and confident enough to subject its self-regulatory instrument for scrutiny against regulator standards;
- members will not walk away from the Codes.

## Recommendation

The Government should work with industry organisations administering Codes of Practice to ensure that each Code's Standards are lifted and subsequently approved by ASIC in accordance with RG 183.

<sup>20</sup> <http://download.asic.gov.au/media/1241015/rg183-published-1-march-2013.pdf>

<sup>21</sup> including Financial Rights, Consumer Action Law Centre, Consumer Federation Australia, CHOICE, Financial Counselling Australia, Redfern Legal Centre, CARE Inc and the CCLC SA

## The Code of Banking Practice

In Financial Rights view, the ABA Code of Banking Practice is arguably the Code that is closest to meeting the requirements of the RG 183. The elements that are required to be met are as follows:

- Freestanding and written in plain language RG 183.55 & RG 183.129
- Body of rules (not single issue, unless Section E of this guide applies) RG 183.19 & RG 183.24
- Consultative process for code development RG 183.49–RG 183.54
- Meets general statutory criteria for code approval RG 183.28–RG 183.41
- Code content addresses stakeholder issues RG 183.55–RG 183.62
- Effective and independent code administration RG 183.76–RG 183.81
- Enforceable against subscribers RG 183.25–RG 183.27
- Compliance is monitored and enforced RG 183.79–RG 183.81
- Appropriate remedies and sanctions RG 183.68–RG 183.73
- Code is adequately promoted RG 183.78–RG 183.80
- Mandatory three-year review of code RG 183.82–RG 183.84

One element that is easily fixed, for example, is shifting the Code review timeframe from every five years to every three years. Financial Rights notes that the current Review was only instigated three years after the implementation of the current Code because of a political climate unfavourable to the banking industry.

Financial Rights notes that the recent Independent Review of the Banking Code has stated that:

*Although it is a matter for ASIC, on my read of the Guide, it seems that the current Code would meet most - but perhaps not all of the criteria.*

Financial strongly believes that the ABA must respond to the Independent Review of the Code of Practice positively and seek approval from ASIC for their Code. If the ABA chooses not to seek approval of its code in accordance with ASIC RG183 it will be up to the Government to intervene to ensure that this takes place.

Furthermore it needs to be noted that there will be a number of finance providers that won't be captured by any new banking Code commitments, including non-ABA members, credit unions (who have not updated their own Code) and other finance providers such as Latitude. Legislation will mostly likely be required to make sure that consumers are protected from the worst excesses of these parts of the sector (who are falling behind best practice standards and benefitting from this).

## Recommendation

The ABA should improve their Code of Practice to meet the standards set by ASIC RG 183 and seek approval from ASIC for their Code. If the ABA chooses not to seek approval of its code in accordance with ASIC RG183, the Government should intervene to ensure that this takes place.

Government should identify those parts of the banking sector not covered by the Code of Banking Practice and ensure that minimum standards apply to all finance providers in the banking, finance and credit sectors.

### **The General Insurance Code of Practice**

The General Insurance Code of Practice was introduced in 1994 and has gone through a four independent reviews (1998, 2006, 2009 and 2012) and has made a number of improvements over time. The ICA has recently launched a new review of the Code.

Financial Rights has a number of concerns with the current review.

This review will not be conducted in a fully independent manner. The review is being deemed by the ICA to be an ad hoc review in consultation with stakeholders. The last time there was a formal independent review was 2012-13 by Ian Enright.

Best practice as set out under ASIC RG 183 is that a Code should provide for regular, independent reviews at intervals of no more than three years. RG 183.82 states:

*“...a code must be independently reviewed at intervals of no more than three years. Independent code reviews are essential to ensuring that a code remains current and continues to deliver real benefits to consumers and subscribers. Reviews provide an opportunity for stakeholders to give feedback on how a code has operated in the past and how it might operate in the future.”*

If the ICA were meeting minimum standards expected this current review would be a fully independent, transparent and complete review

However this current review will be conducted by the ICA and not an independent review. This current review is also limited only examine seven of the Code's 15 sections:

- Section 4: Buying insurance
- Section 5: Standards for employees, authorised representatives and authorised financial services licensees acting on behalf of a Code subscriber
- Section 6: Standards for service suppliers
- Section 7: Claims
- Section 8: Financial hardship
- Section 10: Complaints and disputes
- Section 13: Monitoring, enforcement and sanctions

The review is also mooted to consider whether the Code should be expanded to cover additional areas of insurer behaviour.

Financial Rights believes this is far too limited in scope.

Financial Rights also notes with interest that under the Terms of Reference:

*The review should consider the extent to which the Code complies with the requirements of ASIC's Regulatory Guide 183: Approval of financial sector codes of conduct (RG 183) and the implications of seeking approval of the Code from ASIC.*

If the ICA chooses not to seek approval of its code in accordance with ASIC RG183 Financial Rights expects the Government to intervene to ensure that it be improved and approved.

## Recommendation

The ICA should implement a fully independent, complete review of the General Code of Practice with fully transparent and open public consultation. The ICA should also improve their Code of Practice to meet the standards set by ASIC RG 183 and seek approval from ASIC for their Code. If the ICA chooses not to seek approval of its code in accordance with ASIC RG183, the Government should intervene to ensure that this takes place.

### The Life Insurance Code of Practice

The Life Insurance Code of Practice as launched in October while a modest first step is not enforceable by courts or tribunals, is not an express term of the contract with consumers and is not registered with ASIC in accordance with RG 183. This is of serious concern to Financial Rights. *Prima facie*, it means that the Code does meet the minimum standards expected of a Code of Practice.

Now that the first iteration of the Code has been launched, the industry must begin the FSC must move to begin the registration process as soon as possible so that Australians can have confidence in the code. Financial Rights notes in announcing the Code the FSC stated it will merely “consider making an application for ASIC approval of the second iteration of the Code. *(our emphasis)*<sup>22</sup>

Mere consideration is unacceptable. This is not the expectation of consumers, consumer representatives or the Government. We note that the Minister for Revenue and Financial Services, the Hon. Kelly O’Dwyer MP stated in response to the launch of the Life Insurance Code of Practice in October that:

*...she expects the FSC and life insurance industry will take the necessary steps to ensure that the Code is enforceable across the whole industry, by gaining ASIC approval of the Code.*

*ASIC should work collaboratively with the FSC and the industry to approve the Code. Once the Code is approved, the Government will give ASIC the necessary powers to enforce the Code, so as to ensure financial services licensees’ compliance with the Code.<sup>23</sup>*

We maintain that as a priority the Life Insurance Code of Practice must be registered with ASIC in accordance with ASIC’s *Regulatory Guidance 183: Approval of financial sector codes of conduct, March 2013*.

Confidence in the life insurance industry is at rock bottom. Financial Rights expected the life insurance industry to respond to widespread community concern with the establishment of a registered, enforceable set of best practice standards. As it stands, the Code does not meet best practice standards and does little if anything to restore confidence in the industry. Greater oversight by ASIC would go a long way to bringing the industry into line with community standards.

<sup>22</sup> FSC, *Media Release: Life Insurance Code of Practice*, [http://www.fsc.org.au/downloads/file/MediaReleaseFile/2016\\_1110\\_MediaRelease\\_LifeInsuranceCodeofPractice\\_final.pdf](http://www.fsc.org.au/downloads/file/MediaReleaseFile/2016_1110_MediaRelease_LifeInsuranceCodeofPractice_final.pdf)

<sup>23</sup> Minister for Revenue and Financial Services, *Media Release: Key life insurance reforms to assist consumers*, 12 October 2016 <http://kmo.ministers.treasury.gov.au/media-release/091-2016/>

Again if the FSC chooses not to seek approval of its code in accordance with ASIC RG183 it will be up to the Government to intervene to ensure that this takes place.

Furthermore, there remain significant flaws in the final version of the Code that require development, improvement and, where intractable, potential legislative reform.

The FSC has stated that it will work over the 18 months following the launch of the Code to ensure that they act on a number of elements of the Code:

- a commitment to work with superannuation trustees, ASFA, AIST, ISA and IFF to lift standards through a Group Insurance Code of Practice;
- a commitment to working with the peak adviser organisations to address mutual obligations;
- a commitment to address the issues raised with respect to funeral insurance and consumer credit insurance (CCI) including through limitations on sales and premium structures. These standards would require the second iteration of the Code to be submitted for Australian Consumer and Competition Commission (ACCC) approval
- introducing draft minimum standard medical definitions (see further below) and a standardised process for policy upgrades for existing customers.
- increase obligations on insurers when interacting with consumers suffering mental health issues and working with groups like Beyond Blue, Lifeline, Mental Health Australia and the Public Interest Advocacy Centre to determine how to better serve those consumers with mental health issues.

Government needs to ensure that the FSC follow through on these commitments and if they do not, intervene to ensure improved outcomes for consumers in these areas.

## Recommendation

The Government needs to ensure that the FSC follow through on commitments to improve standards in relation to advisers, problem products such as funeral insurance and CCI, sales practices, medical definitions and mental health obligations. The Government must ensure that the FSC improve their Code of Practice to meet the standards set by ASIC RG 183 and seek approval from ASIC for their Code. If the FSC chooses in 18 months not to seek approval of its code in accordance with ASIC RG183, the Government should intervene to ensure that this takes place.

### A potential Group Insurance Code of Practice

The clearest and most obvious flaw of the recent Life Insurance Code is that it does not cover superannuation fund trustees. Financial Rights argued throughout the drafting of the Code that the FSC needed to bring superannuation fund trustees into the process early on to ensure that they would be covered. People making claims under group policies held by superannuation fund trustees will now not benefit from key elements of the Code, such as claim timeframes and communication obligations. Given that most life insurance in Australia is held under group policies, the exclusion of fund trustees is a serious failing of the Code.

### Case Study – Lisa's story - CLSIS 138747

Lisa was diagnosed with stage 4 melanoma. She realised she had benefits in her superannuation, and so made a claim. The claim is currently with the superfund. It has been 5 months. She never hears from the fund. She follows up with them, and she is often asked to re-send documents she has already sent in. She has received further news from her treating doctors that her prognosis is getting worse. She is seeking advice from Financial Rights about what are the expected time frames. We explain to her that there are no timeframes currently, that the Life Insurance Code of Practice is implementing a time frame of 6 months for claims like hers with insurers, however, the start of 6 months commences from when the superfund makes claim with insurer. It is not clear whether her claim is with the fund or the insurer. No one is talking to her.

We note that a Superannuation Industry Working Group has been established to draft and finalise a code of practice by the end of next year. While we support this work to ensure that the consumer protections created by the life insurance code are similarly provided to those consumers who access their insurance via group insurers, we would also recommend that this Code be approved with ASIC in accordance with RG 183.

A number of issues need to be looked at. For example, where there is a complaint about a Life Insurance Policy owned by a superannuation fund trustee life insurers under the new Code will respond to the superannuation fund trustee so that it can provide a final response to a complaint in writing within 90 calendar days: clause 9.10. This is mandated under section 19, *Superannuation (Resolution of Complaints) Act 1993*. There is no reason that this should be twice the length faced by those consumers who have life insurance directly with an insurer. Financial Rights believe that a total of three months to deal with a complaint is completely unreasonable and impacts upon policyholders suffering financial hardship, injury and/or illness. Either an improvement is written into the upcoming Code or a change to the legislation is required.

### Case Study – Heather's story – CLSIS 138763

Heathers husband passed away 3 months ago. He was on income protection during his last few months. On his passing, Heather made a claim for his death benefits. She does not understand the delay. The insurer stated they are waiting for the superfund, and the superfund, vice versa. She was not sure whether it was due to any issues around the payment of benefits to the nominees or whether they were questioning the claim itself. They kept passing her off to other departments and didn't give a straight answer. Heather has a mortgage to pay, and this is distressing. They treated him poorly when he was sick, they kept asking for medical statements even though he was dying and they knew it. She just wants to know how long she has to wait for a decision

Another common issue faced by consumers is the lack of availability of product disclosure statements on superannuation websites and insurers refusing to provide them to the

beneficiary at the request of the superfund. This is also true for other group policies, through alternative arrangements such as employer benefit programs.

### Case Study – Lakshit's story – CLSIS 136342

Lakshit worked for a large corporation who provided a life insurance product via a group policy as a part of his employee benefits. Lakshit was unable to work due to a mental health issues and wanted to make a claim on the income protection component of the life insurance product. He requested a copy of the policy from the Life Insurer to make the claim but was told that they couldn't provide him with a copy. The Insurer also asked the employer for a copy and they refused to provide it. Lakshit didn't know how he could claim without understanding the terms of the policy, he also wanted to travel overseas to get some family support but without the policy wording he did not know how this would be treated and whether it would affect his claim. Lakshit has had to pursue an internal complaint with the insurer to get a hold of the policy wording and is likely to have to pursue further in EDR.

This is an incredibly frustrating problem for many consumers placing many in limbo for months. The Life Insurance Code makes a commitment to making their PDS's available online to view: clause 3.7. However where it has been prepared for a third party, life insurers will only refer the claimant to the relevant party for a copy and will merely encourage those that they work with to make these available online. Group insurers need to step up and provide all their past and present PDS documents online immediately.

### Recommendation

We recommend that the Government ensures that the superannuation sector develop a Code of Practice that works symbiotically with the Life Insurance Code of Practice and that this new Code be approved with ASIC in accordance with RG 183

That the Government review the *Superannuation (Resolution of Complaints) Act 1993* with an eye to improving consumer protections and improving consumer outcomes relating to claims handling.

### Insurance Brokers Code of Practice, MFAA Code of Practice and Customer Owned Banking Code of Practice

Financial Rights believes that the current Insurance Brokers Code of Practice, MFAA Code of Practice and Customer Owned Banking Code of Practice are far from best practice documents and, similar to our position with respect to the other Codes need to be vastly improved to hold any standing with consumers. Each of these Codes fail to meet the ASIC RG 183 standards and should be reviewed, improved and ultimately approved by ASIC in accordance with RG 183.

## Recommendation

That the Government ensure that NIBA, MFAA and COBA review and improve their Codes of Practice to meet the standards set by ASIC RG 183 and seek approval from ASIC for their Codes. If these organisation choose not to seek approval of their coded in accordance with ASIC RG183, the Government should intervene to ensure that this takes place.

## General and Life Insurance Sectors

### Sales practices, advertising and marketing

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#### Poor and aggressive sales practices in insurance

Financial Rights provides free and independent advice on its national Insurance Law Service (**ILS**). Last year the ILS answered over 8000 legal advice enquiries. In examining queries and complaints relating to life insurance on its phone and email advice a large proportion of the issues raised centre on:

- the general mis-selling of life insurance products by the insurer in the first place;
- bad or incorrect advice from advisors and other sales agents at the time of purchase;
- the mis-selling of problem products most particularly funeral insurance;
- the mis-selling of replacement policies by financial advisors leading to issues of non-disclosure or the loss of accrued benefits.

#### Case Study - Abbie and Alan's story - CLISIS 130009

Abbie had an existing funeral insurance with an insurer covering her and her husband. She took this out as she was concerned Alan's veterans benefits would not be enough to cover his funeral expenses if something happened.

In 2006 Abbie spoke to her insurer about taking out life insurance as well, because they had an outstanding loan that she would not be able to afford herself. After speaking with family, she decided to put her money into paying off the loan faster rather than on life insurance premiums. Then the insurer rang her back to try to persuade her into the policy again. The salesperson encouraged her to cancel her funeral insurance and take out life insurance in its place for an amount to include both the loan and the original funeral insurance. He said it would be "*larger cover, which is going to cover both the loan and also your funerals*". He never mentioned the policy would end at age 70, but did check she received the PDS (that had a guarantee of renewal to age 70 hidden towards the end of a badly worded policy). She agreed to \$50,000 life cover for \$50.01 a fortnight, to replace the existing \$7000 funeral cover for \$40.04 a month

Abbie cancelled the policy last year after being told Alan would no longer be covered as he reached aged 70. After raising a dispute, the insurer agreed to refund \$19,462 which is all the premiums on the life policy – on a confidential basis and with a non-disparagement clause.<sup>24</sup>

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<sup>24</sup> Some details have been changed slightly due to the confidentiality clause.

### **Case Study –Chris's story – CLSIS 130884**

Chris was sent a brochure on life insurance then received a phone call from an insurance representative. Chris has a bank account with the vertically integrated insurer. Chris agreed to have the contract read out and discussed the price however said he didn't agree to be signed up and would seek advice from his financial planner. However, the salesman said he had agreed to the contract and the policy would commence in a few days. Chris submitted a complaint to the insurer's IDR and the policy was cancelled.

### **Case Study – David's story – CLSIS 106506**

David's father has funeral insurance. They called his father and somehow managed to sell his father another funeral plan even though he already had funeral insurance with the same insurer. David found out and complained to the insurer. The insurer refused to give a refund.

### **Case Study – Erica's story- CLSIS119950**

Erica went to a free lunch presentation at work and was asked to put her phone number down in early 2013. Since then, Erica has received regular phone calls wanting to sign her up for insurance. Her phone number was passed to a different company who were more persistent, and insisted they meet with her face to face. At the meeting, she was told to sign for an insurance plan, or be charged \$250 for the consultation.

### **Case Study –James's story- CLSIS 100510**

James suffers from Asperger's disorder, an autism spectrum disorder. He relies on a low income. His father came across a monthly withdrawal of \$47.95 from my client's bank account. James was unaware what this was for, so he authorised his father to make enquiries. This is when he became aware that it was for an insurance policy. The policy was then cancelled straight away. James's father on his behalf requested a refund of all premiums since the start of the policy. The insurer declined. The policy was set up via a verbal telephone agreement. After initially refusing to provide a copy of the voice recording, the insurer subsequently provided a copy of it. It was evident in the voice recording that James was not able to understand what was been told to him by the sales representative. The sales person used fast talk and pressure to push the sale and it was clearly confusing for the client. An ILS solicitor wrote to IDR and they immediately agreed to a full refund of premiums the same day they received the complaint.

## Add on sales practices through third parties (car yards, etc)

Poor add-on insurance and sales practices have been an issue for many years highlighted by a string of Government inquiries<sup>25</sup> and ASIC investigations and surveillances including:

- *Report 413 Review of Retail life insurance advice, October 2014*<sup>26</sup>
- *Report 454 Funeral insurance: A Snapshot, October 2015*<sup>27</sup>
- *Report 470 Buying add-on insurance in car yards: Why it can be hard to say no, February 2016*<sup>28</sup>
- *Report 471 The sale of life insurance though car dealers, February 2016*<sup>29</sup>
- *Report 492 A Market that is failing consumers: The sale of add-on insurance through car dealers*<sup>30</sup> and
- *Report 498 Life Insurance claims: An industry review*<sup>31</sup>

ASIC Report 470 *Buying add-on insurance in car yards: Why it can be hard to say no*, February 2016<sup>32</sup> found that many consumers who had purchased add-on insurance products:

- were not aware of which add-on products they had actually purchased, how much each policy cost and what risks it covered, or when they would be able to lodge a claim;
- if they could recall the purchase, regretted their decision to buy add-on insurance;
- had no awareness of add-on insurance products before entering a dealership to buy a motor vehicle;
- were unaware of the cost of, or cover or value provided by, add-on insurance products and most purchases were made solely on the basis of information provided in the car dealership; and
- were actively sold, and sometimes pressured to buy, add-on insurance products.

ASIC Report 471: *The sale of life insurance though car dealers*, February 2016<sup>33</sup> found that

*"individual sales have identified transactions where consumers were sold car yard life insurance (and other add-on products) without their knowledge or consent, or where the authorised representative of the life insurer told the consumer they had to buy the add-on products to get the car loan.*

*When a product is sold to a consumer (compared to when a consumer actively seeks out or buys a product) the consumer usually has little or no awareness of the product beforehand.*

<sup>25</sup> Parliamentary Joint Committee on Corporations and Financial Services (PJC) inquiry into the *Corporations Amendment (Future of Financial Advice) Bill 2011*; and the PJC Inquiry into the *Corporations Amendment (Further Future of Financial Advice Measures) Bill 2011*. Both of these made specific recommendations about the need to monitor the quality of advice about the sale of risk insurance.

<sup>26</sup> <http://download.asic.gov.au/media/2012616/rep413-published-9-october-2014.pdf>

<sup>27</sup> <http://asic.gov.au/regulatory-resources/find-a-document/reports/rep-454-funeral-insurance-a-snapshot/>

<sup>28</sup> <http://download.asic.gov.au/media/3549387/rep470-published-29-february-2016.pdf>

<sup>29</sup> <http://download.asic.gov.au/media/3549384/rep471-published-29-february-2016.pdf>

<sup>30</sup> <http://download.asic.gov.au/media/4042960/rep-492-published-12-september-2016-a.pdf>

<sup>31</sup> <http://download.asic.gov.au/media/4042220/rep498-published-12-october-2016a.pdf>

<sup>32</sup> <http://download.asic.gov.au/media/3549387/rep470-published-29-february-2016.pdf>

<sup>33</sup> <http://download.asic.gov.au/media/3549384/rep471-published-29-february-2016.pdf>

*This lack of consumer awareness about what car yard life insurance is and what it costs means that insurers are able to price these policies in an uncompetitive manner.”<sup>34</sup>*

ASIC’s 2011 report into CCI Sales practices by banks significant use of harassing tactics and high pressure sales approaches including

1. staff persisting with an insurance sales pitch to a consumer who has clearly indicated they do not wish to purchase the product;
2. the practice of keeping consumers ‘captive’ until after the insurance sales pitch has been completed;
2. using the insurance cooling-off period as a selling point;
3. highlighting the risks of not having insurance if the consumer became sick or
4. unemployed, without providing information about other alternatives such as financial hardship variations; and
5. deliberately masking the cost of the insurance in the loan repayment.

ASIC’s most recent *Report 498 into the Life Insurance Industry* found that “problematic sales practices may lead to poor claims outcomes”<sup>35</sup> including policies sold that were manifestly unsuitable and consumers being misled about the cover under the policy.

The recently launched self-regulatory Life Insurance Code of Practice fails to fully address the serious concerns consumers have with sales practices, particularly commission-based and add-on models. While the Code does include commitments to be clear and not misleading (clause 4.1) and ensure sales rules are in place to ensure staff conduct sales appropriately and prevent pressure selling or other unacceptable sales practices (clause 4.3), the Code does not address add-on sales techniques, via effective methods such as mandated delay and opt-in days after the sale of the loan – a practice that has been introduced in the UK. The Code does not address other problematic practices such as unsolicited marketing calls, the inclusion of which would have improved the protections offered under anti-hawking rules, which provides some exemptions for life insurance.<sup>36</sup>

ASIC has stated in Report 498 that it will conduct a thematic industry review of life insurance sales practices, focusing on non-advised policy sales, and take enforcement action where necessary. While Financial Rights supports this process, we already hold the view that many of these techniques are known and can be addressed either through outright bans or through regulation by:

- introducing an appropriately formulated and monitored delay regime including an opt-in days after the sale of the loan initiated by the consumer;
- removing all exemptions under the anti-hawking rules to prevent unsolicited sales of life insurance;
- requiring insurers to publicise their claims pay-out ratios, as occurs in the UK, in order to signal to a regulator and the consumer whether these products are a problem.

<sup>34</sup> Para 22, ASIC, *Report 471: The sale of life insurance through car dealers: Taking consumers for a ride*, <http://download ASIC.gov.au/media/3549384/rep471-published-29-february-2016.pdf>

<sup>35</sup> Op Cit. ASIC, para 93

<sup>36</sup> *Corporations Act 2001* (Cth) s 992A(3)(a)-(e).

On the latter, ASIC has stated in Report 498 that:

*ASIC and APRA will work with insurers and other stakeholders during 2017 to establish a consistent public reporting regime for claims data and claims outcomes, including claims handling timeframes and dispute levels across all policy types. Data will be made available on an industry and individual insurer basis.*

It is important that this information be provided to consumers on all consumer-facing life insurance product documentation in a legible and easily understandable fashion, rather than kept on the Australian Prudential Regulation Authority (APRA), ASIC or industry funded website where consumers are unlikely to look before purchasing.

It is also important that this data be fully transparent, uniform, with clear definitions and that when reporting ASIC should name insurers who are rejecting large amounts of claims.

As mentioned above Financial Rights believes that many of the aggressive tactics used by car yards and other add-on sales practices can be overcome by introducing an opt-in and delay mechanism. Under this process, consumers would have to call the salesperson themselves after a mandatory delay and say that they want to buy the product. The mandatory delay should be four days after the initial contact with the sales person aligning with best practice requirements in the UK's GAP insurance rules.<sup>37</sup> If there is genuine desire for the product or service the consumer will make contact. This will mean there will be fewer sales, but will simply decrease by the number of sales that were only successful through the implementation of high-pressure tactics and other unethical sales practices.

## Recommendations

That an appropriately formulated and monitored delay regime including an opt-in days after the sale of the loan initiated by the consumer be introduced.

That the exemptions for life insurance under the anti-hawking rules to prevent unsolicited sales be removed.

That ASIC and APRA establish a consistent public reporting regime requiring insurers to fully and transparently publicise their claims pay-out ratios, as occurs in the UK, as well as claims handling timeframes and dispute levels across all policy types. Data should be made available on an industry and individual insurer basis.

## Sale of CCI and other insurance products through banks

Financial Rights goes into more detail on this issue under the banking section titled: **Sales Incentives and Bundling Add-ons**. Suffice it to say here that there are serious issues relating to the banking sector's approach and culture to sales of CCI and other insurance products. The ABA have established an independent review by Stephen Sedgwick AO of product sales commission and product based payments and other incentives, and the Independent Review into the Code of Banking Practice has made a number of recommendations to include

<sup>37</sup> Financial Conduct Authority, Guaranteed Asset Protection insurance: competition remedy Including feedback on CP14/29 and final rules June 2015 <https://www.fca.org.uk/publication/policy/ps15-13.pdf>

particular commitments in the next iteration of the Code of Banking Practice. As mentioned, this is discussed in greater detail below.

### Direct Insurance and suitability obligations

Financial Rights believes that there should be a specific, individualised suitability requirement – that is, that there is an assessment of some of an individual's personal circumstances before making the product available to them. Many insurance products are designed to enable consumers (including very unsophisticated consumers) to improve their financial resilience and protect very important personal assets like their homes and vehicles. There however needs to be clear obligations on insurers to ensure that these products are fit for purpose and that consumers are able to access the information they need to make informed decisions within a range of potentially suitable products.

ASIC Report 415 *Review of the Sale of Home Insurance*, for example, made a number of pertinent observations regarding insurer practices that are insufficient and suggestions for improvement (but we note this is not a comprehensive list):

- That the sales process was designed to meet the insurer's needs rather than promote understanding of the product for the consumer (p6);
- That sales staff were sometimes poorly trained in relation to product features and/or trained to avoid giving any explanations or guidance (no advice model);
- That insurer's telephone scripts could set out better ways for insurers to convey to their customers (p40-41, 44, ):
  - Insurance features and exclusions;
  - How cap and limits operate in practice (through the use of hypothetical examples);
  - Include a plain English explanation of what the sum insured means and how it should be estimated with calculator style questions or at least references to available calculators.

While the ASIC report was focused on the disclosure obligations of insurers, we submit that the above also spells out how a suitability obligation could potentially be implemented, with an obligation on the insurer to explore the objectives and requirements of consumers and match products accordingly.

The Financial Services Inquiry rejected the notion of an individual suitability or appropriateness test stating that

*An individual appropriateness test, where no personal advice is provided, would introduce significant costs for issuers and distributors due to necessary changes to the sales process. Appropriateness tests are also open to manipulation.<sup>38</sup>*

We believe that there are strong arguments to reconsider this finding. Financial Rights also asserts that there are significant structural problems in insurance leading to consumers ending

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<sup>38</sup> FSI Inquiry Final Report p203

[http://fsi.gov.au/files/2014/12/FSI\\_Final\\_Report\\_Consolidated20141210.pdf](http://fsi.gov.au/files/2014/12/FSI_Final_Report_Consolidated20141210.pdf)

up with insurance products that are simply not appropriate or suitable to their needs. These include:

*Sum Under-Insurance:* that is, since most people are realistically unable to assess correctly the value of their home and content leading to systemic underinsurance.

*Feature Under-Insurance:* because insurance contracts and PDS's are highly complex and not easily comparable, consumers are not able to properly assess the features and exclusions in their insurance products.

*Lack of competition* brought about through industry consolidation and complexity of products

*Problem products and channels* – as discussed extensively in this submission there are a number of types of products such as CCI, funeral insurance etc and channels such as car yard add-ons that are sold inappropriately.

Financial Rights acknowledges too that there will be costs involved in creating a suitability test but there are significant costs currently for insurance customers stuck with unsuitable insurance products and the general community and government when they are forced to step and mop up the mess.

Financial Rights notes that a suitability test already exists in the financial services sector– that is, the responsible lending obligations in consumer credit. We believe that a similar approach must be introduced into the insurance sector.

## Recommendation

The government should implement an individual suitability test for insurance products at point of sale.

## Advertising and marketing

With respect to advertising and marketing, Financial Rights notes that the neither the Life Insurance Code of Practice or the General Insurance Code of Practice do anything to move beyond what is already expected on them under the law and current ASIC good practice guidelines.

Financial Rights recommends that the Government examine regulation to ensure that insurers:

- make explicit the nature of stepped premiums and level premiums;
- prohibit the use of terms such as “no cost,” “without cost,” “no additional cost” or “at no extra cost”
- don’t promote products to customers in situations where it is evident that the product is worthless or of very low value to that customer; and
- don’t engage in high pressure sales practices, practices based on exploiting anxiety or guilt, or other ethically or legally questionable selling techniques.

It is Financial Rights' view that ASIC should review its 2012's *RG 234 Advertising products and advice services including credit: Good practice guidance*<sup>39</sup> and consider developing a separate guideline specific to the life and general insurance industries.

## Recommendations

That ASIC review 2012's *RG 234 Advertising products and advice services including credit: Good practice guidance* to tighten the rules around life insurance (and general insurance) marketing claims.

## Insurance Claims Handling

In examining queries and complaints relating to life insurance through our ILS phone and email advice services the most significant categories of concern relate to:

- Delays in claims handling and financial hardship brought about or exacerbated by claims delays
- Unreasonable requests for information or piecemeal evidence gathering;
- Concerns with surveillance tactics;
- Concerns with investigation tactics;
- Impossible to meet definitions and out of date medical terminology;
- Disputes over whether a policyholder is capable of working;
- Disputes centred on non-disclosure or mis-representation;
- Complaints relating to problematic products.

Other issues that policyholders face include poor internal dispute handling processes and disputes over whether a policyholder is capable of working, and no PDS available.

Financial Rights wishes to note our support for the findings and recommendations of ASIC Report 498.

ASIC found that there are significant limitations in relation to their power to oversee and regulate life insurer's claims handling process.<sup>40</sup> Financial Rights supports the recommendations made by ASIC to improve this situation, including removing the exemption under the Corporations legislation for "handling insurance claims" and that more significant penalties for misconduct in relation to insurance claims handling are also included in the review of ASIC's penalty powers.

<sup>39</sup> <http://asic.gov.au/regulatory-resources/find-a-document/regulatory-guides/rg-234-advertising-financial-products-and-advice-services-including-credit-good-practice-guidance/>

<sup>40</sup> Op cit, ASIC, para 58. Claims handling matters outside the scope of the Corporations Act include: (a) negotiations on settlement amounts; (b) interpretation of relevant policy provisions; (c) estimates of loss or damage and value or appropriate repair; (d) recommendations on mitigation of loss and increases in limits or different cover options to protect against the same loss in the future; and (e) claims strategy (e.g. the making of claims under an alternative policy).

We also wish to emphasise that issues around delays and the piecemeal gathering of evidence by insurers are among the most common complaints our solicitors hear on the Insurance Law Service.

We have serious concerns that such delays are in fact unethical strategies used to drag out claims leading to consumers to tire out and disengage with their claims. The onerous demands placed by insurers on policyholders lead many to withdraw their claim, not due to any admission of fraudulent behaviour but simply because the process is too burdensome or invasive for many consumers to bear.

Anecdotally at least Financial Rights believes that the high withdrawal rates related to this issue are such that they are systemic and need close examination and legal reform to ensure that such tactics are prohibited. We note that the ASIC Report 498 found that some insurers had relatively high numbers of 'withdrawn' claims, with three insurers having 34%, 29% and 23% of retail policy claims withdrawn.<sup>41</sup> On particular forms of cover one insurer's withdrawn claim rate was 33% and for income protection another insurer's was 30%. For one insurer, the trauma cover withdrawn claim rate was 26%.<sup>42</sup>

#### **Case Study – Jackie's - CLSIS 130006**

Jackie has been receiving income protection payments since 1998 – approximately 17 years and continues to receive it. CPI increases were not applied correctly and Jackie provided her Tax Notice of Assessment. However, her insurer wants her Income Tax Returns. They haven't paid CPI for the last two years but the insurer is asking Jackie for 17 years of tax returns (that is, her tax return for every year since 1998) and wants her to consent to them accessing full ATO records.

The extent of the information and documentation requested in the above case study and the following case study is suggestive of fishing exercises for any material that may be used against a claimant.

#### **Case Study- Kenneth's - CLSIS 112240**

Kenneth obtained an income protection policy in 2010. 10 months later Kenneth had workplace accident. After his workers compensation benefits ran out, Kenneth made an income protection insurance claim in late 2012. After 12 months there was still no resolution to his claim.

In November 2012, Kenneth signed authorisation for his insurer to access his Medicare and PBS records for the previous five years. A year later Kenneth was asked by his insurer to sign a new form authorising release of information from 1984. When he asked why his insurer told him that it is because he hadn't dated the authorisation form he signed in November 2012, which according to Kenneth was not true – he had dated it. When queried further, the claims officer stated that the reason they are asking Kenneth to sign

<sup>41</sup> Op cit, ASIC, para 186-190

<sup>42</sup> Op cit, ASIC para 194.

release for full medical record going back 20 years to 1984 is that they were looking further into Kenneth's medical history. This, a year after the claim was made.

Financial Rights hears from many clients who are asked to provide excessive amounts of information to maintain their claims. This drip feed of information requests can not only delay claims but in the following case can exacerbate the problems for which they are receiving benefit payments in the first place.

#### **Case Study – Karolina's story - CLSIS 106041**

Karolina has been unable to work for a number of years and has been receiving payments from her insurer. While Karolina has a number of issues with her insurer she is most affected by the amount of information that she needs to provide her insurer. Her insurer used to make her keep an Activity Diary where every 2 hours she'd have to write down her symptoms. Karolina reports she has medical evidence to show this process of noticing and recording her symptoms was actually making her worse because it made her think about her illness constantly.

The insurer also requests that Karolina go to her GP to fill in paperwork every month. Her GPs say that she needs to only go once every 3 months as it is not likely for Karolina to recover any time soon.

The insurer also makes Karolina go to Independent Medical Examinations (IMEs). Lately it has been every two months. But in the past it was once a year. Karolina says the Independent Medical Examinations are exhausting and unnecessary. Karolina says she has Doctors', Physios and Psychologists' reports all saying that the insurer's treatment of her is making her medical condition worse.

Sometimes the burden placed upon a claimant to gather the requested information can be unreasonable.

#### **Case Study – Jaunnie's story - CLSIS 136131**

Jaunnie took out a life insurance policy in 1993 with her insurer. In 2010/2011 C started having mental health problems. Jaunnie lodged a claim in about January 2015 for TPD due to her mental health problem. She's had to provide medical information to them however they're now requesting that she attend an appointment with one of their psychiatrists whose office is approx. 110km away.

On this point we emphasise our support of ASIC's recommendation to undertake targeted surveillance work to examine the reasons for substantially higher than average decline rates and withdrawn claim rates for particular insurers, and consider regulatory options where these reasons cannot be justified.

Financial Rights acknowledges that the new Life Insurance Code of Practice has included a commitment to decide life insurance claims within a maximum of 12 months (clauses 8.16 and 8.17). While the implementation of this timeframe will provide consumers some certainty where none existed previously, 12 months remains a long time. We note too that time frames are also found in the General Insurance Code of Practice. However, Financial Rights is of the view that given the current unenforceability of these Codes of Practice, the Government needs to consider legislative reform to ensure that impose strict time limits on insurers to decide claims.

## Recommendations

As recommended in ASIC Report 498, Financial Rights recommends that:

ASIC establish, with APRA, a new public reporting regime for life insurance industry claims data and claims outcomes and that this data be made accessible and available to all consumers at point of sale and renewal. ASIC should also ensure that this data is fully transparent including attaching insurer names to the claim rates.

The Government strengthen the legal framework covering claims handling including the removal of the exemption of 'handling insurance claims' from the conduct provisions of the Corporations legislation and that more significant penalties for misconduct in relation to insurance claims handling be introduced in ASIC's penalty powers.

The consumer dispute resolution framework for claims handling be strengthened under the Government response to the current Ramsay review by ensuring better and more effective consideration of issues of fairness to supplement the existing jurisdiction and giving better access to consumers with complaints about delays in claims handling and ensure better remedies when these complaints are found in favour of the consumer.

ASIC undertake targeted follow-up reviews on areas of concern, including for individual insurers with high decline, withdrawal and dispute rates, as well as review life insurance sold directly to consumers without personal advice.

The insurance sector comply with ASIC's expectation that it undertake an immediate review of the currency and appropriateness of policy definitions; examine and ensure advertising and representations about the cover align with the definitions and the policy, and report any discrepancies to ASIC; ensure that claims timeframes are consistent with industry standards and expected claims timeframes are adequately communicated to policyholders; and ensure that incentives and performance measurements for claims handling staff and management do not conflict with the obligation to assess each claim on its merit. The results of this should be report by ASIC in the lead up to the first review of the newly introduced Code.

The Government consider legislative reform to impose strict time limits on life insurers to decide claims.

## Surveillance and Investigations

A critical part of the claims handling processes of insurers is the engagement of third party private investigators and the undertaking of surveillance.

In 2016 Financial Rights released a report into insurance investigations in Australia titled: *Guilty Until Proven Innocent*.<sup>43</sup> The report found major problems with the investigations process. Consumers reported:

- being subject to incredibly long interviews up to five hours, sometimes repeated over months;
- being bullied, harassed and intimidated by investigators.
- being “treated like a criminal” and that the investigator has prejudged their guilt with little or no basis, putting forward theories that bear scant resemblance to reality.
- being grilled with repetitive and seemingly irrelevant questions about highly personal and sensitive issues like past relationships and medical conditions.
- that investigators threatened to reject claims and or initiate serious repercussions (such as the reporting of relatives to immigration) if consumers did not act in the way the investigator demanded.
- racial profiling.
- failure to provide people with poor English skills access to appropriate translators and failure to provide consumers with mental health problems the use of a support person
- being given little or no explanation of the investigation process and no mention of any rights or standards.
- being asked to sign documents that are not explained, asked to hand over personal and sensitive documents without warning and with no reasons given, and have had their neighbours, family, friends and business associates or clients questioned without the policyholder being notified.

Financial Rights found that the onerous demands placed on consumers by an investigation led many to withdraw their claim, again not due to any admission of fraudulent behaviour but simply because the process is too burdensome or invasive for many consumers to bear.

The report found that the state of private investigator licensing in Australia is a mess.<sup>44</sup> There is vast variability across jurisdictions in the content and coverage of licensing schemes, training methods and quality control, and a multiplicity of associations and self regulatory codes. This is confusing to consumers. It is not clear there is any uniform competency or accountability standards for private investigators across Australia. This mess is at least in part acknowledged by the industry itself.<sup>45</sup> One private investigator told Financial Rights that they are a member of an Australian association only because he had to be and would not be a member otherwise. He and his colleagues have chosen to be a member of the US based Association of Fraud Examiners which has Sydney and Melbourne chapters. This association provides significant training and certification standards unavailable in Australia.

Financial Rights also notes the substantial ambiguity with respect to whether insurance investigators need to be licensed. All state licensing schemes exempt insurance companies, loss adjusters and their employees from the need to be licensed as a private investigator. The General Insurance Code requires third party investigators to hold a current licence but only “if

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<sup>43</sup> Ibid.

<sup>44</sup> For full details of this mess see pp. 70-76, *Guilty Until Proven Innocent*

<sup>45</sup> ALRC Report on *Privacy Law and Practice*, 2008, para. 44.76

required by law".<sup>46</sup> Some insurance companies do however require their external investigators to be licenced. Ultimately this means that some of the investigators working in insurance investigations will be licenced and others will not. Not that this ultimately means much to a policyholder given the variability of regulations, dearth of standards and lack of clear avenues of redress applying to their conduct.

The Australian Law Reform Commission (ALRC) recommended in its 2008 Report on Privacy Law and Practice that the Federal Governments through the Council of Australian Governments consider developing uniform private investigator regulations. As a part of this there should be a uniform enforceable code of conduct that supersedes the mess of ineffective and unsubstantial self-regulatory codes that currently exists.

In order to ensure greater confidence in the use of third party private investigators in the life insurance (and general) insurance industries, the Federal and State Governments through the Council of Australian Governments develop uniform private investigator licensing regulations with an enforceable code of conduct.

In addition the Federal and State Governments through the Council of Australian Governments develop uniform surveillance and listening devices laws that provide for strong consumer protections. The ALRC Report *For Your Information Only*<sup>47</sup> recommended that surveillance device laws should be uniform across Australia, a recommendation supported by the majority of submissions. Financial Rights supports this recommendation as well. Such legislation should:

- provide stricter protections for members of the public;
- provide greater certainty to consumers and businesses;
- be technologically neutral to ensure that all (known and developing) forms of surveillance be captured; and
- should remove "participant monitoring" exceptions (found in Qld, Vic, and NT), that is outlaw the recording by one party to a private conversation or activity without the consent of other parties.

## Recommendations

That the Federal and State Governments through the Council of Australian Governments develop uniform private investigator licensing regulations with an enforceable code of conduct.

That the Federal and State Governments through the Council of Australian Governments develop uniform surveillance and listening devices laws that provide for strong consumer protections including stricter protections for members of the public; greater certainty to consumers and businesses; technological neutrality to ensure that all (known and developing) forms of surveillance be captured; and removal of "participant monitoring" exceptions (found

<sup>46</sup> GICOP 2014, s. 6.3(b)

<sup>47</sup> ALRC, 2008. *For Your Information Only: Australian Privacy Law and Practice*, ALRC Report No. 108, <http://www.alrc.gov.au/publications/44.%20New%20Exemptions%20or%20Exceptions/private-investigators>

in Qld, Vic, and NT), i.e. outlaw the recording by one party to a private conversation or activity without the consent of other parties.

## Unfair contract terms, standard cover and standard terms

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### Unfair Contract Terms in Insurance

When the ACL commenced in January 2011 it replaced and amalgamated 17 existing laws and included new unfair contract terms (**UCT**) provisions. However, as recently noted in the ACL Review Issues paper, the UCT regime does not apply to insurance contracts. The *Insurance Contracts Act 1984* (Cth) does not include protections against unfair contract terms and excludes any Commonwealth, state or territory laws regarding contractual 'unfairness' from applying to contracts of insurance regulated under that Act, such as the unfair contract terms provisions in the ACL and ASIC Act.

This means that unfair contract term protections currently apply to every other contract an Australian consumer is ever likely to enter apart from insurance including financial products and service contracts under Subdivision BA of Division 2 of Part 2 of the ASIC Act 2001 (Cth).

It has long been the view of consumer advocates that there is no sound reason to exempt the insurance industry.

There have been a number of arguments put forward by the insurance industry against imposing the UCT regime on insurers. One, for example is that the duty of utmost good faith as codified in the *Insurance Contracts Act 1984* (Cth) is adequate to ensure consumers are protected. Insurers have argued that this duty covers the same issues that arise with unfair contracts and imposing the UCT regime on insurers would add an additional layer of regulatory complexity. Financial Rights strenuously disagrees with this view and believes that the duty of utmost good faith has neither prevented the spread of unfair terms in insurance contracts nor has it provided the courts or external resolution schemes with any power to provide a remedy to consumers when an unfair term has been used.

Sections 13 and 14 of the *Insurance Contracts Act* do not provide that an insurer is in breach of the duty of utmost good faith merely because of the fact that they wish to rely on a contractual term that is unfair. Most consumers do not argue on the basis of good faith at the FOS and it is not commonly relied upon, if at all as a basis, for relief from an unfair term. The FOS has struggled in determinations to deal with unfair contact terms due to the limitation in the *Insurance Contracts Act 1984* and the limited scope of the duty of utmost good faith.

Unfair terms are usually hidden away in the fine print of an insurance contract or product disclosure statement and are rarely read or understood by a consumer when selecting coverage.

Financial Rights regularly comes across unfair contract terms in insurance causing a significant imbalance in the parties' rights and obligations arising under the contract. These terms are not reasonably necessary in order to protect the legitimate interests of the party who would be

advantaged by the term, and they cause detriment (whether financial or otherwise) to a party if it were to be applied or relied on.

Financial Rights provides the following general insurance examples to illustrate

The insurer RAA included the following statement in its comprehensive car insurance:

*"If your claim has been investigated and you withdraw your claim or we refuse to accept it, you may have to pay any costs incurred for the investigation of your claim."*<sup>48</sup>

This term is both a significant incentive for the insurer to investigate every case and delay payouts. It also acts as a significant disincentive to make a claim when the policyholder knows that they could be up for the cost of an investigation.

AVEA include the following term in their Motor Vehicle Insurance:

*If You are responsible for damage to another person's Vehicle, We will pay the costs of hiring a substitute Vehicle for that person at publicly available commercial rates not exceeding \$100.00 per day to a total of \$1,500.00. See Additional Benefits Section for details about how rates are calculated.*<sup>49</sup>

and

*If You are responsible for damage to another person's Vehicle, We will pay the reasonable costs of hiring a substitute Vehicle for that person at the lowest publicly available commercial rate, not exceeding \$100.00 per day. This benefit is limited to \$1500.00*<sup>50</sup>

These terms limit liability for 3<sup>rd</sup> parties seeking damages against the at fault party insured with AVEA. They limit the cover to \$1500 when most other policies have liability cover up to \$20 million.

RSPCA Pet Insurance includes the following cancellation term:

*We will only accept notices of cancellation given in writing and signed by you. We will not accept cancellation requests by telephone or email unless agreed to by us. If you return your policy during the cooling off period, we will refund any premiums paid since commencement or renewal, less any reasonable administrative and other transaction costs incurred by us which we are unable to recover and any taxes or duties that we are unable to refund.*<sup>51</sup>

Limiting cancellation to the provision of notice in writing "unless agreed by us" and retention of "reasonable administrative costs" that are not specified unreasonably disadvantages the consumer and causes enormous difficulties to consumers trying to cancel a policy.

<sup>48</sup> RAA, (2014). *Comprehensive Car Insurance, Product Disclosure Statement* <http://www.raa.com.au/documents/comprehensive-car-insurance-pdsapr15> p22

<sup>49</sup> AVEA *Product Disclosure Statement - Motor Vehicle Insurance* [https://www.avea.com.au/download/product\\_disclosure\\_statements/MotorVehicle\\_V011214\\_Web.pdf](https://www.avea.com.au/download/product_disclosure_statements/MotorVehicle_V011214_Web.pdf) p.6

<sup>50</sup> AVEA *Product Disclosure Statement - Motor Vehicle Insurance* [https://www.avea.com.au/download/product\\_disclosure\\_statements/MOT\\_V011115\\_Web.pdf](https://www.avea.com.au/download/product_disclosure_statements/MOT_V011115_Web.pdf) p.8

<sup>51</sup> RSPCA Pet insurance p24. <https://www.rspcapetinsurance.org.au/RSPCA/media/Document/rspca-policy-booklet.pdf>

Youi's Uninsured motorist extension provides cover in the following limited circumstances:

*Under Third Party, Fire and Theft or Third Party Property Only cover, up to \$5,000 or the car's market value, whichever is the lesser, for accidental damage to the car, if there was an uninsured third party motorised vehicle involved and if:*

...

*we agree that the third party was completely to blame for the accident;*

*you provide us with the name, residential address, contact phone number and vehicle make and registration number of the other party; ...<sup>52</sup>*

This term permits the insurer to make an arbitrary decision to exclude if they do not agree and do not have to base this on the facts or evidence before them. The requirement to provide name, residential address, contact phone, vehicle make, model and rego is unreasonable if the driver at fault refuses to provide the details or flees the scene. The cover here is not limited in this way under comprehensive cover policies.

Finally Financial Rights solicitors regularly see terms that involve the automatic renewal of policies or fixed term contracts. The UK Financial Conduct Authority lists automatic renewal of a fixed-length contract where the deadline to cancel is unreasonably short, as an unfair contract term. In Australia, ASIC last year reviewed six insurers' car insurance renewal practices.<sup>53</sup> They found that:

*"consumers were not always clearly informed by insurers, when first purchasing the policy, that it would automatically renew unless the consumer advised otherwise. In most cases consumers were only informed about the automatic renewal practice in the product disclosure statement (which may not be received by the consumer until after the insurance is purchased) and renewal notice."*

The law does not prevent insurers from automatically renewing insurance policies and in some cases consumers seek this feature out, however by structuring the sales and disclosure practice in such a way that does not fully inform consumers of this renewal practice unreasonably advantages the insurer. Where consumers inadvertently find themselves insured twice, they struggle to obtain a refund for the full premium and are often limited in only recovering 50% of the overpaid premium on the basis the insurer was "on risk".

With respect to life insurance claims, Financial Rights points to the ABC 7:30 report on a life insurance claim being rejected on the basis that MLC would only pay out if a patient had been intubated in intensive care with a tube down their throat for 10 days. The patient in the report had had this for 7 days and therefore his claim was not paid. The average for intubation is 4 days. This clearly is unfair and a definition that is simply impossible to meet. In a sense life insurance is providing illusory cover.

<sup>52</sup> Youi, *Car Product Disclosure Statement* p12 <https://www.youi.com.au/GetPDS/?riskType=VEH>

<sup>53</sup> ASIC, 15-345MR ASIC drives better disclosure of automatic renewal of car insurance, 19 November 2015

<http://asic.gov.au/about-asic/media-centre/find-a-media-release/2015-releases/15-345mr-asic-drives-better-disclosure-of-automatic-renewal-of-car-insurance/>

We believe that these terms and the examples provided above *prima facie* meet the definition of an unfair term in that they cause a significant imbalance in the parties' right and obligations arising under the contact, are unnecessary and can and do cause detriment to consumers. Furthermore none of these terms could arguably fall within the duty of utmost good faith nor be remedied by a court or EDR service.

Financial Rights suggests that the wheel does not have to be re-invented with respect to designing an appropriate UCT regime applying to insurance contracts. Financial Rights points to the previous attempt to enact such a regime with the Government's development of an *Insurance Contracts Amendment (Unfair Terms) Bill 2013*. The Federal Government introduced this Bill to extend the protections from unfair contract terms available for consumer contracts of other financial products and services to general insurance contracts. The Bill never entered into law. Financial Rights notes that the UK banned unfair terms in insurance contracts under their Consumer Rights Act 2015.

Before describing the design of 2013 Bill it is worth noting that it would have applied to general insurance contracts only. We are strongly of the view that any unfair contract terms regime should apply to all insurance contracts with no exceptions. Just as it is an unwarranted and unreasonable anomaly that insurance contracts are exempted from the UCT regime, exempting one part of the insurance sector from any new regime would be similarly unreasonable. The issues of fairness of terms in life insurance policies are as important and relevant as those that relate to general insurance and extend to and include group life products that can provide TPD and death cover to the most vulnerable members of the community. Consumer groups, including ourselves did not oppose this approach at the time on the understanding that the Government would consult further on how unfair terms would be extended to life insurance contracts.

The principles for the design of the 2013 Insurance Contracts Amendment (Unfair Terms) Bill were set out by the then Minister as follows:

***Principles for extending Unfair Contract Terms laws to general insurance contracts***

*Unfair contract terms (UCT) laws for insurance will be introduced into the Insurance Contracts Act 1984 (IC Act), based on the UCT regime that applies under the Australian Securities and Investments Commission Act 2001 (ASIC Act) and with the following elements which includes some tailoring for insurance:*

- *the regime will apply to consumer contracts that are standard form insurance contracts;*
- *it will be included as part of the duty of utmost good faith;*
  - *that is, if a term is found to be unfair, the insurer will be in breach of the duty of utmost good faith;*
- *the remedy available where a term is found to be unfair will be that the party may not rely on the term;*
- *in addition to the above remedy, a court may consider whether there is another more appropriate remedy;*

- *ASIC and consumers will both have the right to take action under UCT laws;*
- *ASIC will have the range of enforcement powers that are currently available to it to administer the UCT laws in the ASIC Act replicated in the IC Act for the purposes of enforcing the UCT laws in the IC Act;*
- *the UCT regime will not apply to a term to the extent it:*
  - *defines the main subject matter of the contract;*
  - *sets the upfront price payable under the contract; or*
  - *is a term required, or expressly permitted by a law of the Commonwealth or a State or Territory.*
- *the definition of an unfair term is that the term:*
  - *would cause a significant imbalance in the parties rights and obligations under the contract;*
  - *would cause detriment to a party if relied on;*
  - *is not reasonably necessary to protect the legitimate interests of the party advantaged by the term. For the purposes of determining whether a term in an insurance contract is reasonably necessary to protect a legitimate interest, a term will be reasonably necessary if it reflects the underwriting risk accepted by the insurer.*
- *the insurer will have the onus of proof that a term is reasonably necessary to protect their legitimate interests; and*
- *the UCT regime will not apply to life insurance contracts at this stage.*<sup>54</sup>

This proposal by the Minister came out of extensive consultation by Treasury, the Assistant Treasurer and his office with insurers and consumer advocates. The proposal—in particular the decision to insert new elements in the Insurance Contracts Act rather than simply extend the existing ASIC Act provisions to insurance—was not the preferred option for consumer advocates at the time.<sup>55</sup> However we took the view that the legislation was a workable compromise with the insurance sector, had importantly had the support of the ICA and was a considerable improvement on the current situation. It was also achieved through genuine negotiation between both sides of the debate. Any argument from the ICA against such a regime is disingenuous and simply one of political opportunism.

<sup>54</sup> Minister Bradbury, Media Release: Protection from unfair terms in general insurance contracts. <http://ministers.treasury.gov.au/DisplayDocs.aspx?doc=pressreleases/2012/171.htm&pageID=003&min=djba&Year=&DocType=>

<sup>55</sup> A full description of the options canvassed can be found in Treasury's *Unfair terms in insurance contracts – Options Paper*. [http://icareview.treasury.gov.au/content/\\_download/unfair\\_terms\\_options/unfair\\_terms\\_options\\_paper.pdf](http://icareview.treasury.gov.au/content/_download/unfair_terms_options/unfair_terms_options_paper.pdf) There were five options put forward: Maintaining the status quo; Option A – Permitting the unfair contract terms provisions of the ASIC Act to apply to insurance contracts; Option B – Extending IC Act remedies to include unfair terms provisions; Option C – Enhancing existing IC Act remedies; and Option D – Encouraging industry self-regulation to better prevent use of unfair terms by insurers.

Financial Rights implores this inquiry to consider yet again the full sweep of options considered in 2013 but we would support the compromise design developed at that time. The only exception to this is we believe that the regime should be extended to both general and life insurance contracts for the reasons of inherent unfairness as outlined above.

## Recommendation

That the exemption for insurance products under the UCT regime be removed.

### Standard Cover

In the absence of a specific suitability requirement, or to complement such a requirement, the government should improve the standard cover provisions of the *Insurance Contracts Act* which currently service no practical purpose.

The *Insurance Contracts Act* under sections 35 and 37 provide for standard cover in certain types of common general insurance but allows insurers to contract out of these provisions so long as they clearly disclose this fact in writing. In practice all insurers contract out of the provisions, rendering them pointless.

The standard cover regime was originally enacted as a response to the Law Reform Commission's 1982 Report on Insurance Contracts.<sup>56</sup> The Law Reform Commission argued that:

*difficulties caused by lack of information available to insureds are made worse by the wide of terms of insurance contracts offered by different insurers and the unusual terms which sometimes appear in them. In order to alleviate these difficulties, standard cover should be introduced ...*<sup>57</sup>

The Law Reform Commission continued to state that:

*Policies contain numerous terms which affect in unexpected ways the cover offered. In a few cases, the insured's attention is drawn to the relevant limitation at the time when cover is arranged. In the vast majority of cases, however, nothing is said. The insured's ignorance remains undisturbed until he makes a claim. .... The market is at present distorted by the fact that purchaser discrimination is limited to matters like price, little or no account being able to be taken of differences in the nature of the products being sold.*<sup>58</sup>

The original vision for standard cover was one in which :

*An insurer should be free to market policies which offer less than the standard cover. If it chooses to do so, it should have to draw the insured's attention to that fact and to the nature of the relevant diminution in cover. If it fails to do so, the contractual terms should be overridden to the extent to which they provide cover which is less than the standard.*

<sup>56</sup> <http://www.alrc.gov.au/report-20>

<sup>57</sup> p.xxvi <http://www.alrc.gov.au/report-20>

<sup>58</sup> pp.44-45 <http://www.alrc.gov.au/report-20>

The problem with the implementation of this vision is that, as alluded to above, Section 35 includes a “get out of jail” clause stating that the standard cover regime:

*does not have effect where the insurer proves that, before the contract was entered into, the insurer clearly informed the insured in writing (whether by providing the insured with a document containing the provisions, or the relevant provisions, of the proposed contract or otherwise).*

In other words, insurers don’t have to “draw the insured’s attention” to the fact that they are providing less than standard cover – they just provide it in the PDS and contract. We note the recently released research by the Insurance Council of Australia that found that only between 19% and 26% (depending on the type of general insurance) used the PDS in their pre-purchase decision making and even fewer (3%-7%) used it as their main source of information. Further, while many consumers believed they were aware of the terms of their policy, actual tested comprehension levels were low in comparison to confidence levels.<sup>59</sup> In short, insurer’s can offer less than standard cover simply by tell their customers in a document few read and even less understand.

Financial Rights strongly believes that the Government needs to take another look at standard cover and institute a more effective regime that ensures that consumers can better compare insurance products and decrease the possibility that consumers will end up with an unsuitable product.

## Recommendations

Remove subsection 35(2) of the *Insurance Contracts Act* – that is, the standard cover “get out of jail” clause.

Introduce a complimentary suitability requirement.

Introduce marketing obligations to draw the insured’s attention to product elements that stray from standard cover, and

Introduce a default cover regime requiring insurers to carry standard cover products and placing the consumer in this default cover unless they explicitly choose different cover.

Ensure that the general product design and distribution requirement also applies to insurance, noting that the government has recently released a proposal paper on design and distribution obligations on issuers and distributors of financial products and a product intervention power for ASIC.<sup>60</sup>

<sup>59</sup> Consumer Research on General Insurance Product Disclosures Research findings report, February 2017, available at [http://www.insurancecouncil.com.au/assets/report/2017\\_02\\_Effective%20Disclosure%20Research%20Report.pdf](http://www.insurancecouncil.com.au/assets/report/2017_02_Effective%20Disclosure%20Research%20Report.pdf)

<sup>60</sup> Treasury, Design and Distribution Obligations and Product Intervention Power, Proposals Paper, Dec 2016 <http://www.treasury.gov.au/~/media/Treasury/Consultations%20and%20Reviews/Consultations/201>

Remove section 15 of the *Insurance Contracts Act* which currently excludes the operation of other laws which, for example, provide for judicial review of a contract on the grounds of harshness or unconscionability or relief from the consequences of misrepresentation.

### Standard terms and default cover

Financial Rights notes that the Government has recently had to intervene in the insurance market to ensure that there is one standard term that applies to all home and contents policies: the definition of flood. Following the floods of 2011 and subsequent lack of coverage for many home owner policyholders, flood cover is now included in home and contents insurance policies, with a common definition, but consumers have the choice to "opt out".

In Financial Rights experience many consumers are doing so, or simply finding it impossible to find cover at an affordable price. Financial Rights gets regular calls from consumers who are unhappy with the premium being asked in relation to their flood cover. Complaints include:

- Consumers disagree with insurer's assessment of the risk in the general area
- Consumers have undertaken flood (or storm, or indeed fire) mitigation work that has not been taken into account
- Consumers believe they have been wrongly allocated to an area of general high risk – for example, they are one of the only houses on top of a hill in an otherwise flood prone area
- Consumers simply cannot afford the premium being asked.

Some callers are being refused insurance completely:

*An employee of a shire council rang to report that in the last two weeks nine residents of his council area had rung to complain they have been refused insurance due to increased flood risk. In 2009 the council had conducted a flood risk study done and only three dwellings were in 1% flood risk lines. None of the nine residents who complained were in this risk bracket which meant they had only a 1 in 10 000 risk of flooding.*

Financial Rights been approached by a least one insurer concerned about the number of customers who are opting out of flood insurance and wanting to know to what extent we can assist people better understand their risk. We have noted from our calls that consumers are extremely price sensitive – they will call up complaining about relatively small premium increases or ask why typing one of their neighbour's addresses into the insurance price calculator creates a \$30 difference – and have a tendency to discount the likelihood of loss events occurring.

We are concerned that events similar to 2011 are likely to occur again, with significant numbers of properties uninsured for flood as a result of customers being unable to afford appropriate cover in the private market, being refused cover, or opting out of cover without appreciating the full extent of their risk. The market solution is not currently working. All

indicators currently point to a likely increase in natural disaster events. These events are inevitably going to cost the government significant amounts of money.

The NDIR recommendations offered a solution which invested that money in strategic way, ensuring flood mitigation and improved planning was a key part of the equation.

Either the recommendations of the NDIR should be fully implemented or the government and insurance industry need to come up with an alternative model of default cover which provides real solutions.

### **Standard Medical Definitions**

Recently there have been a series of high profile cases involving life insurance companies denying claims on the basis of definitional gaming and out of date terminology. These include claims denied because a stem cell treatment used the patient's own cells rather than someone else's,<sup>61</sup> because insurers were relying on an outdated medical definition of a heart attack<sup>62</sup> and because insurers were relying on an outdated medical understanding of arthritis treatments.<sup>63</sup>

The most common concerns with medical definitions that Financial Rights sees are firstly, that there are varied definitions used by insurers, which make it difficult for consumers to compare policies and understand exactly what cover is extended to them under their policy. Secondly, not all insurers provide cover for particular events. Thirdly, where certain medical events are excluded or limited, consumers may be unaware of this.

#### **Case Study – Jerry's story - CLSIS133409**

Jerry was refused a claim on his life insurance after a heart attack 3 1/2 years ago. The claim was refused on a technical definition of heart attack. The definition has subsequently been updated, which he believes would fit his original circumstance. He saw the Four Corners report and contacted the ILS to know whether it is worth challenging this decision? His claim was declined in about Sept 2012 and didn't go through with a complaint at that time as he just accepted their decision.

#### **Case Study – Stephen's story - CLSIS109293**

Stephen was injured in a car accident and claimed for whiplash and post traumatic stress under his income protection policy. The insurer rejected PTSD as they don't cover mental illness, and rejected whiplash because they claimed it was caused by mental illness, not the accident. Stephen has a letter from a doctor saying that the whiplash was from the accident.

<sup>61</sup> <http://www.abc.net.au/news/2015-11-25/sick-mother-denied-transplant-over-technicality-in-policy/6970656>

<sup>62</sup> <http://www.abc.net.au/news/2016-03-05/comminsure-denying-heart-attack-claims/7218818>

<sup>63</sup> <http://www.smh.com.au/business/banking-and-finance/arthritissufferers-denied-payouts-due-to-antiquated-medical-js-20160311-gngu5q.html>

### Case Study – Luigi’s story – CLSIS 25299

Luigi took out income protection insurance through his superannuation fund to cover loss of income in the events of sickness and injury. A year later he experienced pain in his left wrist. He sought medical attention, and discovered that his left scaphoid bone was not healed from an injury in ten years previous. Because of his wrist pain, he was unable to work as a chef. He lodged a claim with the insurer and was rejected on the basis that the injury occurred prior to the policy’s commencement.

We raised a dispute that, as the policy did not provide definitions of “sickness” and “injury”, Luigi’s wrist pain came within the meaning of “sickness” rather than “injury” because (a) dictionary definitions provide that “sickness” means a disordered, weakened and unsound condition, and this applies to Luigi’s wrist pain (b) Luigi first became aware of it while the policy was in force. The insurer rejected this argument without providing any explanation.

The claim was eventually paid.

Financial Rights believes that there is significant justification for the government to intervene and consider introducing fair and easily understood standard definitions for common concepts in life insurance. This should include but not limited to heart attack, sickness, injury and illness, that would be used in all Australian life insurance policies.

We note that the newly developed Life Insurance Code has included a clause that promises three-yearly reviews of defined medical events by a ‘relevant’ medical specialist to ensure the definitions remain current: clause 3.2. The FSC have also recently released a draft Minimum Standard Medical Definitions document detailing standard definitions for three medical events: cancer (excluding early stage cancers); severe heart attack (measured by specific tests) and stroke (resulting in permanent impairment).

While we commend the FSC for taking these steps, Financial Rights continues to have serious concerns with respect to the design of these definitions, clauses and guidelines and subsequently the seriousness in which the FSC and life insurers are approaching the issue of medical definitions.

Apart from the fact that the FSC is only considering standardising three medical events, central to our concern is that the ‘relevant’ medical specialist under the draft guidelines does not have to be *independent* of the insurers. Who is a “relevant” medical specialist is entirely at the discretion of insurers and the FSC. This fundamentally undermines the appearance of impartiality and raises questions as to the validity of the draft and any review into medical definitions, in the eyes of consumers.

The draft guidelines also guarantee updates to medical definitions but for ‘on sale’ policies only—this is likely to leave gaps for many people whose policies are no longer ‘on sale’.<sup>64</sup>

Financial Rights also notes ASIC’s concern regarding upgrading policies’ medical definitions and that, as recommended in the FSI report, the Government needs to introduce a mechanism to facilitate the rationalisation of legacy products in the life insurance sector.<sup>65</sup> ASIC also notes the effect of s9A of the *Life Insurance Act*, which provides that an insurer can only pass on the benefit of a change to a policy if they do not charge the consumer more as a result.<sup>66</sup> Financial Rights supports policy reform to “allow upgrades of existing life insurance policies on a portfolio basis to more current definitions, where this is beneficial to policyholders, allowing any premium impact to be spread across the portfolio.”<sup>67</sup>

## Recommendations

That the Government step in to mandate minimum standard medical definitions for inclusion in life insurance policies to be reviewed and regularly updated by *independent* medical specialists.

That policy reform be implemented, as recommended by ASIC, to allow upgrades of existing life insurance policies on a portfolio basis to more current definitions, where this is beneficial to policyholders, allowing any premium impact to be spread across the portfolio.

## Insurance Disclosure

Consumers continue to face significant complexity, confusion and exhaustion when purchasing insurance products. Consumers know they need insurance but shopping around is difficult and time consuming. This leads to people choosing on price or brand rather than detailed consideration of features. At renewal time, the complexity means consumers are reluctant to shop around and this creates an incentive for insurers to increase price more than necessary in the expectation that consumers will tend to be apathetic and remain with their current insurer.

### Premium transparency and contestability

Insurance prices throughout Australia can vary depending on the actuarial and statistical data held by the insurer. Insurance pricing is increasingly becoming more granular. More and more information is being collected about consumer habits and risk profiling. Financial Rights is concerned that the more that granular and specific data is collected the greater the exclusion will be for some sections of the insurance market. The use of granular data may lead to more

<sup>64</sup> For further information see our joint submission to the FSC’s consultation on their draft Minimum Standard Medical Definitions, [http://financialrights.org.au/wp-content/uploads/2016/11/161111\\_FSCDraftMedicalDefinitions\\_Submission\\_FINAL.pdf](http://financialrights.org.au/wp-content/uploads/2016/11/161111_FSCDraftMedicalDefinitions_Submission_FINAL.pdf)

<sup>65</sup> Para 370 *Report 498 Life insurance claims: An industry review*, October 2016  
<http://asic.gov.au/regulatory-resources/find-a-document/reports/rep-498-life-insurance-claims-an-industry-review/>

<sup>66</sup> Op cit, ASIC, para371  
<sup>67</sup> Op cit, ASIC, para 372

targeted (and lower) pricing for some consumers, but others will be left underinsured or uninsured.

Additionally, the more data used to calculate risk and price premiums, the greater the risk for error. Current competition is in our view adversely affected by the lack of transparency in premium pricing. There is currently no adequate mechanism to review whether premiums are being calculated fairly.

Through the Insurance Law Service, Financial Rights regularly receives complaints from consumers about the level of their premium. Consumers sometimes believe their premium has been incorrectly calculated given their claims history, or has been calculated based on incorrect information. From our experience, consumers who dispute their premium or excess pricing with the insurer are generally left feeling unsatisfied. We are told:

- a) the sales team cannot explain why the premium is priced as it is;
- b) they are provided generic answers; or
- c) they do not feel the insurer has taken any steps to look at their particular situation.

For example, in flood coverage for home insurance products, an insurer may historically have priced premiums on a suburb level rather than an individual property level, creating a benefit to shopping around in some regions. Some consumers will benefit from using insurers which take into account specific hydrological data about their property (and price lower accordingly). Alternatively, where a specific property is assessed as high risk for its individual topography, a suburb-based premium could be more competitive. In some regions this does not occur because there are fewer insurers, or no insurers pricing on postcode or a higher peril.

#### **Case study: Failure of contestability in North Queensland**

Sally lives in North Cairns. Her property was built in the 1940's and is located in the White Zone outside the Storm Tide Zone as advised by her Local Council. Since buying the property and after Cyclone Yasi, Sally made some structural changes to the property and was advised by her builder that it was now "cyclone rated". She was insured for Storm, but not Storm Surge or Flood, and her premiums were \$5,000 per annum. She was happy with her policy in light of the property modifications. In early 2014 at renewal time, the insurer wrote to her and declined to renew her insurance policy on the basis her property was an "unacceptable risk".

Sally rang them and told them about the building works and that she was zoned in the White Zone. The insurer did not change its position, and continued to refuse to renew the policy.

Sally rang around other insurers, each time telling them at the point of sale about the works undertaken and that she was in the White Zone. No insurer would offer a policy of insurance to her.

Eventually, she contacted a broker, who arranged insurance for her at a higher price, so she would not be left completely uninsured.

Financial Rights helped her dispute the insurer's refusal to renew, by requesting written reasons under s75 of the *Insurance Contracts Act*. Shortly after ILS raised the written

dispute, the insurer changed its mind and offered Sally a policy at the same price as it was the year before.

Sally was disheartened as Financial Rights had not done anything more than what she had previously done apart from quoting a section of the Act and using legal letterhead. She was still completely in the dark about the reasons for their original decision to decline to cover her, or indeed why this was later reversed. She chose to remain with her new insurer out of dissatisfaction.

Through our extensive advice experience we have found that consumers have difficulty contesting premium pricing by insurers (despite section 75 of the ICA). Even when consumers do all the right things, they face impediments due to lack of competition and a lack of premium pricing transparency. It is commonly accepted that insurers' premium pricing information is "commercially sensitive" and if pricing is known it would somehow detrimentally affect their ability to compete. This guarded approach leads to consumer suspicion, misunderstanding and sensitivity to change. It undermines the insurance industry's credibility in being consumer focused and drives the perception of gouging.

The following case studies demonstrate the lack of information and explanations that insurance companies provide to customers about changes to premiums. Many of these case studies come from our ILS email inquiry form. In those examples identifying information has been removed for this submission, but the content comes directly from each consumer's email.

#### **Case study - Consumer awareness as to premium (Financial Rights email inquiry)**

We have just received our renewal notice a while ago while discussing contents insurance we had been told that we were over insuring our contents which would be costing us more to insure so we rang INSURER and arranged to bring the figure down from \$80,000 to \$45,000, while on the phone we also changed our address details from QLD to NSW. This is when problems started we were told we live in a high risk area so it will cost us more. (we spoke to neighbour they claim rubbish) then our renewal came we had reduced the amount of cover we needed yet the renewal was going to cost us \$85.00 more than it did when we had double the amount my wife was told that it was because the government in different state charge more than others it is not the insurers fault but the government I realise that Australia is not one country but several all run by different people and we need passport it travel from one state to another. so is it true is there a cost hike caused be governments?

#### **Case study (Financial Rights email inquiry)**

My insurance premium for my investment property and my house insurance have gone up 600% in the last 4 years, this company said there is nothing they can do for us and you will find the same quotes elsewhere so I wouldn't even try. My investment property is the problem, as we have fixed the first one. The problem is the [address in SUNSHINE COAST QLD]. the last years premiums were \$347 a month. I could no longer afford this and tried a few insurance companies to see if they could help. I recently had to cancel my policy with INSURER1 and joined INSURER2, their charge was \$90.00 a month. i feel like I've been

ripped off and would like to make a claim, if i look back at the other house premiums and they were as bad so there might be a case there as well. can you please help ??

**Case study: Lack of transparency in premium pricing (Financial Rights email inquiry)**

My car insurance policy is \$700 more expensive because of my address. The "a" after my street number is causing the problem. I own a free standing house with my own title. There are 3 homes with the same issue in this street.

**Case study: (Financial Rights email inquiry)**

Between one policy renewal schedule and the next, my excess increased from \$100 to \$500. My concerns are these:

1. The extent of the increase is 500%. This seems excessive and unreasonable, to say the least.
2. The only notification of the increase was a one-liner in the wording of the schedule itself, and a note at the foot of the reverse of the schedule. There was no prior notification warning of the increase - no letter warning that this might be coming. In my view, INSURER has acted in bad faith in not pre-announcing such a significant increase and therefore failing to allow its customers to consider their continued association with INSURER.

Renewal schedules come out as a matter of course; but a 500% increase in excess is something so out of the ordinary that it should have been flagged separately, and well in advance.

Had I not heard a INSURER Customer Service officer mention in passing a few days ago that the excess had increased by 500%, I would have been in the dark.

**Case study: Unexplained decrease in premiums**

Matthew has an apartment in Queensland. He was paying contents insurance of \$740 in 2012, and then \$841 in 2013 but his renewal this year was for \$231; a reduction of \$500 and over 50%. He rang them and asked what the reason for the reduction was and the insurer has told him they can't tell him. Now he wonders whether they calculated it correctly before and whether he has been overcharged. He worries he may not be covered for events and is now suspicious.

**Case study: Unexplained discounts**

John has insured his cars and homes with INSURER for over 15 years. John rang up to

switch his building insurance to landlord's insurance and was told that he should ring back when the rent is known as that may affect the premium. John did so and spoke to another representative; they noted the rental and the new policy price changed. In the course of the call, the representative said "I'll just make sure all your discounts have been applied, for all the policies" after a few minutes they came back and further reduced the policy price plus reduced the price on his other policies. John was irritated, why hadn't the first person done that and he has had these policies for over 15 years. Had they been doing it before?

In our view, the lack of transparency surrounding how premiums are priced is detrimental to the insurance industry, and it does not foster accountability. The insurance industry should not be able to shield relevant information on the grounds that there are using "commercially sensitive" rating factors and weightings. Consumers should have access to such information if they have a legitimate dispute about the reasons behind a premium or excess price or changes to their insurance policy conditions. There is currently no dispute resolution mechanism for a consumer notwithstanding the consumer's insurance policy may:

- Be offered with a premium the consumer believes to be unreasonable due to inappropriate assessment of risk; or
- Have complex terms and conditions the consumer cannot understand and, as a consequence, the consumer finds they have an inappropriate policy.

In its 2014 publication entitled "*Enhancing the consumer experience of home insurance: Shining a light into the black box*"<sup>68</sup> the Fire Services Levy Monitor (FSLM) reasoned that by improving the efficiency of insurance markets, through removing information asymmetry and making competition more effective, policyholders will be better informed and premiums will fall, thereby making insurance more accessible. In order to achieve this goal and to improve consumer awareness the FSLM specifically recommended that FOS:

*Provide easier access to information and dispute resolution – by removing hurdles to information provision by insurers and dispute resolution by the Financial Ombudsman Service, consumers are less likely to be disadvantaged by opaque risk rating practices of insurers.*

The FSLM report argued there is a need for greater contestability of premium pricing and cost pricing.

Currently, the main way premiums or insurers' decisions in relation to offering insurance is "reviewed" is by consumers shopping around to see what other insurers are offering, a mechanism next to useless in some pockets of Australia, such as northern Australia.

Outside of market forces the only other mechanism available is for an insured to make a request in writing under section 75 of the Insurance Contracts Act 1986. An insured however can only use section 75 when either their insurance is cancelled or by reason of some special risk relating to the insured or to the subject-matter of the contract, or when the insurer offers

<sup>68</sup> Fire Services Levy Monitor, *Enhancing the consumer experience of home insurance - Shining a light into the black box*, July 2014. available at: <http://www.firelevymonitor.vic.gov.au/home/news+and+information/publications/publication+shining+a+light>

insurance cover to the insured on terms that are less advantageous to the insured than the terms that the insurer would otherwise offer.

However, the Act and section 75 provide no guidance as to what information the insurer is obliged to provide in its written reasons, and there is no mechanism for review in the event the decision of the insurer is erroneous or based on incorrect information.

In insurance markets with limited suppliers such as Northern Australia, competition is not an adequate mechanism for consumers to 'review' insurance premiums. If all insurers are using incorrect data or not taking into account localised factors, then competition fails.

As a possible alternative, a consumer may make an application to FOS. However FOS has a very limited decision making power when it comes to reviewing premiums. The FOS Terms of Reference provides:

*Clause 5.1 - The service may not consider a dispute:*

- b) about the level of a fee, premium, charge or interest rate - unless:*
  - (i) the Dispute concerns non-disclosure, misrepresentation or incorrect application of the fee, premium, charge or interest rate by the Financial Services Provider having regard to any scale or practices generally applied by that Financial Services Provider or agreed with that Applicant; ...*
- e) in the case of a Dispute about a General Insurance Policy - about rating factors and weightings the insurer applies to determine the insured's or proposed insured's base premium which is commercially sensitive information;*
- f) about a decision to refuse to provide insurance cover except where:*
  - (i) the Dispute is that the decision was made indiscriminately, maliciously or on the basis of incorrect information; or*
  - (ii) the Dispute pertains to medical indemnity insurance cover; ...*

In the 2015/16 financial year 32 consumers lodged disputes about insurance cover refusals (under clause 5.1(f)) and were excluded from FOS, and 215 consumers lodged disputes about Level of fee/premium/charge and had the dispute refused.<sup>69</sup> The Annual Report does not indicate whether FOS accepted any disputes made by consumers under the above sections.

A review of all of the decisions made by FOS to date shows that 15 determinations have been issued in their jurisdiction about "incorrect premiums", the majority of decisions relate to consumers being misled.

Significantly, determination number 218234 recognises that an insurer has the commercial decision to increase premiums, but must disclose the basis of the increase beyond providing a general explanation. In Financial Rights' view, this was a good decision of FOS as it enabled a consumer some degree of contestability of an unexplained premium increase when the consumer's personal circumstances (and risk assessment) had not changed and the insurer could not justify the increase in the cost. However, this represents only one decision of FOS

<sup>69</sup> see the 2015/16 FOS Annual Review on page 58:  
<https://www.fos.org.au/custom/files/docs/20152016-fos-annual-review.pdf>

and has not resulted in any insurers giving reasons on renewals as to increases in insurance costs.

It is Financial Rights' view that insurers should not be able to hide behind vague reasons and unsubstantiated assertions about how premiums are priced. They should have to substantiate premium pricing across all forms of insurance. In the home and contents space it is essential.

The failure of industry to have any mechanism of review of the fairness and consistency of premium calculations is of significant detriment to consumers. This failure also provides no guarantee that any household mitigation strategies or idiosyncratic household conditions are taken into account when determining premiums. Consequently, premium prices cannot be said to be "accurate" signalling of risk as there is no contestability or transparency in their calculation.

A consumer may reject the premium as an inaccurate reflection of their risk, and where there are few insurers in the market place (or they are all relying on the same incorrect information) a consumer may decide to self-insure or be forced to be uninsured not only for the risk of the hazard but for all claims (where they cannot get any level of cover).

If a robust dispute mechanism was in place creating greater transparency and contestability of premium pricing, Financial Rights expects the following benefits to arise:

- a) consumers may be persuaded they are at risk, and decide to incur the cost to insure;
- b) consumers may undertake personal mitigation strategies; or
- c) consumers may lobby local government for local mitigation strategies.

In the absence of this information, consumers are in the dark and may be making poor decisions. If they could have a premium pricing decision reviewed by an independent body, consumers may be more likely to believe the risk assessments on their properties.

Financial Rights notes that ASIC have recently announced a "no-claims discounts health check" examining whether insurers have implemented measures that improved consumers understanding of how they work and ensuring "insurers are complying with their obligations to provide consumers with accurate information".<sup>70</sup> Financial Rights supports this examination into what is yet another layer of complexity confusing consumers and a lack of transparency from insurers.

## Recommendations

Amend s 75 of the *Insurance Contracts Act 1984* requiring insurers to provide written reasons for why premiums were increased on request in writing from a policy holder. These reasons should include any increased risk factor that the insurer has become aware of.

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<sup>70</sup> Greg Medcraft, ASIC, Regulatory Update to the general insurance industry, 17 February 2017, [http://www.insurancecouncil.com.au/assets/media\\_release/2017/annual%20forum%20day/greg-medcraft-speech-ica-annual-forum-17-february-2017.pdf](http://www.insurancecouncil.com.au/assets/media_release/2017/annual%20forum%20day/greg-medcraft-speech-ica-annual-forum-17-february-2017.pdf)

Alternatively, if legislative change is not feasible, the General Insurance Code of Practice should be amended to include a requirement for the insurer's IDR team to provide reasons for significant premium increases after a request in writing by the policy holder.

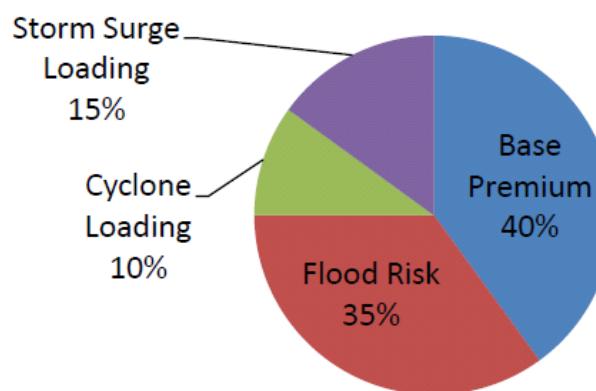
Change FOS Terms of Reference to allow disputes about the level of a premium if there has been an unfavourable change to an insurance policy (or if the insured has recently undertaken mitigation strategies on their home which have not resulted in a reasonable reduction of premiums) and the insurer's IDR response has failed to include adequate reasons for the change.

### Disclosure of Component Pricing

Financial Rights strongly submits that insurers should be required to provide information as to the components in their premium pricing. Knowing what makes up the price of a premium will better inform consumers about risk and what effect mitigation strategies may have on reducing insurance premiums or what behaviours or conditions might increase premiums. Component pricing information should apply uniformly across all insurers but will be particularly helpful in addressing a lot of the issues faced by those in parts of Australia that face severe weather risks. It would provide an easy to read, easy to understand signal to consumers of the risk factors taken into account when premiums are set. For example:

### J. Smith - Home Building Policy 2015

1234 North Street, Cairns QLD



The above would communicate to a consumer the risk, and the potential benefits of changing behaviour to mitigate that risk. To assist homeowners even further, information could be provided directly below the chart detailing practical tips on how a homeowner could mitigate cyclone risk and lower their premiums.

Financial Rights recognises that such a proposal may face objections from some in the insurance industry on the basis that pricing information is "commercially sensitive". Even if "commercial sensitivity" is accepted to be an issue, Financial Rights does not believe that it is insurmountable and asserts that there are simple and creative ways to ensure such information is sufficiently obscured without denying homeowners the right to basic information about their insurance. For example, the component pricing could use percentage

figures that are heavily rounded up or even display information using graphics and images only. The number of solutions available is in our opinion limited only by the will of vested interests rather than anything unique about insurance as a product. It is Financial Rights' view that "commercial sensitivity" must no longer be used as an excuse to continue to keep homeowners in the dark about an essential and important product and should not be wielded as some sort of trump card to prevent any and all changes aimed at improving information asymmetry in the insurance market.

Financial Rights also supports greater access to information on natural hazard mapping, modelling, exposure and risk. Insurance companies are not currently required to make this information available to consumers even when it applies directly to their premium price. This information should be made available by the government through a clearinghouse website (or any alternative government supported measure) to ensure data consistency and reliability. There should also be a review mechanism built in to the process.

Financial Rights supports the continued development of the Insurance Council of Australia's Building Resilience Rating Tool<sup>71</sup> however more work needs to be done to ensure that this tool is accurate and results can be contested if the rating doesn't take into account individual mitigation and resilience factors. We know this tool cannot guarantee that insurance premiums accurately match the ratings provided, but it might be an important step forward in informing consumers about their home's risk.

## Recommendations

Insurers should be required to provide component pricing of premiums.

Government should establish a clearinghouse website (or any alternative government supported measure) to ensure data consistency and reliability of natural hazard mapping and modelling.

Improve the ICA's Building Resilience Rating Tool

### Previous year's annual premium

Financial Rights believes that all insurers should commit to providing the previous year's premium on the annual renewal notice. Information can include

- the price of the new policy if the consumer renews;
- any difference between the new price and the old price; and
- the reasons for any change.

Such a change will alter consumer behaviour by prompting consumers to think about their insurance, ask their insurer about the price and features, and make informed decisions.

This move would be an important step in improving price transparency and assist consumers in making more informed decisions. The information at renewal is an important opportunity for consumers to consider their financial situation and make appropriate decisions. Information

<sup>71</sup> <https://www.resilient.property/>

about (a) the risks of switching and (b) any premium hardship options available under their existing policy may be of benefit to consumers. The industry should consider what best practice may apply at the point of renewal to prevent lapses, unnecessary churning, and other consumer harms.

With respect to the risks of switching, Financial Rights acknowledges that the FSC have included in the new Life Insurance Code of Practice at clause 4.8 that

*When you tell our sales staff that you are replacing an existing Life Insurance Policy, they will tell you that you should not cancel any existing cover until your new application is accepted, and explain the general risks of replacing an existing policy, including the loss of any accrued benefits, the possibility of waiting periods to start again, and the implications of any non-disclosure on your new application (even where unintentional).*

While we support the inclusion of this as an important step towards improved disclosure we do not feel that this goes far enough. Replacing or switching one's insurance cover is a critical moment of interaction between the insurer and policyholder. The failure of these interactions to fully inform the policyholder of the implications and risks of a switch leads to many of the issues that we hear on the Insurance Law Service. One key issue that arises, for example is a failure to fully understand one's own duty of disclosure. This one failure leads to increased levels of investigations and delays at claim time. Financial Rights believes it is incumbent upon insurers to provide full and meaningful information to every potential and current policyholder about the risks of switching, waiting periods, loss of accrued benefits, the duty of disclosure etc. Although it is welcome, it is simply not enough that sales staff explain this, merely when the policyholder "tells our sales staff that [they] are replacing an existing Life Insurance Policy." Financial Rights believes that there are more steps that insurers should take to improve insurance literacy. Online and hardcopy application forms should have Schumer Box-like information summarising the implications of a replacement policy. The Duty of disclosure should be better explained and policyholders should be assisted and encouraged to provide as many details as possible. Behavioural research needs to be undertaken to investigate the best approach to improving literacy in this regard.

Financial Rights also notes that there is a significant difference between the disclosure practices of insurance products obtained directly or via superannuation. Trying to obtain a PDS of a group insurance product is incredibly difficult. PDS's are generally not supplied to group insurance policyholders and generally speaking have no idea what they are covered for. They are also subject to the commercial whims of trustees switching covered for and whether their coverage has been reduced to save money. This too leads to a real risk of underinsurance for group insurance policyholders – something they are rarely if ever aware of or even able to find out.

## Recommendations

That it be mandated that insurers (including life insurers) provide the previous year's premium on the annual renewal notice including

- the price of the new policy if the consumer renews;

- any difference between the new price and the old price; and
- the reasons for any change.

Insurers should provide more meaningful information regarding the risks of replacing insurance products, the design of which should be informed by peer-reviewed behavioural research.

Insurers should provide premium hardship options under every policy they provide and provide this information on the renewal notice.

## Insurance Reporting

The insurance industry has a process of sharing information about the claims history of every consumer that has purchased insurance. The database is managed and supported by Dunn and Bradstreet on behalf of Insurance Reference Services Ltd – a member organisation owned by Australian insurers. The database contains the following information on consumers in Australia:

- Name, date of birth, driver's license, gender and residential address;
- Enquiries made by agents of insurance companies - such as loss assessors, adjustors or insurance investigators;
- Claims made under insurance policies; and
- Details of fraud investigations.

However a consumer can only obtain a copy of their insurance report (called My Insurance Claims Report) from Insurance Reference Services Ltd at [www.insurancereferenceservices.com.au](http://www.insurancereferenceservices.com.au) for \$22 (incl. GST). It was previously only available via Veda [www.myinsurancepassport.com.au](http://www.myinsurancepassport.com.au) for \$29.95 but this service has ceased and is now only available from Insurance Reference Services Ltd. There is no free access available to an insurance report for a consumer.

Insurers regularly check insurance reports when a claim has been made. The consumer purchasing insurance is told about the possibility of reporting to an "insurance reference bureau" (or similar) in the Product Disclosure Statement, often close to the end of the PDS. There does however seem to be inconsistency in obtaining consent to provide this information.

The selling point of an insurance passport put forward by Insurance Reference Services is that:

*"See what information Australian insurance companies know about your home and motor insurance claims history.*

*General insurance companies are required to disclose to policy holders, in their Privacy Statements and Privacy Policies, the extent to which your personal information may be shared with other insurance companies, loss assessors, claims agents and insurance reference bureaus. IRS is an insurance reference bureau and is one of the key resources that insurance*

*companies rely upon for sharing and verifying your insurance claims history across other insurers, to assist in claims management and detection of insurance fraud.*

*This information may be used by insurers to validate information provided to them when quoting, assessing your claim or setting your premium. My Insurance Claims Report is based upon the aggregated home and motor claims records of the IRS home and motor claims database.<sup>72</sup>*

A consumer being able to access a central database of claims information that assists in answering disclosure questions holds some potential value but Financial Rights is unaware to what extent consumers have taken up the opportunity. Insurers tracking consumers who make fraudulent or excessive claims to reduce the instance of fraud and calculate premiums also has potential value but there are many opportunities for misreporting and abuse without adequate rules and oversight.

However in Financial Rights' discussions with insurers, the reports are haphazard, inconsistent and largely unreliable so that the current report provides minimal benefit to insurers or consumers.

It is also Financial Rights' understanding that insurers may be using the database inconsistently, and are not aware of what the information contained on the report may mean. This could lead to a consumer being disadvantaged in unfair premiums, rejections for non-disclosure and inconsistent treatment. The utility and value for a consumer in having the report at the cost of \$22 is therefore undermined if the information it records is not consistent, accurate or up-to-date.

Financial Rights has several additional concerns. First, very few consumers know that insurance reports exist, their purpose and when their information is recorded.

Secondly, if information on a consumer's insurance history is collected and shared amongst insurers, access to this report should at the very least be free. Consumers need to be able to access information held by insurers about them to ensure that that information is accurate.

Finally, Financial Rights is concerned that there are no specific regulations covering insurance reports stipulating the permitted contents of the report, the type and the meaning of listings and the length of time the information is retained on a report.<sup>73</sup> The information held in an insurance report has the potential to be very prejudicial to a consumer in obtaining insurance or in making a claim. The lack of specific regulation in insurance reporting is in stark contrast with credit reports where there is extensive regulation about what information can be held, how consumers can get access and correction procedures.<sup>74</sup> Fraud is a serious allegation and the reporting of fraud on an insurance report is potentially defamatory and needs to be tightly regulated.

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<sup>72</sup> <http://insurancereferenceservices.com.au/about>

<sup>73</sup> According to Veda Advantage insurance enquiries are held for five years and claims for ten years, calculated on the date the information was added to the file and are based on the time limits provided in the Privacy Act 1988.

<sup>74</sup> Part IIIA of the Privacy Act 1988 (Cth) regulates consumer credit reporting in Australia and is supported by the Privacy Regulation 2013 (Cth) and the Privacy (Credit Reporting) Code 2014 (Cth).

Under s. 4.8 of the General Insurance Code (2014) insurers have committed to giving reasons why they cannot provide insurance and supplying consumers with the information they have relied on, if requested. In Financial Rights' experience these reasons are often vague and rarely have information regarding an insurance report. This means consumers are not even aware of the problem on their insurance report.

In summary, insurance reports drawn from the database are haphazard, inconsistent and largely unreliable providing minimal benefit to both consumers and insurers. Very few consumers know that insurance reports exist. Access to a consumer's own information is not free. There are no specific regulations defining and limiting the permitted contents of the report, the time information stays on the report, and no systems in place to ensure that incorrect, prejudicial and potentially defamatory information can be removed.

Similar to the regulation in place already for consumer credit reporting, Financial Rights recommends that the Federal Government, working with the Office of the Australian Information Commissioner and the insurance industry, overhaul the insurance reporting system through regulation. Central to any regulations should be rules to address issues of accuracy, timing, consistency of information, dispute resolution and the application of natural justice. The management of the database should also be put out to tender and principles of competition applied. Consumers should also have free access to the information held on them.

## Recommendations

The Federal Government should introduce insurance reporting regulations to bolster consumer and privacy protections.

## Banking and Credit Sector

### Comprehensive Credit Reporting

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Access to credit is important to consumers, and it is increasingly difficult to live in today's society without credit. One of the key elements to our credit regime is the comprehensive credit reporting exchange which has the power to greatly influence consumer's ability to access credit but is largely invisible to most Australians.

In Australia, credit reporting is regulated under Part IIIA of the federal *Privacy Act 1988*, the *Privacy (Credit Reporting) Code* (Version 1.2) and the national privacy principles. The Office of the Information Commissioner (**OAIC**) is responsible for the administration, regulation and enforcement of the *Privacy Act 1988*.

Financial Rights receives regular complaints from consumers who have been affected by the vagaries of the credit reporting system, and either do not understand the system, or feel they have and in many cases, have been treated unfairly by the system.

In 2014 amendments to the *Privacy Act 1988* allowed credit providers to report more comprehensive information on debtor's consumer credit files maintained by credit reporting agencies. Implementation of the regime, however, has taken considerable time.

In November 2014, the FSI, chaired by David Murray, in its Final Report indicated that the Comprehensive Credit Reporting (**CCR**) regime would not be operational until March 2015 at the earliest.<sup>75</sup> The Australasian Retail Credit Association (**ARCA**) reported that industry was then in the process of developing a data-sharing agreement based on reciprocity between credit providers to implement the CCR.<sup>76</sup> The agreement was not expected to be finalised until March 2015 at the earliest, and industry moreover anticipated that significant portions of credit data will not be exchanged until late 2016 or early 2017.<sup>77</sup>

In February 2015, ARCA sought authorisation from the ACCC in relation to establishing the Principles of Reciprocity & Data Exchange (**PRDE**). The PRDE is described as "a standardised system for exchanging credit liability information between credit reporting bodies and credit providers"<sup>78</sup> consisting of a voluntary set of rules to govern the exchange of comprehensive credit and credit reporting information by lenders.<sup>79</sup> ARCA sought authorisation in relation to provisions of the PRDE that fall into the categories of Reciprocity Obligations, Consistency Obligations and Enforceability Provisions. In December 2015, the ACCC granted authorisation

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<sup>75</sup> Australian Government, *Financial System Inquiry, Final Report*, November 2014, p 190.

<sup>76</sup> The Australian Retail Credit Association (ARCA), Second round submission to the Financial System Inquiry, 2014, p 3-4

<sup>77</sup> Australian Government, *Financial System Inquiry, Final Report*, November 2014, p 190-191.

<sup>78</sup> ACCC, Australian Retail Credit Association Limited, Authorisation - A91482, <http://registers.accc.gov.au/content/index.phtml/itemId/1184971/fromItemId/278032>, accessed 18 July 2016.

<sup>79</sup> Elsa Markula, The Principles of Reciprocity and Data Exchange (PDRE) and what it means for AICM members, *Credit Management in Australia*, July 2015  
[http://aicm.com.au/files/3714/5525/3504/The\\_principles\\_of\\_reciprocity\\_and\\_Data\\_exchange.pdf](http://aicm.com.au/files/3714/5525/3504/The_principles_of_reciprocity_and_Data_exchange.pdf)

to ARCA for the above-mentioned provisions for five years until 25 December 2020.<sup>80</sup> The PRDE has therefore only been operational for less than a year. ARCA projected that contribution of full comprehensive data by signatories would be achieved by 2017.<sup>81</sup> ARCA further anticipated that there would be sufficient factors present driving critical mass participation in the PRDE, thereby rendering unnecessary any government intervention to implement a mandatory system of CCR.<sup>82</sup> ARCA advised that mandatory credit reporting "would likely be more costly and less responsive" than the industry framework of the PRDE.<sup>83</sup> The PRDE review is scheduled to be reviewed three years after its commencement.<sup>84</sup>

In March 2016, Veda reported that CCR progression was gaining momentum and that its implementation in Australia is doing well "compared to other markets that have gone through this transition and in light of the scale of change lenders need to undertake." Participating lenders were reported to have provided CCR data on 24 per cent of retail Australian credit accounts.<sup>85</sup>

In the meantime Financial Rights has already identified a number of issues with CCR and has serious concerns with the regulatory framework, including:

1. Credit providers are inaccurately recording repayment history information (RHI) after a consumer has requested financial hardship. That is, some credit providers are reporting customer payments under hardship variations as delinquent in their RHI, when in fact, if a consumer is making payments on time in accordance with the new variation their RHI should be recorded as paid on time, regardless of what the original credit contract states. Credit providers are also indicating they may not comply with a FOS decision that clearly set out a view on how RHI is to be recorded. Financial Rights will address this issue in further detail below under Financial Hardship.
2. A debt collector accessing credit reports in the thousands without authority. On this a complaint has been lodged with the Office of the Australian Information Commissioner and is in a queue.
3. The Office of the Australian Information Commissioner is severely under-resourced;
4. Representative complaints against Veda by Financial Rights, Consumer Action Law Centre, Australian Privacy Foundation and Financial Counselling Australia. Complaints have been upheld. Veda Advantage Information Services and Solutions Ltd (Veda) is currently being forced to refund thousands of consumers who paid to obtain credit reports under Veda's expedited delivery deal, according to a decision handed down by

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<sup>80</sup> ACCC, Australian Retail Credit Association Limited, Authorisation -- A91482, <http://registers.accc.gov.au/content/index.phtml/itemId/1184971/fromItemId/278039>, accessed 18 July 2016.

<sup>81</sup> ACRA, Principles of Reciprocity and Data Exchange (PRDE), ARCA submission in response to market inquiries, Public version, 29 May 2015, p 17.

<sup>82</sup> Ibid.

<sup>83</sup> Ibid, p 18.

<sup>84</sup> Ibid, p 67.

<sup>85</sup> Veda, "Veda celebrates two years of Comprehensive Credit Reporting with a positive outlook", 15 March 2016, <https://www.veda.com.au/insights/veda-celebrates-two-years-comprehensive-credit-reporting-positive-outlook>, accessed 18 July 2016.

the Australian Privacy Commissioner. The Commissioner found that Veda breached a series of privacy rules when they:

- a. charged for “expedited delivery” of a credit report where the consumer had not sought access to a credit report in the previous 12 months;
- b. failed to prominently state on its websites that consumers have a right to obtain their credit reporting information free of charge;
- c. did not take reasonable steps on its websites and phone line to ensure that the option of free access to a credit report was as available and easy to identify as access to paid credit reports; and
- d. used personal information it held on consumers for the purposes of direct marketing in breach of privacy rules.

Notice for consumers about CCR is another area for concern. The law requires customers to be notified that this information will be shared in a general sense but does not require any notice to the consumer when they are actually reported as being late in their payments. We contend that there are advantages to both lenders and their customers to creating an obligation to notify consumers when adverse information has been listed about them on credit reports.

For banks, consumers will have greater confidence that the bank is being open and transparent if they are notified in a timely fashion about adverse information being reported rather than finding out about it later when they are either refused other credit, or charged at a higher rate of interest than otherwise would be the case. It will also drive consumers who can pay on time to do so. Consumers are extremely protective of their credit information and will not want to pay higher interest on credit in the future, or risk credit refusals. If they have the power to pay on time, they will do so to avoid negative information being shared with other credit providers more readily than in response to late fees. Not informing consumers immediately that a late payment has been reported is a lost opportunity for banks in driving customer behaviour.

For consumers they will receive timely notification of the consequences of their actions so that they change their behaviour accordingly if it is within their power. They will be able to dispute any adverse listing they disagree with in a timely fashion while memories are fresh and evidence can be easily located.

### **Proposals to increase Data Availability**

The Productivity Commission (PC) is currently reviewing Data Availability and Use and has recently published an interim report. In this report the PC recommend the introduction of a *Data Sharing and Release Act* (Draft Recommendation 9.11), a new National Data Custodian (Draft Recommendation 9.5) and a suite of Accredited Release Authorities (Draft Recommendation 9.6).

We contend that these key recommendations as they apply to credit reporting information are fundamentally flawed and should be abandoned.

Financial Rights notes that the PC is solely aimed at improving availability and use of both public sector and private sector data. Financial Rights however has serious concerns regarding any pre-emptive changes to the CCR regime including turning a voluntary regime into a

mandatory regime before it has had a chance work and be reviewed to properly analyse the positive and negative consequences for consumers, businesses and government.

The key arguments that we put forward to argue against any pre-emptive changes to the regime are as follows.

**Mandatory consumer credit is not applied in other jurisdictions:** Financial Rights is not aware of any other jurisdictions where consumer credit reporting is mandatory.

**Mandatory CCR is not recommended by the ALRC:** The ALRC in its 2007 *Review of Australian Privacy Law*<sup>86</sup> advised against compulsory reporting obligations in its recommendation for a more comprehensive credit reporting system. The ALRC reported these conclusions in its *For Your Information Report*<sup>87</sup> stating that such mandatory requirements were inappropriate and that the matter was best left to the responsibility of credit providers themselves and industry associations to decide how to proceed with information sharing within the framework provided by the legislation. These conclusions were made in light of the principle of reciprocity that was generally prevalent and supported by credit providers. The ALRC consequently proposed that the code developed by industry should provide for access according to principles of reciprocity.

**An independent review of CCR has yet to be conducted:** There has been no independent review of CCR and by any standard it is too early to conduct such a review. The CCR regime commenced 1 March 2014. Many credit providers are still making system changes. Many credit providers also waited for the Principles of Reciprocity and Data Exchange (PRDE) Code. We contend that it is normal to have a transition period and 2 years is reasonable – from the time the required regulation was in place – in this case ending with the PRDE.

**CCR implementation indicates growing effectiveness of the voluntary regime:** Financial Rights believes that the iterative development and implementation of the voluntary CCR regime demonstrates that the regime is growing in effectiveness.

The FSI in its Final Report of December 2014 recommended that the Government should only consider legislating mandatory participation if, over time, participation in the voluntary comprehensive credit reporting scheme was inadequate. The Inquiry suggested that the Government, in 2017, should review industry's participation in CCR to determine whether a regulatory incentive or legislation for mandatory reporting is required.

Financial Rights contends that 2017 is too soon given that the PRDE has only recently been implemented.

## Recommendations

Mandatory credit reporting should not be implemented or considered.

An independent review should be conducted into the effectiveness of the new credit reporting laws after 5 years commencing in March 2019.

<sup>86</sup> Australian Law Reform Commission, *Review of Australian Privacy Law*, DP 72 (2007), Proposal 51-2.

<sup>87</sup> Australian Law Reform Commission, *For Your Information Report*, Australian Privacy Law and Practice, Vol 3, Report 108, May 2008, para. 55.193.

The Office of the Australian Information Commissioner should be funded appropriately to deal with increased consumer data privacy concerns

Regulators must ensure that credit reporting agencies enable access to a free credit report to all Australians once every twelve months (and in some additional circumstances) and that access to these free credit reports is as easy as getting a paid report.

That credit reporting agencies are policed to ensure that they are meeting the requirements regarding the use of consumers' personal information for marketing, the content of free reports, and the timeframes in which reports must be provided to consumer.

Lenders who are reporting RHI to any credit reporting agency should be obligated under Privacy Law to notify a consumer by way of their regular statements what numeric code has been submitted to the credit reporting agency for the previous repayment cycle, what that Code means and if relevant, how they can avoid any negative information being listed in future. Where statements are sent less regularly than monthly, timely notification should be given by alternative means.

Any new laws relating to data should be included in the Privacy Act. A separate new Act should not be considered.

Any proposal for a new data sharing regime should involve a comprehensive review of Australia's privacy laws with appropriate additions to ensure adequate privacy laws for the protection of all Australians.

## Repayment History Information

The industry has had significant problems in recording RHI when a consumer varies the contract (for financial hardship or otherwise) or if the debt is not due and payable due to an agreement.

Financial Rights repeatedly stated in all our submissions and discussions throughout the review of the *Privacy Act* (to introduce CCR) that RHI must reset to zero if the contract is varied or the debt is otherwise not due and payable. We contend that the law is clear on this point. Our arguments on this point have been confirmed by FOS in determination 422745.<sup>88</sup> That is, where a payment is no longer due and payable by agreement then the credit report cannot indicate that the payment is overdue.<sup>89</sup>

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<sup>88</sup> FOS, Determination 422745, 21 April 2016

<https://forms.fos.org.au/DapWeb/CaseFiles/FOSSIC/422745.pdf>

<sup>89</sup> Credit providers are at pains to preserve their right to make arrangements that do not restrict their rights to take all forms of enforcement action including reporting payments as overdue. Further, they argue that Australian Prudential Regulation Authority ("APRA") reporting requirements give them no option but to report accounts as overdue by reference to their original repayment schedule when they have been varied on grounds of hardship.

In response we strongly argue that:

- APRA requirements are unrelated to banks' obligations under the NCC. We understand the desire of banks to streamline their systems and procedures by having one reporting standard

It has now become clear that all credit providers have misinterpreted the law and were and potentially still are listing RHI for a default regardless of whether the contract was varied or the debt not due and payable. It is noted that only a few credit providers are listing data and most credit providers are collecting data on a “private” basis with the intention to list this data in the future. The implications of this situation are enormous.

This means that *all* RHI default data recorded (privately or publicly) is inaccurate. It is hoped that many credit providers have changed their practice since the FOS decision, however, this is very unclear. As it stands, all RHI default data that has been collected not in accordance with the FOS decision needs to be deleted.

This means from a data quality standard for the CCR, RHI default data is likely 100 per cent inaccurate and individuals in Australia could have no confidence in that data at all. Of further concern, is that there is no process in place to fix a clearly systemic issue.

These current problems are serious and indicate a need to ensure the current system is working before any further changes can be considered.

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for both APRA and the credit reporting agencies but the law is clear and may not accommodate this. The bank’s obligations to their customers under the law and under their own Code of Practice are distinct from their reporting obligations to APRA and not mutually exclusive. It is possible to comply with both, even if it is not necessarily the cheapest and most convenient option. We submit that provided systems are developed to accommodate the difference, compliance with both should not be overly onerous.

- While banks are able to refuse to offer a variation on grounds of hardship under the law they should:
  - treat any verbal or written indication from a consumer that they are unable to pay (for example due to unemployment, illness, family breakdown, etc.) as a hardship notice and respond accordingly;
  - have reasonable grounds for refusing a hardship variation (for example that the customer is not likely to be able to get back on track and repay the debt within a reasonable time);
  - clearly communicate that they have refused hardship assistance where applicable and inform the customer of their right to challenge that decision in EDR;
  - Explain the possible consequences of not having an arrangement in place including, for example, whether the person will have a default or negative repayment history information listed on their credit report, whether proceedings may be commenced without further notice, as well as any advantages (such a freezing or reducing interest). We note that ASIC Class Order [CO 14/41] exempts credit providers and lessors from providing written confirmation of any variation to the contract of no more than 90 days. The Code has nonetheless always contained a commitment to confirm the main details of any arrangement in writing. While we originally had no strong objections to the terminology used by banks provided people obtained sensible arrangements and avoided enforcement action, it is now clear that there are negative consequences for consumers that must be addressed. We are now opposed to the continuation of the class order and would have objected to its recent extension had ASIC engaged in consultation on the issue.<sup>89</sup>
  - Do not confuse or mislead consumers by implying or stating that there are “informal” arrangements when this is clearly inconsistent with the consumer credit laws.

When ARCA made an application to the ACCC to have its Reciprocity Code approved, consumer groups put in multiple submissions arguing that authorisation of the PRDE should be conditional on the formal resolution of the treatment of hardship variations on credit reports. When it was clear that we were not going to prevent authorisation completely we argued that at least re-authorisation should be conditional on this critical issue being resolved. ACCC seemed to agree in the end:

In its final determination ACCC said:

*The ACCC has considered the concerns raised by the consumer associations, in relation to the recording of financial hardship arrangements and settlement of defaults. The ACCC understands that this issue has been the subject of discussion between ARCA, relevant regulators and consumer groups for some time. The ACCC considers that this issue needs to be resolved in order to address consumer concerns and notes the work that ARCA is doing to progress the issue. However, the ACCC considers that this should be co-ordinated by industry and relevant regulators outside of this authorisation process. The ACCC will be keen to see this matter resolved in assessing any application for re-authorisation.*

**Authorisation is granted until 25 December 2020.<sup>90</sup>**

Thus far ARCA has not resolved this issue, nor have consultations with consumers been productive.

## Recommendations

A review of data quality protections are required given the serious systemic issue with accuracy already identified

## Financial Hardship

Although Financial Rights believes that the banking industry has been a leader in financial hardship protections for consumers in the Australian financial services sector and has in the main shown a strong commitment to working with consumers in this regard, there is more to be done to ensure that consumers are better assisted when experiencing hardship.

Financial Rights continues to see a range of issues with respect to how banks implement their financial hardship processes and programs. We will address the issues in two parts:

1. Inadequate compliance with the NCC in so far as it relates to regulated credit and hardship.
2. Customers not currently covered by the NCC - small business and individual investors

<sup>90</sup>ACCC Determination: *Application for authorisation lodged by Australian Retail Credit Association Ltd in respect of the Principles of Reciprocity and Data Exchange* Date: 3 December 2015; Authorisation number: A91482. Available at: <http://registers.accc.gov.au/content/index.phtml/itemId/1184971/fromItemId/278039/display/acccDecision>

## **Inadequate compliance with the National Credit Code in so far as it relates to regulated credit and hardship.**

In addition to the problems detailed above with respect to RHI and credit reporting, Financial Rights sees the following common problems:

- Banks making artificial distinctions between hardship arrangements under the NCC and other arrangements (where hardship is clearly present and the *National Consumer Credit Protection Act 2009 (Cth) (National Credit Act)* applies but the customer has dealt with collections instead of the hardship team, for example). This has flow on effects for credit reporting, particularly for the collection and sharing of RHI, but also for enforcement options.
- Banks not informing customers about their rights under the NCC as required by the current Code of Banking Practice.
- Banks and other financial service providers providing statements and other correspondence that conflict with agreed arrangements (written or verbal) creating confusion. There is an over-reliance on phone contact only.
- A failure by banks to clearly explain what will happen at the end of a period of reduced payments, or no payments being required – are extra payments required? Will the arrears be capitalised?
- A failure by banks to allow arrangements to work – recommencing enforcement action, or referring to debt collectors, when a promised payment is only few days late, or one payment missed after a period of compliance.
- Failure to consider moratoriums in appropriate circumstances.
- Consumers in financial hardship being asked by banks to pay fees to release copies of their statements. Clearly if they're in hardship, they won't be able to pay for statements
- The on-selling of a debt by a bank despite a hardship application being submitted.
- The commencement of enforcement proceedings by banks where a hardship application has been lodged.
- Charging of default fees by banks where a customer has applied for hardship; as with statement charges (referred to above).
- Financial institutions regularly 'lose' documents and the consumer is expected to send sometimes multiple copies of the same documents, all slowing down the hardship application process.

## **Hardship variations under the law versus other arrangements & failure to inform customer of hardship provisions**

The NCC requires all lenders offering regulated credit to consider varying a debtor's contract on grounds of hardship when they have received a hardship notice, which is broadly defined to

include oral and written communication. We note in the latest FOS Annual Review 2015-16 that 33 per cent of hardship complaints involved a credit provider failing to respond to a request for assistance.

The Code of Banking Practice further obligates signatory banks to inform customers of the hardship provisions of the NCC if they may apply to the customer's circumstances.<sup>91</sup> Financial Rights has found that contrary to this, banks go to some lengths to avoid classifying repayment arrangements as variations under the NCC.

### Case study – David's story

David had previously had a hardship arrangement with the Bank because he had been unemployed. The original arrangement involved no repayments for three months. The arrangement was silent as to what would happen at the end of this period. Just before the end of the three-month period David received a demand for \$3,500 in arrears. His next statement required the payment of the arrears plus another minimum payment. This was shortly followed by a default notice. David had recently secured new employment and paid what he could over the next few weeks. Towards the end of the default notice period he realised that he would not be able to pay all the arrears, plus the new minimum payment due, before the default notice expired. He then applied for hardship again via e-mail. He sought further time to pay the arrears. As he was back in employment, it was clear that he would be able to get back on track within a reasonable time as required by the NCC.

The Bank responded by telephone. David agreed to a repayment arrangement that he thought was challenging but reasonable over the phone. The Bank then confirmed the arrangement in writing. The letter said "this arrangement does not constitute a variation of your contract or change to your contractual obligations in any way. In accordance with our entitlement under the terms and conditions, interest, fees and charges (including late fees) will continue to accrue until the balance is cleared, even if you are meeting the terms of the payment arrangement." At no point does the letter acknowledge the hardship notice, that the provisions of the NCC might apply, or indeed that they have in fact refused to grant a hardship variation under the Code and should therefore have given David their reasons for refusal and information about EDR

### Case study- Katia's story

Katia was unemployed. She was behind on her credit card with a major Bank for several months running and she received a call from collections. She explained that she was unemployed and looking for work. The Bank made a verbal arrangement with her to pay \$50 per fortnight for 3 fortnights. When she later complained to the Bank about a misunderstanding about what would happen at the end of the arrangement she received an e-mail from the bank's IDR which said:

*"My understanding of your concern is*

*You are unhappy as you were on hardship arrangement, but later the [bank] Low Rate credit*

<sup>91</sup> Clause 28.7

*card was referred to an external debt collections agency. You advised that the reason for hardship was unemployment.*

*What we've done about this*

*I sincerely apologise for any inconvenience caused to you.*

*As per our conversation on 12 April 2016, I confirm that I have spoken with the Credit Cards Hardship department and was informed that you have not received hardship assistance. The arrangements that were made were with Credit Cards Collections department."*

The hardship provisions of the NCC clearly apply and yet the Bank never mentioned them. Further, the telephone conversation with collections where the customer said that she was unemployed clearly constituted a hardship notice under the law, and yet the Bank did not provide any response, or request for further information. The Bank went on the offer hardship as part of the resolution of this complaint but never explained why they did respond in the way they did to what was clearly a hardship notice in the first place.

This distinction between hardship under the law and other repayment arrangements has potential ramifications for customers. As noted above, fees and charges, including late fees, may continue to accrue, further entrenching hardship. Debts may be outsourced to debt collectors. Default listings may be made, and as banks start to use the comprehensive credit reporting system, RHI may show consumers behind in their payments.

We appreciate that many banks now offer customers very flexible arrangements including interest rate reductions or stopping interest altogether, discounts on the amount outstanding, reduction or complete removal of fees and charges and in some cases debt waivers. We are very supportive of these initiatives but it is important that where these offers come with consequences for the customer's ongoing credit worthiness, the customer should be made aware of this and given the option of accepting a less generous hardship variation without these attendant consequences if they meet the relevant criteria.

#### **Over-reliance on phone contact and verbal arrangements & failure to explain what will happen at the end of the hardship variation/repayment arrangement**

Many clients report their dealings with the bank are entirely over the phone. Financial Rights supports the banks conducting hardship conversations over the phone, and particularly support many arrangements being made without over-reliance on lengthy paperwork and documentary evidence. There are, however, some problems arising from increasing reliance on phone contact:

- Customers may not receive written confirmation of arrangements, or only partial written confirmation. To add to this, documentation they do receive may be at odds with the verbal arrangement made.
- Customers in hardship may be overwhelmed by collections activity and stop answering their phones.

Where banks make verbal arrangements which are not reflected in statements, customers get confused about what is expected of them. Sometimes the statement will state the amount due

consistent with the original contact but have a clear notice indicating the account is subject to a hardship arrangement and that the customer should comply with the separate notice which sets out the terms of the arrangement. In other cases, there will be nothing on the statement to indicate that a payment is not due, or a different lesser amount is expected in accordance with the arrangement. This is very confusing, even more so when the original arrangement has not been confirmed in writing.

Through their own industry Code of Practice, banks have committed to confirming in writing the main details of an arrangement with their customer. However, in our experience this is not done consistently well. Specifically, it is often unclear what is expected at the end of the arrangement including:

- Does the consumer continue their normal repayments or do the repayments increase? Has the bank talked to their customer about whether increased repayments are affordable?
- What happens to any arrears? Are the arrears capitalised and the term of the loan extended? Is the customer required to pay the arrears in a lump sum? Are the arrears being repaid with higher repayments so the term does not need to be extended?
- How will these arrangements be reflected on the consumer's credit report?

#### Case study – Darshani's story

Darshani had lost her well paid job and was making ends meet by temp jobs. She was applying for jobs and hopeful to get a well paid job soon so she can pay her normal mortgage repayments. Darshani rang the bank and explained her situation. The Bank agreed to reduced repayments while she looked for a job. Darshani was relieved because she was supporting and caring for her elderly parents who live in her home.

The Bank rang Darshani and said she had missed a payment. Darshani was shocked because she had definitely made the agreed payment. Then the Bank said that the arrangement was due to end next week and she then had to make the full repayment. Darshani knew nothing about this and the Bank had never explained the terms of the arrangement or what would happen at the end. The Bank is threatening legal action and Darshani was now very distressed.

In David's case above there was no mention of the treatment of any arrears at the end of the original arrangement. In Katia's case she made a further verbal arrangement with the hardship department to pay \$50 per fortnight until she returned to work (which would be within a month) and then return to minimum repayments. When she returned to work she paid her minimum payment as reflected in earlier statements as she had received no further statements or correspondence from the bank. She was subsequently informed she had breached her hardship arrangement because she had stopped paying the \$50 per fortnight in addition to her minimum repayment. The need to do this had never been made clear.

Almost inevitably, customers who are in hardship will be struggling with many accounts – water, electricity or gas, phone, internet, rates and often multiple credit accounts. This

amounts to a lot of calls from various collections departments. The sheer number of calls alone can be stressful, and then you add the potential embarrassment of receiving such calls within earshot of colleagues at work, or on crowded public transport. For some customers the underlying cause of hardship may be an additional stressor, such as physical or mental illness or relationship breakdown. Depression and anxiety can also result from job loss alone. It is not unreasonable that many people in financial stress start screening their calls or stop answering their phones at all. For this reason, we consider that banks should try a number of means of contacting their customers before taking enforcement action, when for example they miss a payment under a repayment arrangement, or pay less than the amount expected.

#### **Case study – Sanjay’s story**

Sanjay was unemployed. He made a verbal arrangement with his bank to make fortnightly repayments of \$60 until he started his new job on a particular date and then he would return to normal repayments. The job fell through before he started. Too embarrassed to tell the bank he paid them half his normal repayment and stopped answering his phone. Meanwhile he continued to look for work. The next correspondence he received was from the bank’s solicitors demanding the entire amount outstanding on his credit card.

#### **Failure to allow arrangements to work**

Related to the above, customers in hardship will usually have committed to a number of arrangements with a number of creditors. For a range of reasons their ability to meet these commitments consistently may have been over-stated – they may be influenced to over promise due to pressure from collections, or they may be simply overly optimistic about how much they can survive on after meeting the promised commitments. Often, it is simply something unanticipated which has come up. Whatever the cause, customers who are able to comply to the letter with repayment arrangements, every pay cycle, without fail, are more likely to be the exception than the rule. It is important that banks recognise that hardship is often a complex web, involving a number of competing creditors and recognise genuine efforts to comply, rather than taking a sudden death on failure approach.

#### **Failure to consider moratoriums in appropriate circumstances**

Financial counsellors report a decline in access to moratoriums for clients in recent times (where a client is relieved from repayments and interest for a set period). It is our understanding that this is also being driven by APRA requirements. While on the whole it is preferable that clients pay something towards a debt rather than nothing when they can, there are circumstances where they really have no capacity to pay at all. Further, clients may have no capacity to pay at all for a set period, but still have a very good chance of getting back on track within a reasonable period (for example, where someone needs surgery with a defined recovery period and has little or no income in the interim but a job to ultimately return to). We reiterate that APRA requirements are designed to control risk at the macro level and should not dictate the bank’s relationship with individual customers. Further they do not change the bank’s obligation to the debtor under the credit law.

## 2. Customers not currently covered by the NCC: small business and individual investors

There are a group of consumers (using banking and other financial service providers) than are not covered by the *National Credit Act* and hence the NCC. There have been numerous Senate Enquiry recommendations recommending the extension of FOS's jurisdiction in relation to small business, talk in Parliament and the press of a Royal Commission, or alternatively a Banking Tribunal, and FOS consulting on and proposing to expand its small business jurisdiction,<sup>92</sup> the time is ripe to address this distinction.

The principles behind the NCC provisions are simple and fair in essence. A customer gives notice that they are in financial hardship; the creditor seeks to confirm both that they are in hardship AND that they have a reasonable prospect of getting back on track; then the creditor either agrees to work with them to get back on track with an appropriate arrangement, or the creditor refuses. Where the creditor agrees to hardship, then an agreement is made that should as far as possible enable the debtor to get back on track with minimal long-term consequences. This should include no credit report listing, no enforcement action and no punitive measures taken under the contract (such as default interest and charges), changes to security arrangements etc. Where the creditor does not agree the consumer gets the right to internal and EDR. Where the creditor's decision is confirmed, either the creditor proceeds to enforcement, or the creditor proposes another solution that may assist the debtor, but may have some long term consequences (such as a credit report listing or change to underlying security arrangements etc.).

There is nothing in these principles that is too onerous for banks or other financial service providers to comply with for all customers. Further, they represent only an incremental step from what they are doing already and are consistent with the proposal FOS is currently consulting on whereby they will have similar powers to impose a reasonable arrangement in a small business or individual investment matter as they currently do in relation to regulated credit.

FOS in its submission to the Ramsay Review has proposed that the national consumer credit protections should be extended to fill in the gap in coverage with respect to small businesses, stating:

*Yes for responsible lending provisions and Parts 2 and 6 of the NCC relating to disclosure, related mortgages and guarantees.*<sup>93</sup>

Financial Rights further notes that the Ramsay Review Panel have found that small business does not have adequate access to EDR because the existing monetary limits of \$500,000 for the value of the claim under disputes and \$2 million in relation to credit facilities preclude

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<sup>92</sup> <https://www.fos.org.au/custom/files/docs/fos-small-business-consultation-paper.pdf>

<sup>93</sup> FOS, Submission to the Review of the financial system external dispute resolution framework, February 2017

<http://www.treasury.gov.au/~/media/Treasury/Consultations%20and%20Reviews/Reviews%20and%20Inquiries/2016/Review%20into%20EDR/Submissions/PDF/Financial%20Ombudsman%20Service%20Submission.ashx>

disputes from being able to be brought to the industry ombudsman schemes. They have recommended that:

*The new industry ombudsman scheme for financial, credit and investment disputes should provide small business with monetary limits and compensation caps that are higher than the current arrangements, and that are subject to regular indexation.*<sup>94</sup>

## Recommendations

The *National Credit Act* should be amended to give small business and individual investor banking customers the same rights as those currently provided to consumers of regulated credit under the NCC, including acceptance of a broadly defined hardship notice; flexible hardship repayment arrangement options, stays of enforcement and a right to go to EDR.

Either the a new industry EDR scheme, or FOS, should provide small business with monetary limits and compensation caps that are higher than the current arrangements, and that are subject to regular indexation.

## Sales Incentives and Bundling Add-ons

Financial Rights notes that the ABA is currently conducting an independent review of product sales commission and product based payments received directly or indirectly by people selling retail banking products.<sup>95</sup> This review is due to report in late March 2017. Financial Rights however notes that the Review specifically excludes consideration of 'Remuneration structures, product design issues and quality of advice regarding life insurance products' from the scope of the review.<sup>96</sup>

It is important that banks recognise the impact and distortions these sales incentives create. Problems involving the sale of add-on insurance, and particularly CCI, have been raised by Financial Rights and other consumer representatives, for decades. Reports by ASIC from 2011 and 2013 demonstrated serious problems with CCI sales practices by Australian banks and other financial service providers. Westpac, for example, has been required to repay consumers who have been mis-sold CCI associated with its home lending, and Esanda has agreed to compensate consumers for sales conduct of a broker which included selling add-on products without the knowledge or consent of the consumer.<sup>97</sup>

<sup>94</sup> Draft Recommendation 3

<sup>95</sup> Stephen Sedgwick, AO, *Retail Remuneration Review*, January 2017

[http://retailbankingremreview.com.au/wp-content/uploads/2017/01/Issues-Paper\\_Retail-banking-remuneration-review.pdf](http://retailbankingremreview.com.au/wp-content/uploads/2017/01/Issues-Paper_Retail-banking-remuneration-review.pdf)

<sup>96</sup> This has been done on the basis that Corporations Amendment (Life Insurance Remuneration Arrangements) Bill 2016 has been introduced into the Federal Parliament which, consistent with the intent of the recommendations of the Trowbridge Review, will restrict remuneration arrangements to a model based on a fixed level of commission (phasing down over time) supplemented by a two-year clawback for lapsed policies.

<sup>97</sup> For further information see Consumer Action's *Junk Merchants: How Australians are being sold rubbish insurance and what we can do about it*, December 2015,

In its 2011 report on CCI, ASIC identified a series of systemic issues:

- consumers being sold CCI products without their knowledge or consent;
- pressure tactics and harassment being used to induce consumers to purchase CCI products;
- misleading representations being made during the sale of CCI products; and
- serious deficiencies in the scripts used for the sale of CCI products.<sup>98</sup>

The issues identified by ASIC five years ago however continue to occur. Consumer Action's December 2015 report *Junk Merchants: How Australians are being sold rubbish insurance and what we can do about it*, details the serious problems of add-on products including their poor value, low claim rates, high decline rates and the fact that they are regularly mis-sold. The Report also provides 12 case studies on the issue.

In the meantime the ABA has just received the final report of its Independent Review of the Code of Banking Practice, although has yet to respond. This report examined bank staff-to-customer practices and what changes to the self-regulatory Code should be made in relation to these to promote responsible sales practices. The report makes a number of recommendations for clauses to include in a re-draft of the Code of Banking Practice to curtail some of the practices:

*Recommendation 65: The Code should require signatory banks to ensure that their staff and authorised representatives, when promoting or selling financial services or products to Code customers, do this in a fair and ethical manner, without engaging in pressure sales techniques.*

*Recommendation 66 The Code should prohibit a signatory bank from charging a Code customer for the acquisition of a financial product or service from or through the signatory bank unless the signatory bank is able to evidence that the customer's explicit consent was obtained at the time of the acquisition.*

*Recommendation 67: The Code should include a new provision that applies to signatory bank distribution of consumer credit insurance. This should specify:*

- a) A signatory bank's representative must not promote consumer credit insurance to an individual customer where the signatory bank's representative should have been aware that the individual is not suited to the policy.*
- b) A signatory bank must provide an individual customer with prominent, timely and sufficient information to make an informed decision as to whether or not to purchase the product.*
- c) Signatory banks should ensure that their consumer credit insurance sales processes are tailored appropriately to meet the needs of a wide range of customers, including those not familiar with consumer credit insurance.*

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<http://consumeraction.org.au/Junk%20Merchants%20-%20Consumer%20Action%20Law%20Centre%20December%202015.pdf>

<sup>98</sup> ASIC (October 2011) Report 256: *Consumer Credit Insurance: A review of sales practices by authorised deposit-taking institutions*, paragraph 8  
<http://download.asic.gov.au/media/1343720/rep256-issued-19-October-2011.pdf>

*d) A signatory bank must not complete an individual customer's application for consumer credit insurance earlier than the day after information is provided to the customer about consumer credit insurance. Moreover the sale may only be completed if the customer contacts the signatory bank to proceed with the application – a signatory bank representative must not follow up the customer to see if the customer wants to proceed.*

Financial Rights supports these recommendations and their inclusion in a re-drafted Code of Banking Practice. If the ABA fail to act to reign in these practices immediately, regulatory intervention will be required to ensure that sales of all forms of add-on insurance or any other insurance or financial product should be subject to an opt-in and delay mechanism.

The banks are at considerable reputational risk if this problem is not addressed. In our view, the banks need to stop selling junk insurance to consumers in a culture with a commission structure that encourages sale by stealth.

The case studies below are even more recent examples that demonstrate the ongoing nature of the problem.

#### **Case study – Theresa's story**

Theresa has held a credit card account with her Bank since 2001. She only just found out that she was paying \$26-27 per month for insurance to cover her if she was retrenched or to cover medical expenses. At the time she signed up to the card she was a student, not working and receiving Centrelink income. The product was totally unsuitable for her since she could not make a claim. Theresa worked casually in 2003 in a bar for a couple of years. She did not commence full time work until 2006. She stopped working in 2012 when she became pregnant. Since then she has been caring for her child. She intends on studying her masters before returning to work. In 2007 she replaced the credit card with two new credit cards. At the time she was not advised that she had the insurance product that she was paying for. Because she was overdrawn one month ago she was advised that one of the charges was for insurance \$27 per month. It was only then that Theresa realised she had the insurance and had paid a total of \$5000 in premiums since 2001.

#### **Case study – Maricor's story**

Maricor owns her own property secured by mortgage with her Bank. A friend of hers, Jean, approached Maricor to assist her with a car loan she needed for Jean's husband. Maricor introduced Jean's husband to her Bank. Maricor explained everything to the teller that the loan was for her friend Jean's husband and he would need to repay the loan. Maricor says it was not her intention to be a co-borrower for the loan. Maricor says that she sat with Jean's husband whilst he applied for the loan and believed the loan would be in Jean's partners name alone. A loan for \$53,000 was applied for and granted with a \$9000 premium for Loan Protection Insurance. Jean and her husband are now considering going bankrupt and Maricor is now left with a large debt and a huge add-on insurance debt.

ASIC recommended in their 2011 report that bank staff should:

- *make a clear statement that they intend to try to sell CCI, rather than just beginning the sales pitch;*
- *be clear that the purchase of CCI is optional;*
- *use words like 'purchase' and 'buy' to describe the purchase of CCI, rather than potentially misleading words such as 'activate', 'enroll' and 'process';*
- *include a clear question asking the consumer if they consent to purchase CCI;*
- *obtain evidence that a consumer has consented to purchase CCI, such as through a signature or a voice recording (for phone sales); and*
- *end an attempted telephone sale if the consumer indicates once (or at most, twice) that they don't want to buy CCI.*

Again strongly recommend that if the banks cannot commit to introducing suitability requirements with respect to their sales practices then the Government must consider legislative action. Banks have an obligation to ensure that those consumers who are already experiencing hardship are not left worse off due to the sales practice of the banks.

Financial rights supports a mandatory deferred opt-in procedure to impose a break between purchase of the primary product and an add-on financial product limiting the point of sale advantage held by those selling add-on insurance. A banks' representative salesperson would be able to promote the product, but the transaction would not be completed until the consumer takes a step to opt-in. That is, they would have to call the salesperson themselves (after the mandatory delay) and say that they want to buy the product. The customer must be told that they can buy it elsewhere and be given information on how to shop around. To avoid doubt, no add-on should be sold through an 'opt out' mechanism, such as where the contracts have a pre-ticked box saying that the consumer agrees to buy the add-on unless they say otherwise.

Financial Rights notes again that the Khoury Review has recommended a form of opt-in and delay to be included in the Code of Banking Practice with a one day delay. Financial Rights view is that this delay should be longer.

The UK's Financial Conduct Authority have introduced a similar policy for sales of Guaranteed Asset Protection (GAP) insurance in June 2015. The rules prevent GAP insurance from being introduced and sold on the same day. Instead, there is a four day deferral period in which the customer can consider the purchase and shop around. After the four day period, the business can contact the customer to try to complete the sale. Consumers would be able to make the purchase sooner, at their own initiative, if they wished to do so.

## Recommendations

If the financial services industry does not effectively self-regulate to resolve the issues listed below (in the current Code of Banking Practice Review and other Codes of Practice), the Federal Government must enact legislative reforms which:

- a. include commitments that arise from the current Independent Review of Product Sales Commission and Product Based Payments;

- b. institute suitability requirements with respect to all sales within banks and other financial service providers, at minimum requiring that consumers are left no worse-off from switching to another product or purchasing the additional product;
- c. introduce a mandatory delay of at least 4 days between the sale of the primary product and the sale of the add-ons;
- d. allow the promotion of products but prohibit the completion of a sales transaction until the consumer takes a step to opt-in. That is, the consumer would have to call the salesperson themselves (after the mandatory delay) and say that they want to buy the product
- e. commit banks and all third party financial service sellers to tell a customer that they can buy the add-on product elsewhere and be given information on how to shop around.
- f. prohibit the sale of add-on products via an 'opt-out' mechanism, such as where the contracts have a pre-ticked box saying that the consumer agrees to buy the add-on unless they say otherwise.
- g. require banks and all financial service providers to review the cover offered by add-on products on a regular basis, to assess whether it meets the needs of the consumers who are buying.
- h. require banks and all financial service providers to review their sales practices for add on products on a regular basis, to ensure they assist consumers provide informed consent in respect of both the cost and the cover offered.

## Credit Cards

### Responsible lending and Credit Cards

Credit cards have been a key source of financial problems for consumers over a decade. Statistics released by the Reserve Bank of Australia show that as at June 2016 there were 16.5 million credit cards with outstanding balances of \$52.2 billion.<sup>99</sup> Sixty-three per cent of outstanding balances, or almost \$33 billion, was accruing interest. This represents a 25 per cent increase in balances accruing interest over the past 10 years.<sup>100</sup> These statistics correspond with the huge increase in household debt. The ratio of household debt to disposable income has almost tripled since 1988, from 64 per cent to 185 per cent.<sup>101</sup> Nearly

<sup>99</sup> Reserve Bank of Australia, 'Statistical Tables - Credit and Charge Card Statistics C1', 2016, available at: <http://www.rba.gov.au/statistics/tables/index.html#money-credit>

<sup>100</sup> Ibid.

<sup>101</sup> AMP, NATSEM Income and Wealth Report, *Buy Now, Pay Later, Household Debt in Australia*, December 2015.

[http://www.natsem.canberra.edu.au/storage/AMP.NATSEM%20Report\\_Buy%20now%20pay%20later\\_Household%20debt%20in%20Australia\\_FINAL.pdf](http://www.natsem.canberra.edu.au/storage/AMP.NATSEM%20Report_Buy%20now%20pay%20later_Household%20debt%20in%20Australia_FINAL.pdf)

50 per cent of callers to Money Help at Consumer Action Law Centre hold credit card debts exceeding \$10,000, while nearly 10 per cent have debts exceeding \$50,000. Every week Money Help receives at least one call from a consumer with credit card debt exceeding \$100,000 - it is not unknown to receive calls from consumers with up to \$200,000 owing on credit cards. Credit cards top the list of consumer finance products motivating calls to its National Debt Hotline, and have done every year for the past three years.

There have been a number of regulatory developments aimed at addressing this issue including:

- The introduction of responsible lending as part of the *National Credit Act* which came into effect for banks in January 2011;
- The requirement for consumers to have to *opt in* to receive credit limit increases, which came into effect in 2012.

Despite this problems persist.

#### **Case study – Alexandra’s story**

Alexandra earns \$80,000 per annum before tax. She has two credit cards, each with an available limit of \$20,000. She currently has a balance of \$1,000 on one and \$0 on the other. She set up a new transaction account with a new bank in 2014 and applied for a credit card as they offered her low interest rate, and bonus points with her transaction account. Alexandra was asked to provide her payslips and details of her liabilities which includes a large mortgage of \$1,000,00 with a co-borrower. The credit provider did not ask her what the credit card was for, and offered her a limit of \$27,000. Alexandra now has an available credit limit of \$67,000. If she reached the maximum on all three facilities, she could not afford to pay the three credit cards and meet her obligations under her mortgage or pay for her basic living expenses.

#### **Case study – Brad’s story**

Brad was living with a serious psychiatric condition that meant he could not work. His sole source of income has been the Disability Support Pension for over ten years. He desperately needed a car and decided to get a credit card to use the money to purchase a car.

He went to a major bank in about 2015 and applied for a credit card. He only needed around \$2000 to buy the car. The bank did not ask him about the limit he wanted or any detail about his living expenses. The bank did check his income. The bank assessment assigned an amount for his living expenses that was completely unrealistic. A credit card was approved with a limit of \$8000. Brad promptly spent it all in a manic phase and was unable to make the minimum repayments.

Financial Rights notes that the government is currently proposing significant reforms with respect to the offer of credit cards under its *Credit Cards: improving consumer outcomes and*

*enhancing competition Reform Paper.*<sup>102</sup> These reform proposals have arisen at least in part from ongoing concerns raised in the Senate Economic Reference Committee's report from the previous December *Interest Rates and Informed Choice in the Australian Credit Card Market*. Financial Rights strongly supports the implementation of the recommendations which relevant to this section include:

- Tightening responsible lending obligations to ensure card issuers assess suitability based on a consumer's ability to repay the credit limit within a reasonable period.
- Prohibiting issuers from making unsolicited credit limit increase offers including the ability to seek prior consent.
- Requiring issuers to provide consumers with online options to initiate a card cancellation or reduce their credit limit.

The Federal Government has also indicated that it considers setting higher minimum repayment amounts is worthy of further consideration and is currently seeking stakeholder feedback on this option in this review. Financial Rights strongly supports a phased increase in minimum repayment percentages or at the very least an increase on new accounts going forward. We believe that it would go a long way toward ameliorating consumer over-indebtedness if banks were made to:

- *Assess all credit card applications on the basis that the customer has the capacity to pay the account out in full within three years if it been fully drawn to its designated credit limit;* too often consumers are able to meet their minimum repayments (at least until they experience a change of circumstances) but cannot make any serious inroad into their outstanding balance;
- *not offer unsolicited credit card limit increases by phone, face to face or any other way.* Unsolicited credit limit increases encourage consumers to take on more debt than they initially intended and can lead to financial difficulty. If consumers want a credit card, or to increase the credit limit on their existing card, then the consumer is in a position to make the approach and actively apply to the credit provider, for that product.
- *Increase minimum repayment amounts on all new accounts* to ensure that consumers are encouraged to pay off their balances faster than is currently the case and consequently pay less interest.
- *Ask all consumers the credit limit they are seeking and not approve a limit above that requested.* Consumers often report being granted a higher limit than requested and then using it because it is available. This is a particular trap when people encounter financial hardship and run up their cards on essential living expenses rather than seeking timely advice about other options;
- *provide online tools to cancel a card and reduce their credit limit.* Some credit card issuers already provide online tools allowing consumers to reduce their credit limit

<sup>102</sup> <http://www.treasury.gov.au/ConsultationsandReviews/Consultations/2016/Credit-card-reforms>

and there is no reason why such portals could not also offer consumers the option to close off their credit card account.

- *provide consumers with notification of how much credit they have used.* If used strategically such a commitment will help consumers remain mindful of their credit card use, and may help consumers become proactive money managers.

## Recommendations

Legislative reform should mandate the financial services sector to:

- a. assess all credit card applications on the basis that the customer has the capacity to pay the account out in full within three years if it has been fully drawn to its designated credit limit;
- b. not offer unsolicited credit card limit increases by phone, face to face or any other way;
- c. increase minimum repayment amounts on all new accounts;
- d. if the credit card is being obtained to purchase goods in a linked credit transaction, the limit for the credit card cannot exceed the price of the goods.
- e. ask all consumers the credit limit they are seeking and not approve a limit above that requested
- f. provide a right to cancel a credit card and reduce their credit limit in writing and an easy to use automated process on online banking and phone banking
- g. provide consumers with notification of how much credit they have used at no cost.

## Honeymoon offers and balance transfers

Financial Rights also supports a prohibition on “honeymoon” interest rates where promotional interest rates often induce consumers to enter into credit card contracts and be unable to repay the debt once the promotional period is over, incurring large interest charges.

Credit card issuers of low interest honeymoon periods take advantage of consumers with low levels of financial literacy, who do not understand or consider the actual impact of interest rates until it is too late.<sup>103</sup> Further, while banks are able to offer honeymoon interest period credit cards to lure in vulnerable consumers, there is little incentive for these banks to reduce credit card interest rates in order to become more competitive.<sup>104</sup>

<sup>103</sup> Ian McAuley, ‘Behavioural Economics and Public Policy: Some Insights’ (2013) 4 *International Journal of Behavioural Accounting and Finance* 1, 22.

<sup>104</sup> Ibid.

Financial Rights believes credit cards with honeymoon interest periods place disproportionate costs on disadvantaged consumers and are part of the problem relating to the current gap between cash rates and credit card interest rates.

If honeymoon offers continue to be available then their harmful impact should be minimised by:

- *providing consumers with timely electronic notification of balance transfer expiry periods.* This would help consumers to manage balance transfers positively, to ensure they gain the maximum benefit from the product.
- *Not offer honeymoon periods for periods of less than 12 months.* This would give consumers an opportunity to take advantage of the honeymoon offer by making considerable inroads into their debt. Current offer of six and nine months really offer limited savings and limited opportunity to reduce the debt where the person can only meet the minimum repayment.
- *Provide regular disclosure of how much should be repaid per month to pay off the debt within the honeymoon period.* This would assist in nudging consumers towards taking full advantage of the offer to improve their financial circumstances.

*Require consumers to close the original account from which the balance was transferred.* Many consumers get into difficulty because they keep the original account open “just in case” and end up drawing on it again. In some cases this happens multiple time accumulating more debt each time. This could be facilitated by only granting transfers of full balances and seeking the consumer consent to close the original facility as part of the transaction.

## Recommendations

Legislative reform should commit the banking industry to undertake not to offer low interest/interest free honeymoon period on cards including on balance transfers; or alternatively

- d. provide consumers with timely electronic notification of balance transfer expiry periods;
- e. not offer honeymoon periods for periods of less than 12 months; provide regular disclosure of how much should be repaid per month to pay off the debt within the honeymoon period;
- f. require consumers to close the original account from which the balance was transferred.

## Cancelling Direct Debits

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There are two distinct problems under this topic: cancellation of direct debits against savings/transaction accounts and cancellation of direct debits in relation to card scheme transactions.

### Savings and transaction accounts

There is no doubt that a bank can and must cancel a direct debit set up against a savings/transaction account when instructed by to do so by the customer. However, this is an area where Financial Rights has ongoing concerns as consumers regularly report difficulties cancelling direct debits. An instruction to cancel a direct debit on this type of account should be actioned as soon as it is received by the bank and a receipt number given to the customer for their records. We appreciate the recent work done by the ABA in developing fact sheets on this topic but this is not sufficient to address an issue that has been raised continuously for over ten years and causes consistent consumer frustration and losses, including impacting most seriously on those least able to absorb these losses.

Banks suggesting consumers also contact the debit user is too often misinterpreted by customers. Consumer's frequently report that the bank is refusing to act on their instruction or counselling them against cancellation.

The ABA has expressed the concern that banks do not want to be seen as encouraging people not to meet their obligations. Financial Rights argues that it is not the bank's role to interfere with the customer's relationship with other creditors/service providers. Consumers are generally well aware that cancelling a payment will have consequences. The bank should simply act on their customer's instructions as to where to direct (or not direct) their own funds.

Banks should also make the process easier by allowing customers to cancel direct debits through their online accounts.

Financial Rights also believes that banks should be strictly prohibited from charging fees to stop a direct debit arrangement. We are aware of at least one bank charging for stopping a direct debit arrangement up until complaints from consumer representatives were made. For many consumers, especially those with low account balances (who include many of the clients of our services), an unanticipated or ill-timed direct debit transaction can cause significant difficulties. This can include overdrawing an account, causing additional fees and charges imposed by both the bank and the merchant; transactions being dishonoured, which can also result in fees and leave consumers at risk of other collection measures; or loss of funds, which may have needed to be prioritised for other purposes. In our experience, the cancellation of a direct debit is often necessary when a consumer is in financial hardship to ensure basic living expenses (e.g. rent and food) are paid as a priority. Fees being imposed for cancelling direct debits can be a substantial barrier for low income or vulnerable consumers.

The Final Report of the Independent Khoury Review of the Code of Banking Practice examines this issue and in the view of Financial Rights has failed to recommend any effective solution to the issue. Recommendation 59 states:

*Signatory banks' Customer Advocates should be tasked with championing better customer service in relation to direct debit cancellation requests. They should work with internal management to achieve this, using all the resources and tools that they will need to be effective in their roles over the long term.*

*Signatory banks' Customer Advocates should report regularly to the CCMC as to the steps the signatory bank is taking to enhance compliance by staff with customer direct debit cancellation requests and the impact those steps are having.*

*The CCMC should publicly report on signatory banks' progress in improving compliance with direct debit cancellation requests, including by releasing signatory banks' data on an anonymised basis, together with the CCMC's trend analysis and assessment of the adequacy of signatory banks' efforts.*<sup>105</sup>

Financial Rights does not believe that this will in any way resolve the matter in a quick manner.

### **Card Schemes (Visa and Mastercard)**

Banks' commitment to cancelling direct debits needs to be extended to recurring transactions via the Visa, MasterCard and all other credit card systems.

Financial Rights appreciate that there are difficulties in achieving this outcome as a result of the involvement of card schemes, but we think that this problem is so important to consumer confidence that it needs to be resolved. To make matters worse many transaction accounts are now accessed via scheme debit cards, greatly increasing the percentage of transactions that may be affected by this limitation. Although consumers can sometimes avoid this problem by providing their account details rather than their card details, this is not always possible, and most consumers are not aware of the different implications for cancellation in any event.

The same problems flow for consumers on low incomes when they cannot cancel a debit set up on a card as for a transaction account. Further, all cardholders face a number of barriers if they wish to switch credit cards and one of the most significant barriers to switching is cancelling recurring direct debit transactions that are set up from a consumer's credit card. Currently, recurrent payments made from a credit card are much more difficult to cancel than payments from a transaction account, and credit card recurrent payments can continue to be made even after the card itself is cancelled.

Consumers commonly establish recurring transactions and standing authorities with third party merchants to pay regular bills, such as insurance, utility bills or fitness club memberships. We note recurring payments on credit cards are increasingly common and is encouraged by banks through the establishment of loyalty schemes. However, very few consumers would be

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<sup>105</sup> p. 143

aware that if they wish to cancel direct debits from their credit card, they must contact each merchant individually. Problems can arise when a merchant does not act on an instruction to cancel a regular payment. These problems can also arise when a consumer closes their credit card account but does not arrange with third party merchants to cancel regular payments. In this case, a consumer is generally responsible for establishing and cancelling authorities directly with the relevant merchant. They will also be responsible for any transactions debited to the credit card account, even after the account has been closed.

Financial Rights submits that there should be no difference in treatment between credit card accounts and other accounts. In our view, a consumer should be able to instruct their bank to cancel a credit recurring payment authority, as they can with a transaction account direct debit authority. Further, upon cancellation or closure of a credit card account, a bank should take steps to cancel all regular transactions and other standing authorities.

There should also be no cost to the consumer for cancelling an instruction to debit their own credit or charge card account. Currently consumers can write to the merchant and then complain to the bank, and if necessary FOS, if the merchant does not act on their instructions as the payment is then unauthorised. This is a lengthy, cumbersome process, but it is at least free. Any replacement system should not set consumers backwards.

## Recommendations

Government should examine ways to ensure that banks commit to providing ways for a customer to cancel a direct debit via both phone banking and online banking.

Despite the views expressed in the Khoury review, consideration should be given introduction of the payment of a fine in addition to reimbursement of any actual loss incurred as a result of a debit overdrawing a consumers account, if a bank has not implemented a direct debit when instructed do so.

A prohibition on fees being charged to stop a direct debit or recurring payment on their own credit or debit card account.

Ensure that consumers can cancel recurring payments on credit cards without requiring the customer to contact the debit user.

Require that banks not set a timeframe for reporting unauthorised transactions and other transactions that may qualify for a chargeback that is more than seven days less than the timeframe set by card providers

## Fees and Charges

### Current fees and charges

Fees can have harsh and disproportionate impacts upon lower income consumers. Financial Rights is aware of extant late payment fees ranging from \$9 to \$40. A \$40 default fee a

consumer on Newstart earning \$13,717.60 a year pays equates to approximately 7.6 per cent of their fortnightly income. The same fee for someone earning an average fortnightly income of \$80,000 pays 1.3 per cent of their fortnightly income on a default fee.

A \$40 fee can mean the difference between eating and not eating for a family who are struggling. These fees not only deplete low earning consumer's incomes but also affect whether debits made from their account for things like rent or electricity can proceed or be rejected, as there is less money in the account to pay them. The fees have little deterrence value where the consumer's problem is not organisation but insufficient funds and simply drive consumers faster down the path of financial hardship and pain.

### Case study – Anne's story

Anne is living in a women's refuge in South Australia. She was from Pipalyatjara in the APY lands. English is Anne's second language, her first language is Pitjantjatjara. She is a single mother, and suffers from depression and anxiety. In 2015 she entered into a contract for funeral insurance. The direct debits were \$34 per fortnight. The Insurer made 17 dishonoured direct debits. After the School Kids Bonus was deposited the Insurer deducted \$590. She had incurred approximately \$250 in fees from her bank. Financial Rights raised a dispute with the insurer and sought the refund of the premiums taken. They were refunded. Financial Right also sought a refund of the dishonour fees. The Bank refunded on a good will basis without admission approximately \$250 being the dishonour fees accrued.

And the situation only seems to be getting worse. Bank fees continue to rise with fees growing at 2.8 per cent – faster than the consumer price index.<sup>106</sup> Fees have been rising fastest on credit cards, with a 5.9 per cent growth in fees in 2014. Australians paid nearly \$12 billion in bank fees in 2014. In that year the average household paid \$468 in bank fees.

This seems to be set to continue following the High Court's decision upholding a decision that the ANZ was entitled to charge late payment fees which included a range of indirect costs, such as bad debt provisioning, increase in regulatory capital provision and the shared costs of running collections (even though no actual collections may have occurred).<sup>107</sup> Many of the fees charged by banks penalising their customers for breaches of terms and conditions (late fees on credit cards, overdrawn fees, inward dishonour and honour fees) are essentially regressive. They are both incurred more often by consumers who are struggling with their financial circumstances, or have lower financial literacy levels, or both, and impact many of those same consumers more than others by virtue of the size of the fee in relation to their income and overall wealth.

Credit card late fees as high as \$35 are disproportionate, bear no resemblance to what a late payment actually costs a bank and penalise those who can least afford it. Fees purporting to cover the actual loss suffered by the bank are a form of double dipping given the fact that

<sup>106</sup> Kelsey Wilkins, *Banking Fees in Australia*

<http://www.rba.gov.au/publications/bulletin/2015/jun/pdf/bu-0615-5.pdf>

<sup>107</sup> *Paciocco v Australian and New Zealand Banking Group Limited* [2016] HCA 28

<http://eresources.hcourt.gov.au/showCase/2016/HCA/28>

credit card interest rates are set at very high levels in order to reflect the risks and costs involved in unsecured debt.<sup>108</sup>

The consumers carrying debt from month to month (63 per cent of outstanding balances accrue interest)<sup>109</sup> pay high interest and effectively cross-subsidise all other card holders who pay off their accounts regularly and incur almost no interest. Within the 63 per cent of card holders who incur interest there is a sub-group that carry significant balances, far higher than the average balance. The overwhelming majority of people carrying significant credit card debt do so because they do not have the means to pay it down quickly or at all. Even those on higher incomes usually carry credit card debt because they have overextended themselves and cannot afford to pay it off except over time. For people who are overstretched, late fees only make the task of repayment more difficult. Banks already charge high interest, make considerable profits, and have other enforcement options apart from late fees.

To the extent that late fees are intended to alter consumer behaviour by acting as an incentive to pay on time, a significant number of consumers do not pay on time because they have insufficient funds and/or cash flow problems. They therefore do not respond to such incentives because they cannot. For other consumers, we submit that our recommendations in relation to disclosures under the section on comprehensive credit reporting would be more effective in inducing a change in consumer behaviour than late fees in any event – particular for those who can afford to pay them.

Inward dishonour fees and honour fees, and overdrawn fees, where consumers have insufficient funds in their accounts to meet certain scheduled expenses, are equally regressive in effect. Increasingly consumers are being driven into using direct debits, for example, by virtue of cost incentives or limited payment options offered. For low income consumers paying for goods and services over time is essential, but a direct debit, which triggers late fees by both banks and merchants spells financial disaster for consumers who are living from hand to mouth.

Financial Rights believes that this issue needs to be urgently addressed. Public confidence in banks is low. Even without the recent string of scandals & inquiries, the public are extremely sceptical about a sector which posts record profits year after year and yet hits them with dubious charges every time they make the slightest misstep.

This inquiry provides an opportunity for Government to acknowledge the issues consumers have with fees and to take steps to place some parameters on unreasonable charges and limit the scope for abuse. There is a good argument to spread some of the costs of the risks of the overall business should be born by customers broadly and shareholders, not placed on those least able to bear them. In the absence of decisive action on this point by banks, consumer Representatives will have good cause to pressure the government to address the recent High Court decision through legislative change. The public would no doubt support such a move.

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<sup>108</sup> For a full discussion of the illegitimacy of late payment fees see: Adam Schwab, High Court says it's OK for banks to double dip into customers' wallets, *Crikey*, 1 August 2016, <https://www.crikey.com.au/2016/08/01/anz-wins-high-court-challenge/>

<sup>109</sup> Reserve Bank of Australia, 'Statistical Tables - Credit and Charge Card Statistics C1', 2016, available at: <http://www.rba.gov.au/statistics/tables/index.html#money-credit>

## Innovative services generate yet more fees

Internet and phone banking have increased the potential for banks to offer innovative services for managing their finances. This is to be encouraged. However, sometimes such services come at a cost and those costs are not clearly disclosed. For example, a customer is invited to set up dishonour alerts. The customer clicks on the feature and receives a long paragraph of information in addition to a couple of obvious boxes to tick about which account and what form of notification:

*This alert notifies you when an account has been overdrawn by a cheque, direct entry or periodical payment. Upon receipt of a dishonour alert you may wish to reverse this by depositing funds into your account accordingly by 1:30PM, that day. You will be charged an honour fee to have the dishonour reversed.*

**Note:** We, and all of the third parties we rely upon to provide the Alerts Service are not liable or responsible for any failure or delay in transmitting information to you or any error or failure in such information. We are not liable to you or responsible for losses arising from any industrial action, or any cause beyond our reasonable control including (but not limited to) any equipment or electronic or mechanical failure or malfunction, the failure of your Electronic Equipment to receive information, or telecommunications breakdowns. We are not liable to you if you suffer loss due to an Alert not being received accurately or at all. If you fail to ensure the security of your Electronic Equipment, or if you fail to notify us of a change in your email or SMS details, we have no liability to you in respect of any loss or damage that may occur after transmission of any Alert by us. You acknowledge that we are not responsible for any loss or damage caused to your data, software, computer, Electronic Equipment or other equipment caused by your use of the Alerts Service.<sup>110</sup>

If the consumer does not read the above carefully, they can easily miss the warning about the honour fee. Further, the amount is not disclosed. Equally, when the alert is received there is no mention of the fact that the fee will be charged to the account. Without careful checking of statements or Internet transaction details such fees can be missed and continue to be incurred without the consumer's knowledge.

Financial Rights argue that where banks offer such services, fees need to be much more clearly disclosed both when they opt into a service and when they incur the fee, including where possible a dollar amount, or at least a range and method of calculation.

## Recommendations

Financial Rights recommends that the Government address consumer concerns with excessive fee charging. The Government should commit banks to:

- a. Examine their fees structures to address the extent to which any of their fees are regressive;

<sup>110</sup> Example from St George internet banking.

- b. Limit the charging of fees for breaches of terms and conditions or default to a maximum of the direct costs incurred as a result of the breach;
- c. Ensure bank fees and charge will not trigger further fees;
- d. Provide consumers a warning that a fee will be imposed if a particular transaction goes ahead, and if a particular service will incur a fee both when the customer opts into the service and when the fee is incurred;
- e. When a bank offers services through physical branches, not charge fees for face to face interaction with branch staff or penalties for going into a branch;
- f. Not charge for providing a document under this Code in the following circumstances:
  - iii. Where documents or computer access have been lost due to family violence or natural disaster;
  - iv. The customer has a low income with Centrelink benefits as their main source of income.

Financial Rights notes that recommendations in other sections of this submission are also relevant including:

- c. Not charging customers default fees while the bank is considering a hardship arrangement
- d. Account suitability.

## Responsible Lending

### Loan Practices: Impairment of Customer Loans Report

Regarding hardship and the general provisions, Financial Rights notes the relevance of the findings of the recent Parliamentary Joint Committee on Corporations and Financial Services' Report on *Impairment of Customer Loans*<sup>111</sup> in May 2016. In examining small business lending, the committee determined that there has been a "persistent pattern of abuse of the almost complete asymmetry of power in the relationship between lender and borrower." The Report makes a series of recommendations. They include:

- authorised deposit taking institutions must commence dialogue with a borrower at least six months prior to the expiry of a term loan. Further, where a monetary default

<sup>111</sup>

[http://www.aph.gov.au/Parliamentary\\_Business/Committees/Joint/Corporations\\_and\\_Financial\\_Services/customer\\_loans/~/media/Committees/corporations\\_ctte/customer\\_loans/report.pdf](http://www.aph.gov.au/Parliamentary_Business/Committees/Joint/Corporations_and_Financial_Services/customer_loans/~/media/Committees/corporations_ctte/customer_loans/report.pdf)

has not occurred, they must provide a minimum of three months notice if a decision is made to not roll over the loan, even if this means extending the expiration date to allow for the three months following the date of decision;

- if a customer is meeting all terms and conditions of the loan and an authorised deposit taking institution seeks to vary the terms of the loan, the authorised deposit taking institution should bear the cost associated with the change and provide six months notice before the variation comes into effect;
- customer protections relating to revaluation, non-monetary defaults and impairment should be explicitly included in the Code of Practice; and
- subscription to a relevant Code of Practice becomes mandatory for all authorised deposit taking institutions.

Financial Rights supports these recommendations. The report details a series of further recommendations for regulatory and legislative reform.

Financial notes that ASIC has commenced civil penalty proceedings against Westpac for breaching home-loan responsible lending laws. ASIC allege that Westpac failed to properly assess whether borrowers could meet their repayment obligations before entering into home loan contracts.<sup>112</sup> Financial Rights understands that ASIC are investigating a further 11 banks over their home lending practices.<sup>113</sup>

Financial Rights further notes that the Khoury Review into the Code of Banking Practice has not accepted a recommendation by the Joint Consumer submission to extend clause 27 of the Banking Code to expand upon the responsible lending process requirements in the *National Credit Act*, mainly to avoid duplication and to inexplicably avoid strict compliance with ASIC RG 209 on responsible lending. This is disappointing since the failure of the Banks to adhere to RG 209 has led to the problems we are currently seeing being pursued by ASIC.

Financial Rights also reiterates its view that the newly proposed design and distribution obligations and product intervention powers (discussed above) should also apply to credit products.

## Recommendation

Government should implement the recommendations of the Parliamentary Joint Committee on Corporations and Financial Services' Report on *Impairment of Customer Loans*

<sup>112</sup> ASIC, 17-048MR ASIC commences civil penalty proceedings against Westpac for breaching home-loan responsible lending laws, 1 March 2017 <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/>

<sup>113</sup> Michael Janda, Westpac not alone in ASIC home loan investigation, 2 March 2017  
<http://www.abc.net.au/news/2017-03-02/westpac-home-loans-asic-court-action/8317750>

## Refunding Lender's Mortgage Insurance

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Lenders Mortgage Insurance (LMI) is often required when a customer's loan to valuation ratio (LVR) exceeds a certain threshold. This insurance protects the bank from any shortfall on the sale of the property which forms security for the loan. It does not protect the borrower. The borrower nonetheless is required to meet the premium and this is financed under the mortgage. Premiums can be very high (e.g. thousands to tens of thousands of dollars), greatly increasing the size of the mortgage and incurring interest accordingly.

Where a consumer pays out a loan early by refinancing or otherwise the bank may be entitled to a rebate on the LMI premium financed by the mortgage. Whether this rebate is passed onto the customer is unclear. The NCC provides for a rebate on CCI expressly, but not LMI. Banks should commit to always refunding the customer where they receive a rebate and should be transparent about the arrangement.

### Case study – Joan's Story

Joan bought a property in 2013, but her LVR did not meet the banks criteria. The bank advised her she needed to pay \$29,000 for LMI for the loan to be approved. The LMI was offered by a bank branded LMI provider. Joan obtained the mortgage. In mid-2016 she refinanced to a new lender whose interest rates were more competitive. Her new loan was approved. She queried whether she would get any refund of the LMI she had paid. The bank advised her that there was no refund.

A key problem relating to lenders mortgage insurance for consumers is that it is paid for by consumers but it does not cover them—it covers the lender. This results in consumer confusion and cost. Consumer complaints about lenders mortgage insurance at the Credit Ombudsman tripled in 2012/13.<sup>114</sup> The Credit Ombudsman states that complaints are generally arise because:

*where a loan is not fully repaid from the proceeds of the sale of the security property and the lender makes a claim on its mortgage insurance policy for the shortfall, the right to recover the shortfall is generally assigned to the lenders' mortgage insurance provider.*<sup>115</sup>

Efforts advanced by the previous former Gillard Government to improve consumer understanding of LMI stalled with the change of government. It was proposed that a key fact sheet would be introduced to better explain this product to consumers, and we think such a reform would be worthwhile. We do not think that this goes far enough, however, and we suggest a further reform to reduce the consumer detriment associated with lenders mortgage insurance. That is making lenders mortgage insurance portable and refundable—should consumers switch mortgages during the period of insurance, then they should be entitled to a

<sup>114</sup> There were 20 complaints regarding lenders' mortgage insurance in 2010/11 and 2011/12 (COSL 2012 Annual Review, p 23) and 58 in 2012/13.

<sup>115</sup> COSL Annual Report on Operations, p 29.

refund of a pro-rata amount of the premium and/or be able to 'port' the insurance to a cover a new mortgage.

## Recommendations

The Government should ensure that:

- a. only the actual cost of the LMI to the bank is paid by the consumer;
- b. banks pass on any rebate they are entitled to receive on LMI to the customer who has paid the premium in the event of a refinance;
- c. bank provide clear information to customers about how and when a rebate may be claimed as apart of the documents provided when getting the loan; and
- d. a key fact sheet is provided to better explain this product to consumers.

## Small Amount Credit Contracts and Consumer Leases

Under the *National Credit Act* small amount credit contracts (**SACCs**) are loans of up to \$2,000 where the term of the contract is between 16 days and 12 months. Consumer leases are regulated under Part 11 of the same Act when the amounts payable under a lease for a good exceed the cash price of the leased good; the lease term is for more than four months or for a defined period; and the lease is not an employment related lease (such as a novated lease or a lease paid via a salary sacrifice arrangement).

The laws governing SACCs and consumer leases were subject to an independent review in 2015, with a final report<sup>116</sup> recommending significant reform. The Government has now responded to this report and is planning implementation of these reforms later this year.

Based on our extensive casework experience with the payday lending we continue to believe these loans should be banned. The payday lending industry has repeated and systemically demonstrated that:

- it has a culture of avoidance of the law
- it relies on repeat borrowing
- there is systemic non-compliance with the responsible lending laws

In many of our cases, consumers are provided loans they simply cannot afford to repay. Consumers present to Financial Rights when they are in difficulty. We then analyse their situation to determine whether their difficulties are the result of a change in circumstances or

<sup>116</sup> <http://www.treasury.gov.au/ConsultationsandReviews/Consultations/2016/SACC-Final-Report>

a failure of responsible lending in the initial granting of the loan. For other types of loan, responsible lending breaches are the exception rather than the rule, although some types of credit contract are more likely to reveal systemic lending issues than others. Pay day lending is the only segment where responsible lending breaches are almost invariably the root cause of the problem rather than subsequent changes of circumstances (although these may have exacerbated the problem in some cases).

ASIC's *Report 426: Payday lenders and the new small amount lending provisions*<sup>117</sup> supports this conclusion, with the report finding that lenders are still failing to comply with basic record keeping and information-gathering requirements, and are structuring credit contracts to avoid regulation. The report also demonstrates that the presumptions of unsuitability have not effected any real behavioural change in the industry. 'Bright line' enforcement rules, rather than 'presumptions', are likely to be more effective.

Our advice and casework experience strongly suggests that many consumers are still stuck in a harmful cycle of debt. Consumers already struggling to make ends meet simply cannot afford to make repayments, and are caught in a harmful cycle of repeat borrowing. For our clients there has been no change in this situation since the amendments to the legislation were introduced in 2013. The 'presumptions' of unsuitability have failed to break this cycle.

Financial Rights, with Consumer Action and Good Shepherd Microfinance commissioned a report, funded by Financial Literacy Australia, into the use of SACCs comparing data from 2005, 2010 and 2015.<sup>118</sup> The report found that lending in the SACC sector is larger than ever since the new laws were enacted, in number of loans and value of pay day loans outstanding. DFA research shows the percentage of users with more than one payday loan in the last twelve months has increased from 17% in 2005 to 38% in 2015.<sup>119</sup> Further there has been notable growth in both the number and percentage of consumers taking out more than one SACC in a 12 month period in every category from 2 loans to 10 or more.<sup>120</sup> There has been a smaller but similar increase in the number of borrowers with multiple SACCs at any one time.

For these low income and vulnerable customers SACCs can be very detrimental and the industry's business model seemingly depends on this detriment to survive. According to the DFA research, the average income of payday borrowers has changed very little over the past 10 years. In 2005 the average income was \$35,459 and by 2015 it has only increased to \$35,702<sup>121</sup> which has not even kept pace with inflation. This level of income is still very low compared to the general Australian population where full-time earnings average \$75,603 a year.<sup>122</sup>

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<sup>117</sup> ASIC Report 426 (2015), 'Payday Lending and the small amount lending provisions', available at: <http://download.asic.gov.au/media/3038267/rep-426-published-17-march-2015.pdf>

<sup>118</sup> The Stressed Finance Landscape Data Analysis October 2015 A report by Digital Finance Analytics and Monash University Centre for Commercial Law and Regulatory Studies (CLARS) <http://financialrights.org.au/wp-content/uploads/2015/10/The-Stressed-Financial-Landscape-Data-Analysis-DFA2.pdf>

<sup>119</sup> Digital Finance Analytics, *The Stressed Finance Landscape Data Analysis*, October 2015. Sec 3.2, Table 11.

<sup>120</sup> Ibid. Sec 3.2.

<sup>121</sup> Ibid. Sec 3.5, Table 26.

<sup>122</sup> Average Salary in Australia: <http://www.livingin-australia.com/salaries-australia/>

### **The payday lending industry is also booming**

The 2013 regulations haven't seen the death of the industry. In fact, ASIC recently reported that the number of lenders leaving the credit industry has been declining, with 89 cancellations for payday lenders in the 2013–14 financial year, down from 115 in the previous year.<sup>123</sup> Applications for credit licenses continued to be received from new entrants to the market, despite a number of large operators acquiring smaller licensees. These large operators have reported 'record breaking' lending performance. For example, Money3 announced a profit before tax of over \$10 million for the half year to 31 December 2014, a 126% increase on the prior year.<sup>124</sup>

Research from the Australian Centre for Financial Studies has found that regardless of new regulations there has been a twenty-fold increase in demand for short term, small amount loans in the last decade.<sup>125</sup> Research from DFA similarly confirms that there has been a dramatic increase in the number of Australians using payday loans (in the last 3 years), increasing from 356,097 in 2005 to 643,087 in 2015<sup>126</sup>. The report also estimates a continuing upward trajectory for the size of the pay day lending market<sup>127</sup>.

We have also seen huge growth in online lending. Research by RMIT University in May 2014 found that payday loans were directly available through 65 websites.<sup>128</sup> Traditional shop front lenders are also seeing growth in online business. For example, in February 2015 Cash Converters reported that growth of the online personal loan business in Australia continues to be very strong with the value of loans written increasing to \$31.3 million, up 65.2% on the previous corresponding period.<sup>129</sup> DFA research confirms this dramatic change with nearly 70% of payday loans being accessed online, when less than 1% were accessed online in 2005.

### **Pay day lending expanding into a new demographic**

While the average income of pay day borrowers has not changed dramatically<sup>130</sup>, our experience is that there are new categories of borrower. While we still see largely Centrelink recipients with multiple difficulties, we are also seeing low income, working borrowers, with problems created rather than exacerbated by pay day lending. The considerable presence of pay day lending in mainstream media, and particularly online, has made it both appear more

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<sup>123</sup> ASIC Report 426 (2015), 'Payday Lending and the small amount lending provisions', available at: <http://download.asic.gov.au/media/3038267/rep-426-published-17-march-2015.pdf>

<sup>124</sup> Money 3, 'Media Release December 2014 Half Year Results', available at: <http://www.asx.com.au/asxpdf/20150226/pdf/42wx5lyft7styg.pdf>

<sup>125</sup> Banks, Marcus, De Silva, Ashton & Russel, Roslyn "Trends in the Australian small loan market" Australian Centre for Financial Studies, School of Economics, Finance and Marketing, RMIT University, October 2015, p. 5. Available at:

<http://australiancentre.com.au/sites/default/files/NewsDocs/Commissioned%20paper%20-%20Trends%20in%20the%20Australian%20small%20loan%20market.pdf>

<sup>126</sup> Digital Finance Analytics, *The Stressed Finance Landscape Data Analysis*, October 2015. Sec 3.1, Table 11.

<sup>127</sup> Ibid. Sec 3.8, Figure 14.

<sup>128</sup> Banks and Ali (2015), 'Into the Mainstream: The Australian Payday Loans Industry on the Move', The Finsia Journal of Applied Finance

<sup>129</sup> 'Cash Converters (2015), 'Cash Converters Half-Year Result', available at: <https://www.cashconverters.com/Investors/AsxAnnouncements>

<sup>130</sup> Ibid. Sec 3.5, Table 26.

normalized and able to be accessed anonymously. These loans are now being marketed to a wider audience, irresponsibly suggesting that payday loans can be used to pay everyday expenses like utility bills, rounds of drinks, and presents. This seems to be leading to people borrowing for less desperate reasons and then becoming caught in a cycle of borrowing when they cannot afford to repay their loans (see for example Case Studies 8 & 2 in Appendix 1).

Research from DFA similarly confirms that there has been a dramatic increase in the number of Australians using payday loans, but also shows that there has been a shift in the mix of household segments using these services.<sup>131</sup> When the population is divided into financially stressed and financially distressed households, with the latter being those in more dire financial straits, payday lending has decreased by a modest 5% in the distressed category since 2010 but exploded in the stressed category.<sup>132</sup> In 2005 around 350,000 financially distressed households were using payday loans, and only about 7,000 financially stressed households. By 2015 the number of distressed households using payday loans has increased slightly to over 375,000, but troublingly the number of financially stressed households has increased almost 40 times to over 250,000.<sup>133</sup>

The explosion in online lending discussed above has serious implications for future growth in the industry.<sup>134</sup> The research states “the increased penetration of payday lending amongst financially stressed households appears to be linked to the rise of mobile technologies and the ease and convenience of online originated loans.”<sup>135</sup> In addition, we submit that the failure of the legislation to require SACC providers to disclose an APR is contributing to this growth and giving the SACC industry an unfair advantage over their competitors – to the great detriment of consumers.

### **Payday loans continue to be excessively expensive**

Competition between large lenders has failed to reduce fees and charges.

The vast majority of payday lenders, including Nimble, Cash Converters and Payday 247, are charging the maximum amount permitted by legislation, indicating that price competition does not work in this market.<sup>136</sup>

Annualised interest rates for payday loans often exceed 240%. For a borrower already struggling to make ends meet, repayment of these excessive fees and charges can leave the borrower with another shortfall and encourage them to return to the lender.

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<sup>131</sup> Ibid. Sec 3.2, Table 11.

<sup>132</sup> Digital Finance Analytics, *The Stressed Finance Landscape Data Analysis*, October 2015. Sec 3.2, Table 11.

<sup>133</sup> Ibid. Sec 3.2, Table 11.

<sup>134</sup> Ibid. Sec 3.1, Figure 7.

<sup>135</sup> Ibid. Sec 3.8, Figures 14 and 15.

<sup>136</sup> Credit Corp released a product called Wallet Wizard with a 15% establishment fee and 2% per month fee. Available at: <http://www.walletwizard.com.au/costs/>. Fair Loans fast Community Finance charge the establishment fee but no monthly fee on a SACC. Available at <http://www.fairloans.org.au/personal-loan-repayments>.

## All loans and leases in Australia should be subject to a 48% interest cap

We have no confidence that the industry will ever comply with the law in any meaningful way so consumers are adequately protected.

In these circumstances, the only effective way to protect consumers is to ban the industry through an interest rate cap (as has been enacted in a number of countries and states in the USA). This would be achieved by applying an all-inclusive cost cap of 48% or less and enacting adequate avoidance provisions.

While we support any action taken by the Government to restrict the negative and destructive impact the pay day loans can have on the industry, Financial Rights continues to believe that that the simplest approach to dealing with the dangers of small amount credit contracts and consumers leases is to ensure that they are all subject to a 48 per cent Annualised Percentage Rate (APR) cap.

We strongly believe a 48 per cent cap would be easier to enforce, the best means of protecting consumers from predatory lending, and still maintain viability of those loan providers whose lending model does not rely on financial hardship and repeat borrowing to be profitable.

With respect to consumer leases, there is also no reason for lessors not to be subject to the 48 per cent cap that applies to credit contracts in general and should apply to all types of consumer leases, including car leases.

All cases where a consumer pays more for the goods than their retail value should be treated as a regulated credit contract and subject to a 48 per cent cap. This would be the least complicated and most effective way to address the problems in the market.

## Recommendation

All small amount credit contracts and consumer leases should be subject to a 48 per cent cap.

## Mortgage Brokers

ASIC is currently undertaking a review at the request of the Government in relation to mortgage broker remuneration structures and their effect on consumer outcomes. ASIC was to provide this to the Government by the end of 2016 but has received an extension.

Mortgage brokers are subject to requirements under the *National Consumer Credit Protection Act 2009* to make reasonable inquiries about the consumer's requirements and objectives in relation to the loan and make an assessment of the as to the suitability of the loan they assist the consumer in obtaining.

Financial Rights is concerned with the inherent conflict of interest in the broker remuneration model and the poor practices identified by *ASIC Report 493 Review of interest-only home loans: Mortgage brokers' inquiries into consumers* including:

- Brokers only providing general information, rather than tailored information on specific products and loan features;
- Poor record keeping
- Poor provision of loan choice explanation.

In 2015 CHOICE magazine conducted a shadow shop of mortgage brokers<sup>137</sup> and found three key problems:

- Clients were not well-informed about the size or nature of the commissions that brokers receive.
- The quality of some broker recommendations was poor and some brokers encouraged consumers to pursue risky borrowing strategies.
- Mortgage brokers help arrange credit for the largest purchase most people make, a house. Yet, brokers are only required to arrange a 'not unsuitable' loan, not the best possible loan.

A key objective in the enactment of the *National Credit Act* was to address predatory lending in the home loan market. Brokers which charged large up-front fees (financed under the loan) featured regularly in blatant equity stripping cases. As a result commissions were not a significant focus in the reform process, with disclosure being the only requirement imposed. While the law has been largely successful in addressing the extremes of predatory lending in relation to home loans, other problems as outlined above are rife. Disclosure alone is clearly insufficient to address the inherent conflicts of interest in the market. While we are not necessarily calling for outright ban on commission, we support ASIC's current work in this area and strongly recommend action being taken to address identified areas where commissions (including soft dollar incentives) are contributing to poor consumer outcomes.

The legislative standard for mortgage broker activities should also be enhanced. The *National Credit Act* subjects brokers and lenders to more or less the same standards in relation to responsible lending, that being that credit providers should not enter loans, and brokers should not recommend loans, which are "unsuitable". A loan will be found to be unsuitable if it does not meet the consumer's requirements and objectives, or if it appears based on reasonable enquiries and verification that the consumer will not be able to repay the loan without substantial hardship. While this may be an appropriate standard to hold a lender to, it is hard to argue that it is an appropriate benchmark for a mortgage broker who purports to give independent advice and match consumers with the most suitable products from a range of lenders.

We also note that while we are able to often be able to settle individual cases where there has been a failure of responsible lending, we see no evidence that lenders systemically monitor their broker networks to identify and rectify concerning trends in poor product distribution.

## Recommendation

<sup>137</sup> CHOICE, Mortgage broker investigation, 6 May 2015

<https://www.choice.com.au/money/property/buying/articles/mortgage-broker-shadow-shop>

The government should take urgent action to expose and address conflicts of interest driving poor behavior in the mortgage broking market;

The responsible lending provisions of the *National Credit Act* should be enhanced to improve the standards of advice provided by credit assistants (brokers);

The design and distribution obligations and product intervention powers currently being consulted on by Government should include credit products within its purview.

## Exemptions in NCCPA for Point-of-Sale Vendors

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The National Credit Reforms that took place in 2009 saw the introduction of a requirement for persons who engage in credit activities to hold an Australian Credit Licence or otherwise be authorised under the *National Credit Act*. Persons engage in credit activities where they either provide credit or offer consumer leases to consumers or they provide credit services such as recommending particular products, assisting a consumer to apply for credit or referring a consumer to a credit provider or lessor.

However, businesses that arrange finance with a lender or lessor in connection with the provision of goods or services are engaging in credit activities and would ordinarily need to obtain an Australian Credit Licence and to meet the obligations imposed by the *National Credit Act*, such as responsible lending conduct requirements but the Government decided that these Point-of-Sale (POS) retailers would be exempt from the *National Credit Act*, pending a review of the sector. In 2013 this sector was reviewed but the exemption remained in place.<sup>138</sup>

Financial Rights has not supported the exemption of POS retailers from the *National Credit Act* at any time. Financial Rights considers the exemption to be a large loophole in the current consumer protections under the *National Credit Act*.

Financial Rights believes the following problems still exist with POS retailers:

- a. they are not required to meet any entry standards, and ASIC is also unable to exclude vendor introducers from the credit market (even if they engage in conduct that is incompetent or dishonest);
- b. they can select, recommend or propose credit products without having to conduct an assessment as to whether the product is suitable for the consumer, or meets their financial requirements or objectives; and
- c. there are limitations on the ability of consumers to access remedies for the conduct of vendor introducers, including lodging their disputes with a recognised external dispute resolution scheme.

Financial Rights strongly supports POS retailers being regulated under the *National Credit Act*. It is essential that consumers are confident that they will have basic rights and protections when dealing with POS retailers. This is currently not the case. As a consequence, Financial

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<sup>138</sup> <http://www.treasury.gov.au/ConsultationsandReviews/Consultations/2013/Point-of-sale-vendor-introducers>

Rights has had a number of cases where consumers have been in dispute with car dealers who acted as finance brokers (ie charging fees) but under the current legislation those consumers have no access to any external dispute resolution.

Research into consumer behaviour has shown that consumers are unlikely to be familiar with the cost or the terms of POS finance contracts, and because consumers tend to be psychologically committed to obtaining the product, they are vulnerable to signing up for a credit contract that they do not understand. POS retailers exercise substantial control over the terms of finance and credit for consumers, and there is significant risk that consumers will be steered towards more expensive finance options because retailers will receive higher commissions.

It is critical that the protections of the *National Credit Act* be extended to POS retailers that engage in credit activities in relation to the sale of goods and services, rather than allow this unsatisfactory gap in consumer protection to continue.

As can be seen from the following examples, the POS retailer can attempt to insert terms into their application form processes that attempt to avoid liability in their role as setting up the loan. Whilst it is true they would be captured under the linked credit provisions of the *National Credit Act* to some extent, the insertion of such terms seeking to avoid liability would confuse a consumer as to their rights of recovery. The rationale of the linked credit provisions of the Code is to make a financier liable for wrongful conduct of a supplier – generally for the quality of the goods, misrepresentation, or a failure of consideration of the contract. It is not a mechanism that directly addresses the harm identified below and provides the necessary disincentive of such conduct.

#### **Case study –Sam's story - Unaffordable car loan arranged by dealership**

Sam originally purchased a second hand car on finance in 2014. The finance was for approximately \$22,000 (the Subaru). The Subaru was traded in for \$15,000 when he purchased a Holden in May 2015. The Holden was \$34,000 (inclusive of on-road costs) the finance was \$43,000. Shortly after he traded in the Holden for \$23,000 and he then entered into another loan \$61,892 in September 2015. The loan was arranged by the dealership.

The vehicle cost \$30,000. The balance after the trade-in was the balance of the previous loan, extra's and stamp duty. At this point his loan was twice the value of the vehicle. The repayments on the proposed loan \$645.87 per fortnight. This equated to 36% of his monthly income.

The loan application required Sam to make various acknowledgements including, amongst other things:

- “total monthly expenses to be reduced when assessing the loan as my spouse/de facto contributes to these expenses, is in permanent (not casual) employment and has a net monthly income as detailed above”.
- Acknowledge that the dealer named in this application (the dealer) is not acting as my agent in relation to my application for finance from St George and is not authorised to

negotiate in relation to the loan contract on my behalf

- Acknowledge that the Dealer may perform some activities under the National Consumer Credit Protection Act on behalf of St George as its representative, but is not its agent, except undertaking customer identification or providing documents as legally required may perform some activities

Have chosen finance one or more insurance products and confirm the agent for the insurance company (the Dealer) has explained the benefits, exclusions and cost of the product(s) and the impact of the cost including the premium in the financed amount"

The alleged de facto earned \$4,500 per month.

The dealer did not have an Australian Credit License.

There was no de facto. No verification was undertaken in respect of the de facto's existence or income.

The car was repossessed leaving a \$47,000 shortfall. A responsible lending argument was raised, and the FSP agreed to reduce the debt to \$20,000 being the amount refinanced to his benefit. The lender had applied the FOS Approach to responsible lending remedy.

Issues:

- The Dealer attempted through its documentation to not have any responsibility in setting up the loan
- The linked credit provisions of the *National Credit Act* do apply – however there are limitations. The Dealer does not need to be a member of EDR. The documentation does not mention they are linked credit providers and on the face of reading the acknowledgements the consumer would be left with an impression they had no remedy against the dealer who by all accounts is not acting as an agent for anyone
- Remedy problem – clients who are churned through multiple car loans are sometimes left with no car and a large unsecured debt once the remedy is applied to the last in the chain of refinances. In Sachin's case – the last lender applied the FOS Approach to an unsuitable loan, he was however, still left with significant damages. If the POS retailer had an obligation to determine whether refinancing car loans was going to meet the consumers stated objective and purpose then Sachin may have a remedy against the POS retailer who encouraged him to discharge his previous loan and enter into a new loan.

#### **Case study – Jay's story – expensive bed set**

Jay is of Tongan background and although she was able to speak some English, she needed a Tongan interpreter to get into the finer details of her matter.

Jay had seen Harvey Norman advertisements for interest free finance offers and decided she

would like a new bed set. She went into the store to purchase the bed set under their interest free finance. The bed set cost around \$2000 and after paying a deposit, she applied to have the balance of about \$1500 placed under finance. The sales representative recommended to Jay that she should get a credit card to help her pay for the bed set and to Jay's understanding, the credit card would also be interest free. Jay required interest free finance for \$1500 (to cover her bed set) but walked out of the store with a credit card with a limit of \$12,000 (with interest payable). Jay was of the understanding that the credit was interest free and that her repayments would only be \$49 per month which she thought was affordable.

Jay had used the card to pay for everything and it was not long before she had spent the entire \$12,000 limit. It came as a shock to Jay that the monthly repayments increased to about \$360 a month. Jay made about Jay or so payments but just could not afford to pay anything else. She was very stressed about this and had to take sick leave from work. She was placed on a mental health plan by her doctor, she also cried a lot when we spoke. Financial Rights helped her to lodge her complaint in IDR and argued that the loan was unsuitable and that Jay could not repay it without substantial hardship. Financial Rights argued that GE failed to meet their responsible lending obligations by giving her a credit card for \$12,000 when she only asked for a interest free loan for \$1,500; they also did not verify her financial situation; they failed to assess unsuitability (no assessment was provided by them); and that the contract was unjust. Financial Rights was able to help Jay settle with GE for an amount she could afford to repay fortnightly with no further fees or interest charges added.

Where a POS supplier is identified as engaging in systemic misconduct, it would be up to credit provider to take steps (such as cease using the POS retailer). There are examples where it is clear no follow up has taken place. For example, in ASIC Report 471<sup>139</sup> no authorised representative had their authorisations cancelled for misconduct and only nine were warned in writing for misconduct. Reliance on a credit provider is not sufficient to ensure standards are met by POS staff.

Where the loan is found to be unsuitable, the remedy as set out in the FOS Approach Responsible Lending<sup>140</sup>

If the POS retailer had obligations under credit assistance providers obligations from the NCCP – i.e. the same obligations of a broker, there would be arguably scope for the additional losses suffered by the consumer, for example, the shortfall on the refinanced loan to be pursued against the entity who failed to provide an assessment as to the suitability of the refinance i.e. a remedy against the POS retailer for the remaining shortfall.

<sup>139</sup> at paragraph 117 ASIC Report 471 *The sale of life insurance through car dealers: Taking consumers for a ride*, February 2016 <http://download.asic.gov.au/media/3549384/rep471-published-29-february-2016.pdf>

<sup>140</sup> <https://www.fos.org.au/publications/our-approach/the-fos-approach-to-responsible-lending/>

## Recommendation

Apply the *National Credit Act* without modification to POS retailers. Where a POS retailer is engaging in credit activities, by performing or undertaking functions regulated by the Credit Act, they would be required to either: a) hold an ACL; or b) be appointed as a credit representative of a licensee.

POS retailers engaging in credit activities should have to be a member of a recognised external dispute resolution scheme.

### 3. The impact of consumer outcomes of incentive-based commission structures

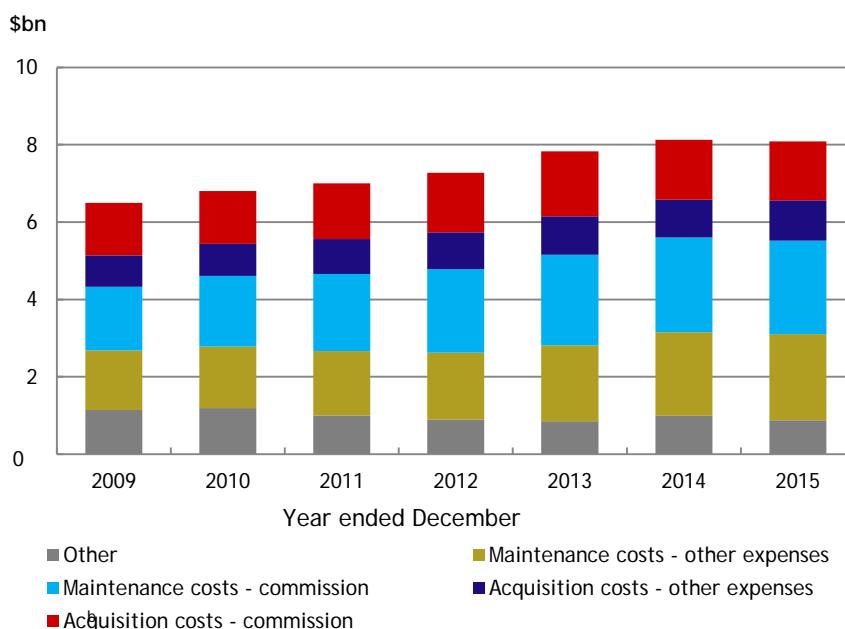
#### Remuneration

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Consumers buying life insurance directly will often use a financial adviser to make the arrangements. These financial advisers are still able to receive high upfront and ongoing commissions for selling life insurance, even though commissions are banned for all other kinds of personal advice.

The cost to insurers for life insurance distribution through adviser channels is significant, with ongoing and upfront commissions costing the life insurance industry billions each year.

Graph: Life Insurer Operating Expenses<sup>141</sup>



Despite the high costs to insurers, there has been significant resistance from all sections of industry to removing commissions from life insurance advice.

Commissions give an adviser a strong incentive to place consumers in the policy that attracts the biggest payment for them, not necessarily the policy that's best for the client. There is clear evidence that advisers who receive commissions are more likely to recommend inappropriate products for their client and are more likely to switch a client into a new product unnecessarily.

<sup>141</sup> Australian Prudential Regulation Authority Quarterly Life Insurance Performance Statistics, issued 16 February 2016 <http://www.apra.gov.au/lifs/Publications/Pages/quarterly-life-insurance-statistics.aspx>

A 2014 ASIC review of retail life insurance advice found high levels of churn across the industry, where clients are placed into new products. 37 percent of advice failed to prioritise the needs of the client and comply with the law. High upfront commissions are strongly correlated with poor advice; 45% of advisers who were paid through up front commissions failed to comply with the law.<sup>142</sup>

The ASIC report clearly found that high upfront commissions led to the worst consumer outcomes. The report concluded that:

*"High upfront commissions give advisers an incentive to write new business. The more premium they write, the more they earn. There is no incentive to provide advice that does not result in a product sale or to provide advice to a client that they retain an existing policy unless the advice is to purchase additional covers or increase the sum insured."*<sup>143</sup>

Current remuneration arrangements encourage advisers to sell products rather than provide quality personal advice. Being sold an inappropriate life insurance product causes long-term financial and personal harm to consumers. It means consumers waste money on a product they can't use, and should something go wrong, they or their families are not covered as expected. Over time, widespread mis-selling and poor behaviour from advisers means consumers will lose trust in the financial system.

The Federal Government has introduced a legislative package to reduce toxic upfront commissions and decrease the likelihood of inappropriate product churn.<sup>144</sup> The *Corporations Amendment (Life Insurance Remunerations Arrangements) Bill (2015)* and associated regulations place limits on how financial advisers arranging life insurance can be remunerated. It does this by removing the current exemption that allows advisers to receive commissions for life insurance products and enabling ASIC to determine acceptable remuneration arrangements. In the short-term ASIC will cap upfront and trail commissions and introduce a two-year clawback requirement to reduce the risk of inappropriate product churn.<sup>145</sup>

This suite of reforms is an important step in the right direction but needs to be taken much further. Given the harm that commissions cause consumers they should be banned in life insurance advice, just as they are for other kinds of advice.

See also above under Mortgage Brokers for further discussion of remuneration issues.

## Recommendations

That the *Corporations Amendment (Life Insurance Remunerations Arrangements) Bill (2015)* is passed as soon as possible without amendment.

That the Federal Government sets a clear date for the removal of all commissions in life insurance advice, starting by phasing out up-front commissions shown to lead to the worst consumer outcomes.

<sup>142</sup> ASIC (2014), *Report 413: Review of retail life insurance advice*, pp. 5-7.

<sup>143</sup> Ibid para 147.

<sup>144</sup> <http://kmo.ministers.treasury.gov.au/media-release/024-2015/>

<sup>145</sup> Op cit, ASIC

## 4. 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

### Legal advice and financial counselling for banking consumers

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Free, independent financial counsellors and community based credit and debt lawyers play a vital role in the Australian financial system.

Financial Rights runs the NSW arm of the National Debt Helpline (formerly the Credit and Debt Hotline), which provides legal advice and financial counselling information and referrals to NSW residents. The 1800 007 007 telephone service is the central point of contact for people requesting assistance in relation to credit, debt and financial hardship.

The goal of the National Debt Helpline is to assist as many consumers as possible to self-advocate. This can include one off discrete advice, or ongoing conversations as matters progress including updating advice and strategies as consumers navigate their problem. Many consumers who are able to self-advocate are referred to our online resources and provided advice over the phone. For consumers who are unable to self-advocate, either because of the complexity of their problem, or their level of disadvantage, may be referred to their closest face-to-face financial counselling service or provided with assistance in-house, by solicitors, financial counsellors, or both.

Financial Rights solicitors and financial counsellors on the National Debt Helpline work closely with other colleagues in both Sydney and regional and remote NSW regions, providing training on relevant issues, and attending financial counselling meetings and conferences. We also have a dedicated telephone number for financial counsellors to access our service as a priority for when they have clients present.

The timely access to advice and assistance often assists both consumers and traders to come to a speedier resolution. When consumers are in financial difficulty they are tempted to take a number of options which exacerbate their problems in the longer term including:

- Paying nothing at all because they cannot afford the amount claimed or demanded;
- Stopping responding to letters and phone calls; or
- Turning to high cost lenders to meet their short term needs, leading to much bigger problems in the longer term.

Given appropriate advice from an independent source these people can be encouraged to take more constructive steps towards resolving their problems. In recognition of this banks and other credit providers have become a significant source of referrals to our service.

Where real and meritorious disputes exist, early access to advice often means that the issues are aired as quickly and efficiently as possible and consumers get help to compile their evidence. This can mean an early resolution of an otherwise drawn out dispute.

Credit cards remain the most common product held by consumers seeking assistance, but home loans are close behind. About 15% of the calls about personal loans involved payday loans and other small amount, high cost contracts (often multiple contracts for a single caller). Personal loans are closely followed by car loans. Energy is still the most common debt type among our clients that is not credit related.

Financial counsellors and community based credit lawyers struggle constantly to maintain funding levels sufficient to meet demand. Funding for financial counselling has long been ad hoc, inconsistent and uncertain. Governments increase, decrease or in some cases defund services almost at a whim.

Funding for Financial Rights to run the National Debt Helpline comes from the Financial Counselling Services Program NSW administered by the Department of Finance and Services (Fair Trading), the Community Legal Services Program of the State and Federal Attorney-General's Departments, and the Financial Wellbeing & Capability Program - Commonwealth Financial Counselling, administered by the Department of Social Services for our core services.

Financial Rights has also recently established the Aboriginal Advice Service (**AAS**) as a national specialist service offered by the Financial Rights Legal Centre. The service provides legal advice on credit, debt and insurance matters and access to financial counselling for Aboriginal and Torres Strait Islanders via our national 1800 808 488.

Financial Rights notes that a user pays funding model is currently being introduced for ASIC. Furthermore, Financial Counselling Australia has argued that this user-pays model should be extended to include funding for free financial counselling, a model that has been implemented in the UK. Financial counselling clients have debts with financial service providers they are struggling to pay. The finance industry benefits enormously when customers are able to get back on top of their finances because of the assistance of a financial counsellor. However Financial Service Providers do not contribute to the direct cost of service provision.

Financial Rights supports Financial Counselling Australia's call for a more sustainable funding model for financial counsellors and argues that this should be further extended to sustainable funding for free and independent credit and debt legal advice for vulnerable consumers.

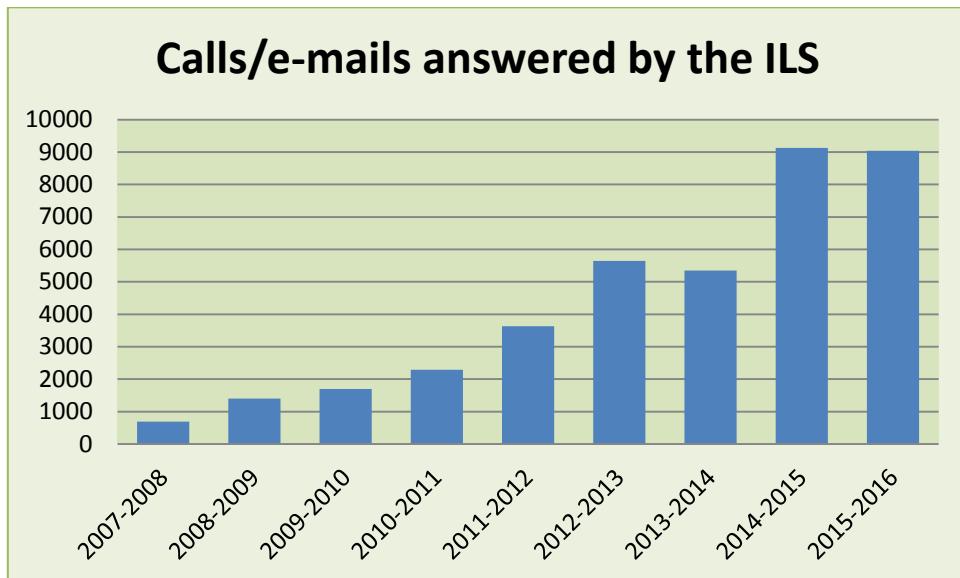
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## Recommendation

The Federal Government should develop an ongoing and sustainable, industry-contributed model for free and independent financial counselling and legal advice to vulnerable consumers with credit and debt problems.

## Legal services for insurance consumers

Since 2007, the Financial Rights's national ILS has provided a free and independent advice service for vulnerable consumers impacted by natural disasters, motor vehicle accident, theft, illness and injury. Over this time demand for the service has consistently increased from close to 700 calls in 2007-08 to over 9000 calls taken and emails answered in the last two financial years.



At current funding levels the ILS does not meet the overwhelming demand for the service, answering only 58% of calls on average.<sup>146</sup>

The service is currently funded by a combination of general CLC program funding (1 position), two-year funding directly from the Commonwealth Attorney-General's department (about 2 positions) and one off funds from the Victorian Fire Services Levy consumer refund process (another 2-3 positions). Both Commonwealth funding and the one-off Victorian Fire Services Levy cease in June 2017.

The Commonwealth has yet to confirm whether it will fund the ILS from June 2017. This is disappointing given the vital role the ILS plays in providing assistance at a time of increased need. Without this funding the ILS will only be able to engage one solicitor to work the ILS phone service, run cases and produce consumer education resources.

Financial Rights has received a one-off community benefit payment from IAG and Allianz as a result of concerns raised by ASIC in relation to CCI sold in conjunction with payday loans

<sup>146</sup> Actually less than 58% in January and February 2017 but we are currently recruiting additional solicitors with the one-off funds referred to in this section.

arranged by Cash Store<sup>147</sup>. The payment has been designated for use for the ILS including the AAS.

This one-off funding will enable the ILS and AAS to employ a number of lawyers for a limited period. While Financial Rights is grateful for the additional funding at a moment of significant funding uncertainty, we believe a sustainable Federal funding model for the national Insurance Law Service is long overdue.

Aside from the clear and demonstrable consumer need for the ILS, it is important to understand the critical role Financial Rights and the ILS plays in the EDR regime. FOS refers a large and increasing number of consumers to the ILS for independent advice. Financial Rights received 1,363 client referrals from FOS in 2014, increasing to 1,838 referrals in 2015 and 1,102 referrals in the first nine months of 2016. In light of difficulties in tracking referrals, these figures significantly underestimate the actual number of referrals and need for assistance.

EDR schemes are intended to be accessible, free and fair. In theory, consumers should not need an advocate assisting with their dispute. In practice, however, some financial disputes are technically and legally complex. Independent legal advice is critical for consumers faced with complex matters, confused by the multiplicity of schemes and requiring assistance to navigate the rules and processes. Many consumers are simply overwhelmed by the process, compounding the stress arising from the substantive issues in dispute.

Given there is a current review of the dispute resolution framework (and funding for these arrangements) the Government must acknowledge and account for the heavy reliance that the EDR system place on the ILS to function properly.

The Government and the insurance industry are also increasingly reliant on the consumer focussed expertise that Financial Rights can provide for policy development and regulatory review processes. Over the past year alone Financial Rights has:

- actively engaged with the Financial Service Council Code of Practice Steering Committee in development of its recent Code;
- assisted ASIC with their investigations into CommInsure's practices through the provision of hundreds of call records identifying systemic issues;
- highlighted the need for ASIC and industry to examine the insurance industry's claims handling practices and the need for regulatory reform following the release of our report *Guilty Until Proven Innocent: Insurance Investigations in Australia*.

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<sup>147</sup> 15-175MR CGU Insurance and Accident and Health International to refund \$2 million in 'useless' payday insurance premiums <http://asic.gov.au/about-asic/media-centre/find-a-media-release/2015-releases/15-175mr-cgu-insurance-and-accident-and-health-international-to-refund-2-million-in-useless-payday-insurance-premiums/> & 15-044MR Allianz agrees to refund \$400K in 'useless' payday insurance premiums, <http://asic.gov.au/about-asic/media-centre/find-a-media-release/2015-releases/15-044mr-allianz-agrees-to-refund-400k-in-useless-payday-insurance-premiums/>

At a time where there is greater need than ever for free and independent legal advice on insurance matters, it is critical that the ILS be funded in an ongoing, sustainable manner to continue an essential resource for vulnerable consumers, government and the insurance industry.

## Recommendation

The Federal Government support independent and free legal assistance for vulnerable consumers subject with insurance problems through the development of an ongoing, sustainable funding for the national ILS including the AAS.

## Legal advice for financial advice consumers

No service is funded to provide free assistance to clients affected by poor financial advice. Both state and federal governments, fund community legal centres and Legal Aid. This funding is provided for a range of purposes, mostly family and criminal law, but also civil law. Civil law services are largely provided by community legal centres, except in NSW, where Legal Aid NSW has a large civil practice. The majority of work done in relation to financial services is provided by a handful of specialist legal centres such as our own.

The National Partnership Agreement (which governs the funding of Legal Aid and Community Legal Centres) nominates a list of civil law priorities including (among others): bankruptcy, consumer law, and insurance matters. None of these cover people who have received poor investment advice from financial planners. The historical reasons for this are sound: government funding is targeted at low income and/or disadvantaged people who by definition have no money to invest because they have barely enough money to meet their day to day living expenses.

The problem with this approach is that some people who have been affected by poor and unethical financial planning advice end up facing the loss of their only asset, usually their home. Some of these affected people are currently receiving very poor advice online and from support and/or lobby groups who purport to represent their interests, exacerbating their already precarious financial situations.

Importantly, ASIC and the government are also missing out on an important source of intelligence. Community Legal Centres (especially specialist legal centres) and Legal Aid provide ASIC and the government with valuable information about unfair practices, whether illegal or not in relation to consumer credit, insurance, banking services (such as payment system and fee disputes) and debt collection practices. Financial Rights sits on ASIC's Consumer Advisory Panel along with a number of other consumer organisations. We assist consumers to complain to ASIC and also respond to Notices issued by ASIC requiring the production of information. For example, ASIC recently sought several thousand anonymised records from Financial Rights' client database to aid them in their review of Commissure and the life insurance industry more broadly. This flow of information does not exist in relation to financial planning and investment scams.

The government is already looking at resourcing ASIC to police the sector, establishing professional standards for financial planners, supporting EDR and is considering establishing a last resort compensation scheme. Financial Rights believes that the missing piece of the puzzle in relation to both ensuring affected people get some access to assistance, and that the regulator knows what is really happening on the ground, is an independent expert advice service.

It would not be sufficient to simply change the funding guidelines for Community Legal Centres or Financial Rights. All services are currently working to capacity to provide assistance in the areas already covered. There would also be an element of upskilling staff to operate in a new area. The investment required by Government would however be very modest.

Financial Rights believes that what is required is the development of a Financial Advice Assistance Service to provide casework assistance to consumers referred via financial counsellors, legal services, ASIC, the FOS and our existing advice lines.

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## Recommendation

Financial Rights recommends that Government needs to fund a Financial Advice Assistance Service pilot to provide casework assistance to consumers affected by poor financial planning advice.