

# choice

## CONSUMER PROTECTION IN THE BANKING, INSURANCE AND FINANCIAL SECTOR



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# ABOUT US

Set up by consumers for consumers, CHOICE is the consumer advocate that provides Australians with information and advice, free from commercial bias. By mobilising Australia's largest and loudest consumer movement, CHOICE fights to hold industry and government accountable and achieve real change on the issues that matter most.

To find out more about CHOICE's campaign work visit

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# INTRODUCTION

Consumers are getting a bad deal from the banking sector in big and small ways. For example, due to a lack of competition across the sector, consumers face growing fees and unjustifiably high-interest on credit products. Consumers face more acute harm when dealing with professionals in the sector, whether that's an adviser that thrives off a fee-for-no-service business model because they still receive conflicted asset-based fees or a mortgage broker that may suggest a risky lending strategy to get a higher commission.

To address the significant consumer harm caused by the banking sector, the current regulatory and legislative framework must be strengthened. We have focused our comments on the areas we believe have the greatest potential for reform and are not being thoroughly explored in other processes: the lack of competitive pressure across the sector, the need to lift standards for professionals and the need to bolster support services for consumers.

We recognise the recent reforms to address some aspects of harm in the banking sector. Notably, the Federal Government has passed legislation to reduce commissions for life insurance advice and lift standards in the financial advice sector. The government is also progressing reforms to give ASIC new powers and stable funding. These reforms are essential but even more work is needed to address the deep, systemic problems that cause consumer detriment.

Banks can't be left alone to address these problems. There must be publicly agreed rules, in the form of legislation or regulation, so these institutions are held to account in the long-term and not just when the public debate is focused on their sector's shortcomings.

The Committee also has an important role to play in dispelling harmful myths about the necessity and helpfulness of rising bank profits that are built on systems focused on aggressive selling and growing fees and charges. In discussing record profits, bank CEOs frequently note that returns are given back to the Australian community in the form of share dividends. For example, NAB CEO Andrew Thorburn recently defended high-interest products

by noting that “Eighty per cent of that profit overall is paid straight back to Australians by way of dividends to themselves or to their super funds. It is a virtuous and good cycle.”<sup>1</sup>

We urge the Committee to recognise that the “return” to the Australian public through dividends is not a fair or equal redistribution. Low-income households hold higher debt, are more likely to carry credit card balances forward and incur ongoing interest payments than high income households.<sup>2</sup> Similarly low-income households are less likely to have extensive share portfolios or significant funds in their superannuation accounts. High dividends should never be used as an excuse to shield banks from genuine competition, especially when they contribute to a redistribution of income from vulnerable to high-income Australians.

We urge the Committee to prioritise the needs of low income and vulnerable consumers when considering the reforms needed to the banking, insurance and finance sectors. These consumers are the ones that pay the most and receive the least from our banking system and would benefit greatly from significant reforms.

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<sup>1</sup> Transcript of House of Representatives Standing Committee on Economics Review of Australia's Four Major Banks (Public) Friday, 3 March 2017 Canberra. Witness: National Australia Bank.

<sup>2</sup> From Treasury (2016), *Credit cards: improving consumer outcomes and enhancing competition*, <http://www.treasury.gov.au/ConsultationsandReviews/Consultations/2016/Credit-card-reforms> Over 15 per cent of credit card users in the lowest income quartile were likely to persistently revolve credit card balances (and, therefore, pay interest), compared to less than 5 per cent of users in the highest income quartile (Reserve Bank of Australia, 2015).

## Summary of recommendations

### Actions to address competition problems in the banking sector

1. Competition is added to ASIC's mandate as soon as possible.
2. The Treasurer direct the Productivity Commission to review the state of competition in the financial system, focusing on specific issues with savings, home loan, secured loans, insurance and investment products as credit card issues have been well explored in other processes.
3. ASIC is provided with additional funds to conduct field tests and mass data analysis to improve product disclosure across the banking sector.
4. Treasury prioritise work on credit card information reforms and release a Final Assessment Regulation Impact Statement (RIS) associated with the proposed reforms as soon as possible.
5. The Federal Government introduces legislation to facilitate online credit card cancellation. We suggest an amendment to sections 133BA-133BR of the National Consumer Credit Protection Act 2009 that states:  
Cancellation of credit card contracts
  - a. Credit card contracts must be able to be cancelled through a one-step process.
  - b. The cancellation process must be provided on any platform that the card provider offers card services including websites and online applications.
6. The Federal Government pursues a suite of initiatives to allow consumers to cancel or easily switch direct debits on credit cards, including:
  - a. legislation to establish a 'tick and flick' switching process to allow customers to easily transfer direct debits to a new credit card. The process should be offered online and in-branch.
  - b. test a requirement that credit card statements include information about direct debit cancellation and switching processes.
7. The epayments Code is reformed from a voluntary code of practice to a mandatory code of conduct for all parties offering payment services.
8. The epayments Code is amended to clarify that consumers can share their information with an ASIC approved list of secure third-party services.
9. Consumers are given a legal right to access their own transaction and consumption data in a useful format.



### **Actions to lift standards and address conflicts for professionals**

10. ASIC develops a plan to completely phase-out commissions for personal advice on life insurance.
11. The Federal Government legislates to require that advisers prominently disclose whether they are truly independent or aligned with a financial organisation. The exact terms for disclosure should be based on consumer testing.
12. The Federal Government mandates a phase-out period for commissions that were grandfathered under the FoFA legislation and regulation.
13. Current exemptions to the conflicted remuneration ban are removed from the Corporations Act and the ban extended to cover asset-based fees received by advisers.
14. The Federal Government, in consultation with the states and territories, brings the regulation of the property investment industry into line with regulations applicable to the financial investment industry by:
  - a. making the regulation of property investment advice a Commonwealth responsibility (recognising that services provided by licensed real estate agents would remain under state and territory regulation);
  - b. inserting a definition of property investment advice into the Corporations Act and the Australian Securities and Investments Commission Act; and
  - c. requiring that anyone providing property investment advice should hold an Australian Financial Services Licence.
15. ASIC conducts a large shadow shopping exercise to determine the scope of discussions that brokers have with clients as well as the quality of information and recommendations provided.
16. The Committee considers lifting requirements for mortgage brokers. Specifically, the requirement to arrange a 'not unsuitable loan' should be lifted to require that brokers arrange a loan in the best interests of their client.
17. Financial services providers are required to publicly report on performance indicators and incentive structures for staff with a customer facing role and their direct supervisor.

### **Actions to bolster support services for consumers**

18. The proposed industry-funding model for ASIC is expanded to include funding for financial counselling and community legal services to assist consumers experiencing harm caused by the financial sector.
19. A compensation scheme of last resort for the financial sector is established.

# 1. COMPETITION ACROSS THE BANKING SECTOR

Across the banking sector there is market concentration, low switching rates and increasing vertical integration. There are strong parallels with the issues in Australia and those in the UK, where the Competition and Markets Authority (CMA) recently found that:

*the older and larger banks, which still account for the large majority of the retail banking market, do not have to work hard enough to win and retain customers and it is difficult for new and smaller providers to attract customers.<sup>3</sup>*

There are plenty of options for consumers in the banking market but consumers are not using them and the big players aren't competing on price. This lack of demand-side competition manifests itself in multiple negative outcomes for consumers: increasing fees and costs, poor consumer understanding of products and high concentration of consumers in some of the worst value products in the market.

## Detriment from lack of competition: a highly-concentrated market

The Australian banking market is highly concentrated – most people hold products with a big four bank or one of their sub-brands even though these products cost more and give less.

CHOICE research has found that:

- Consumers who bank with the big four banks or one of their sub-brands experience lower levels of satisfaction than customers of smaller institutions.<sup>4</sup>
- Despite this, in 2014 most people had a transaction account (77%), home loan (71%), credit card (77%) or savings account (66%) with the big four banks or one of their sub-brands.
- 58% of people agreed that the Australian banking sector lacks competition on the services and offerings provided to consumers.<sup>5</sup>

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<sup>3</sup> CMA (2016), *Making banks work harder for you*, p.3.

<sup>4</sup> CHOICE Consumer banking survey 2014. Referenced in CHOICE, Submission to the Financial System Inquiry. <http://fsi.gov.au/files/2014/04/CHOICE.pdf> The survey was conducted between 20-23 March 2014 with 1048 Australians aged 18+ from a permission-based panel (Pureprofile). Of these, 1005 indicated they had at least one of the following: everyday transaction account (and/or any offset account used for everyday transactions), home loan, credit card and savings account or term deposit. A nationally representative sample was drawn based on population data sourced from ABS Census 2011, and the final sample was weighed by age group, gender and location.

<sup>5</sup> Ibid. 18% answered "Don't know".

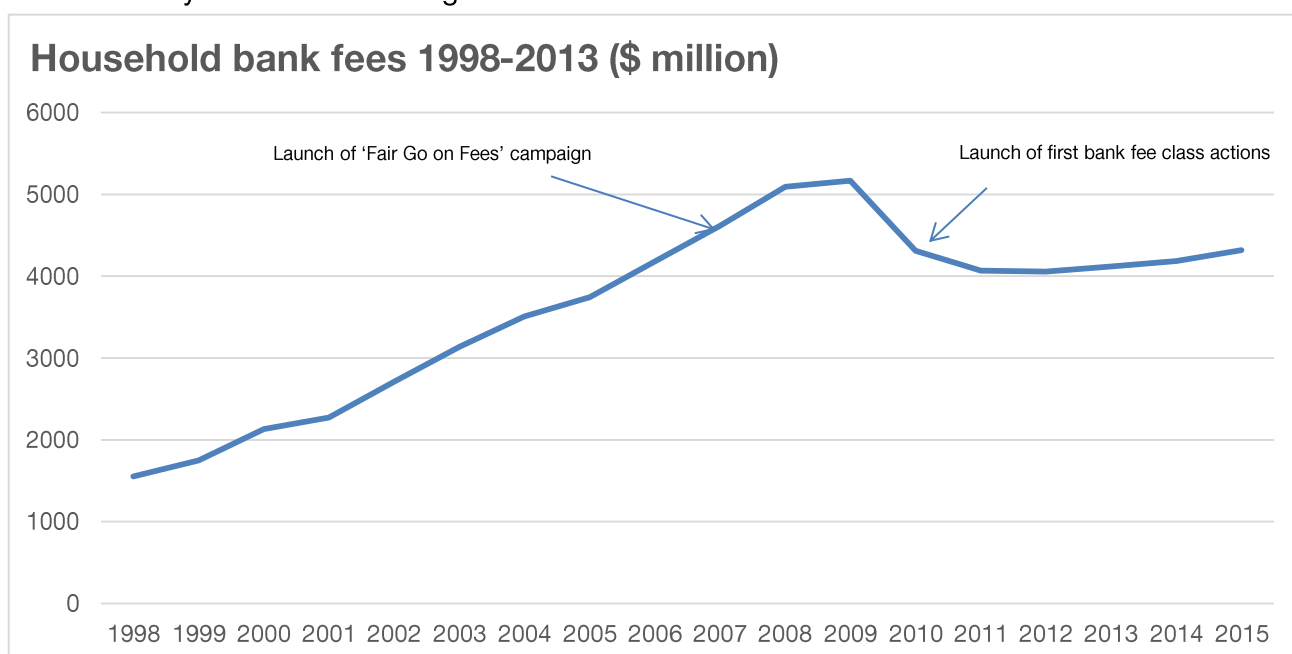


- Only 13% of people in 2014 had switched home loans in the last two years. 25% considered switching but did not change.
- 36% of people didn't switch because it was "too much hassle."
- 32% didn't switch because they wanted to keep all accounts in one place. This was highest reason for transaction accounts and savings accounts and lowest for home loans, suggesting that home loans are the product that 'anchors' a consumer to an institution.
- 48% of people with a transaction account, home loan and credit card had all three products with the same institution.

This data shows that larger incumbents in the banking sector do not have to work as hard as their smaller challenger counterparts to retain or attract market share. Ultimately, this lack of competition leaves customers paying more.

## Detriment from lack of competition: rising bank fees

Despite strong public concern about high costs in banking, fees continue to rise. Australians paid nearly \$12.5 billion in bank fees in 2015.<sup>6</sup> In 2014-15, bank fees increased more than the cost of education, groceries and housing.<sup>7</sup> An average household paid \$468 in bank fees, with credit card fees rising the fastest, up from 5.9% in 2014 to 6.6% in 2015.<sup>8</sup> This was the third consecutive year that bank fees grew.



<sup>6</sup> See RBA, Banking Fees in Australia, 2016 <http://www.rba.gov.au/publications/bulletin/2016/jun/pdf/bu-0616-6.pdf>

<sup>7</sup> Australian Bureau of Statistics, March 2016 Consumer Price Index <http://www.abs.gov.au/ausstats/abs@.nsl/mf/6401.0>

<sup>8</sup> The Australian Bankers' Association, Fees for Banking Services – 2016 Report, shows that an average household paid \$9 in fees each week, or \$468 in the year.

Major banks claim consumers should be grateful because fees are below their previous peak in 2009, but consumer campaigns and subsequent class actions forced a reduction in unfair ‘exception fees’ six years ago.<sup>9</sup>

High bank fees hurt consumers as they erode savings and escalate debt. These high fees imposed on bank customers directly contribute to record profits that all major Australian banks have posted over successive years.

## Detriment from lack of competition: poor consumer understanding of product features

Consumers often tell CHOICE of their feeling of powerlessness when dealing with financial institutions. This is partly because understanding the market and the terms and conditions of different products can be impossible without help. The extent of this “information asymmetry” between providers and customers who need their products leads to harm as consumers pay for products that they don’t need or aren’t the best deal in the market.

Generally, consumers struggle to understand terms and principles that the finance sector consider basic. Research commissioned by ASIC into consumer understanding of finance has found that only 33% of people have heard of and state they understand the concept of ‘risk/return trade-off’.<sup>10</sup> 30% find dealing with money to be stressful and overwhelming.<sup>11</sup>

The best example of poor consumer understanding of basic banking products is with credit cards, covered below, where most people don’t know the interest rate that applies to their credit card or understand how minimum monthly repayments work. But we also see poor understanding through consumers taking up products that they don’t or can’t use. For example, add-on insurance sold through car yards where consumers have paid \$1.6 billion in premiums but received just 9% back in claims, indicating that most people are paying for this insurance they don’t and likely will never use.<sup>12</sup>

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<sup>9</sup> The reduction in household bank fees since 2009 consisted mostly of a reduction in so-called ‘exception fees’, for example penalties relating to insufficient funds, over-limit or late-payments. This reduction followed the launch of a joint ‘Fair Fees’ campaign from the Consumer Action Law Centre and CHOICE from June 2007. As the campaign gained momentum, the RBA published bank exception fee data for the first time, in its May 2009 bulletin. In July 2009, NAB announced it would scrap penalty fees on transaction accounts, with other banks announcing reductions in August. In May 2010, Maurice Blackburn announced class actions targeting a series of bank exception fees.

<sup>10</sup> ASIC (2016), *REP 481: Australian financial attitudes and behaviour tracker, Wave 4: September 2015-February 2016* <http://www.financialliteracy.gov.au/media/559536/australian-financial-attitudes-and-behaviour-tracker-wave-4.pdf>

<sup>11</sup> Ibid.

<sup>12</sup> ASIC (2016), *REP 492 A market that is failing consumers: The sale of add-on insurance through car dealers* <http://asic.gov.au/regulatory-resources/find-a-document/reports/rep-492-a-market-that-is-failing-consumers-the-sale-of-add-on-insurance-through-car-dealers/>

## Market-wide solutions to increase competition

As a starting point, competition in the banking sector must be closely investigated and the factors stifling demand-side competition addressed.

In its response to the Financial System Inquiry's final report, the Federal Government committed to introduce competition into ASIC's mandate by end of 2016 and to task the Productivity Commission to review the state of competition in the financial system beyond 2016.<sup>13</sup> Both actions would be important steps forward and they should be prioritised. As an alternative, the House of Representatives Economics Committee has proposed that the ACCC be tasked with reporting on the state of competition in the banking sector every six months; CHOICE would support this alternative approach if the ACCC was provided with additional funding to complete the work and focused on demand-side challenges.

Regulators in the United Kingdom have been focused on issues of competition within the banking sector, with reviews and specific tests leading to tangible change and an understanding of long-term reform required to the sector. Australia would benefit from a study like the UK's Competition and Market Authority's 2016 'Making banks work harder for you' report, which recommended a suite of proposals to address the dominance of incumbents in the UK banking sector, from better governance, use new technology and changes to disclosure to consumers.<sup>14</sup> This study could be conducted by the Productivity Commission or the ACCC.

In addition to a broad study into competition, Australian regulators should again borrow approaches applied in the UK and invest in trials to improve consumer engagement and understanding of specific products through effective disclosure. For example, the Financial Conduct Authority in the UK has:

- Partnered with a large financial institution to test the effect of switching behaviour for over 20,000 customers with savings accounts using targeted and timely reminders.<sup>15</sup>
- Partnered with home and motor insurers to conduct trials with 300,000 customers to test improved renewal notice formats. They found that placing last year's premium on

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<sup>13</sup> Federal Government (2015), *Improving Australia's Financial System, Government response to the Financial System Inquiry* [http://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://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>14</sup> Competition and Market Authority (2016) 'Making banks work harder for you'

[https://www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/544942/overview-of-the-banking-retail-market.pdf](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/544942/overview-of-the-banking-retail-market.pdf)

<sup>15</sup> Financial Conduct Authority, (January 2015), *Occasional Paper No. 7, Stimulating interest: reminding savers when to act when rates decrease*.

renewal notices caused 11-18% more consumers to switch or negotiate their home insurance policy.<sup>16</sup>

- Obtained data about over 500,000 customers across two banks to demonstrate that the use of text alerts and mobile applications could reduce reliance on costly unarranged overdrafts by 24%.<sup>17</sup>

Financial institutions are heavily investing in marketing and data insights to better capture and keep customers, not always to the clear benefit of customers. Regulators need to keep up with these data-driven approaches. Australian consumers would greatly benefit from similar studies, ideally conducted by a regulator with the power to act on findings about effective disclosure. To achieve this, ASIC should be given additional funding for field tests and data analysis.

## Recommendations

- Competition is added to ASIC's mandate as soon as possible.
- The Treasurer direct the Productivity Commission to review the state of competition in the financial system, focusing on specific issues with savings, home loan, secured loans, insurance and investment products as credit card issues have been well explored in other processes.
- ASIC is provided with additional funds to conduct field tests and mass data analysis to improve product disclosure across the banking sector.

## Credit cards: a competition case study

Credit cards have been the focus of government inquiries over the last two years. As a result, we have a better understanding of the specific failings of this part of the banking sector as well as specific solutions to address consumer harm. This demonstrates the value of focusing on competition issues by product category. Ultimately, savings products, home loans and insurance products should receive the same attention as credit cards to address the wider consumer harm outlined in the section above. In the short-term, government and industry have a clear role to play to address known consumer harm caused by a lack of competition in the credit card market.

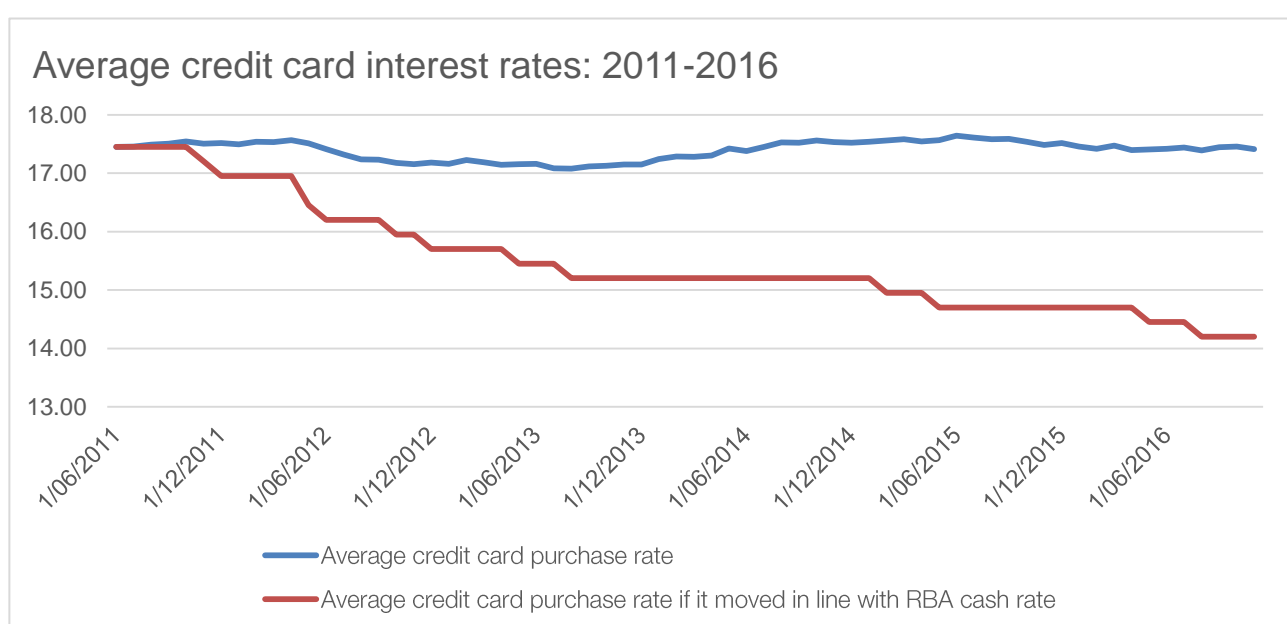
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<sup>16</sup> Financial Conduct Authority (December 2015), *Occasional Paper No.12, Encouraging consumers to act at renewal: evidence from field trials in the home and motor insurance markets*.

<sup>17</sup> Financial Conduct Authority (March 2015), *Occasional Paper No. 10, Message received? The impact of annual summaries, text alerts and mobile apps on consumer banking behaviour*.

Using data supplied by comparison site Mozo, CHOICE replicated our 2015 assessment of trends in the credit card market from June 2011 (the point when card interest rates largely stopped responding to movements in the official cash rate).<sup>18</sup>

The data shows that consumers have been getting a progressively worse deal on credit card products since 2011, and even though significant pressure has been placed on the banking sector in the last two years, credit card products have not improved.



Source: Mozo data

## Credit card interest rates

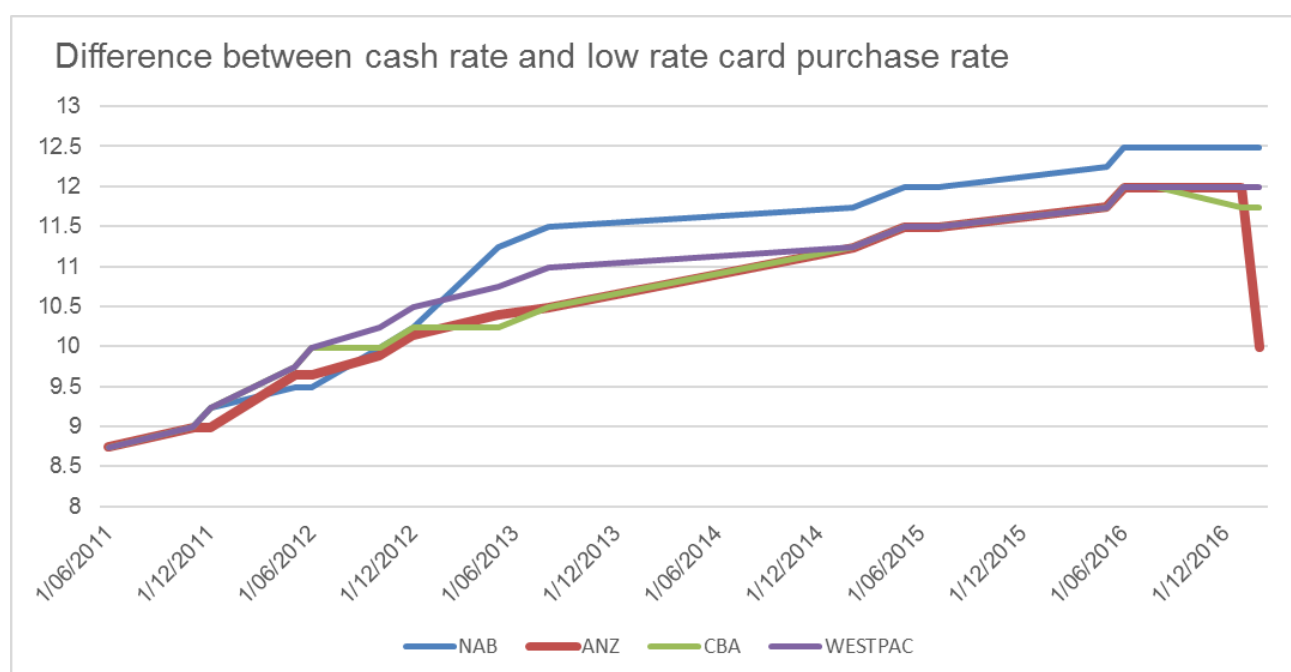
The Reserve Bank has cut the official cash rate by 3.25% since June 2011 but Australian credit card holders have seen no relief in the form of cuts to credit card purchase rates. The average credit card interest rate has dropped only slightly over the last five years from 17.41% to 17.35%. If banks moved rates in-line with the RBA cash rate, the average credit card interest rate would be 14.2%.

<sup>18</sup>The original assessment is available in CHOICE's submission to the Senate Economic Committee's Inquiry into Matters Related to Credit Card Interest Rates (submission 10) [http://www.apf.gov.au/Parliamentary\\_Business/Committees/Senate/Economics/Credit\\_Card\\_Interest/Submissions](http://www.apf.gov.au/Parliamentary_Business/Committees/Senate/Economics/Credit_Card_Interest/Submissions)

Consumers are paying the price in this high interest credit card environment. As of November 2016, the total value of credit card balances accruing interest was \$32.2 billion.<sup>19</sup> If credit card interest rates had moved in line with the Reserve Bank cash rate over the last four years, Australian credit card holders would have paid \$3.49 billion less in interest since mid-2011.

## Margins on low rate credit cards

The average credit card rate is now 11.5 times higher than the cash rate. The margin or gap between the average credit card rate and the cash rate is now 15.85%. This margin is particularly galling on 'low rate' credit cards offered by the major banks.



Source: Mozo data

Low rate credit cards do not have other features that contribute to the cost of the card for the provider, such as added travel insurance, rewards points or zero currency conversion fees. Low rate cards are no-frills products and should be the most likely to respond to changes to a major cost input like the official cash rate. However, as the graph above shows, the gap between the cash rate and the purchase rate on 'low rate' credit cards from the big four banks

<sup>19</sup> RBA Credit and Charge Card Statistics C01 12/01/2017.



has increased dramatically since 2011 as purchase rates have remained largely static. Even though ANZ has very recently cut the interest rate on their low rate card, from 13.49% to 11.49%, there is still a larger gap between the RBA cash rate and the ANZ interest rate today than in 2011.

## Consumers perspectives on credit card interest rates

Credit card debt can cause consumers major financial and personal harm. As noted above, harm is not spread equally across the population. Low-income households hold higher debt, are more likely to carry credit card balances forward and incur ongoing interest payments than high income households.<sup>20</sup>

We asked CHOICE supporters to tell us about their experiences with credit cards. Consumers describe their relationship with their bank as one-sided. They see the high fees and interest that can occur for accidental or infrequent failures to pay as very unfair and they know that credit card debt can be the trigger for financial detriment or even bankruptcy. Here are some perspectives from CHOICE supporters:

- *Due to these ridiculous interest rates I just cannot get on top of my accounts. Then when I can't pay them on time they hit me with an exorbitant fee that puts me further behind the eight ball.*
- *My son had to go bankrupt because the Commonwealth bank allowed him credit of \$50,000 although they had on record that his net income was no more than \$600 per week.*
- *The fees and interest charges are outrageous. There is no recognition of years of loyalty, and very little transparency.*
- *I was offered a credit card while on the dole and in a year spent to the limit. I took five years to finally get rid of the rolling debt and cost several times the original debt.*
- *Banks phoning my son who is unemployed to encourage him to buy using his GE Credit Card. He is over 21, but has difficulties. The interest rate was 29%. I was luckily able to intercept one of the calls and warn the off. But I am not sure if they know his mobile phone number so am still anxious about GE Credit and what situation they are putting my son in.*
- *Yes, too often I find myself being hit with over limit fees and late fees simply because I went over by a few dollars and I was a day or two late in making the monthly payment.*

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<sup>20</sup> From Treasury (2016), *Credit cards: improving consumer outcomes and enhancing competition*, Over 15 per cent of credit card users in the lowest income quartile were likely to persistently revolve credit card balances (and, therefore, pay interest), compared to less than 5 per cent of users in the highest income quartile (Reserve Bank of Australia, 2015).

*This is no more than exploitation by the banks. The interest rates verge on pay day lender rates and unconscionable given the low prevailing official rates.*

## Poor demand-side competition as a primary driver of consumer harm

There is little issue with supply in the Australian credit card market. Consumers have hundreds of options available to them and typically can choose between many cards in just one institution. However, most consumers are with institutions with the highest-cost and lowest-value products.

CHOICE undertook consumer research in 2015 and found that the credit card market was highly concentrated and consumers struggled to understand products or switch.<sup>21</sup> The key findings from this research were that:

- Nearly eight in ten consumers (77%) had their primary credit card with one of the big four banks or sub-brand owned by the big four (like St George or UBank).
- Over seven in ten consumers (72%) had not considered switching credit cards in the last two years. 17% considered switching had not; only 11% had switched in the last two years.
- Consumers who did switch were largely influenced by sweetheart deals that have high revert rates and fees. 29% switched for an interest free period and 29% switched for a balance transfer deal.
- Most people didn't know or understand the key cost-drivers of credit cards. Over 64% of consumers didn't know their interest rate. Over half (54%) said they didn't know or answered incorrectly when asked about the meaning of the minimum monthly payment on their credit card statement.

CHOICE has raised concerns about the lack of demand-side competition in the credit card market for some time. These concerns have been recognised by the Senate Economics Committee in the 2015 inquiry into credit card interest rates<sup>22</sup> and the Federal Treasury.<sup>23</sup>

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<sup>21</sup> CHOICE, survey into consumer use and understanding of credit cards, July 2015. This survey was conducted among 1,679 Australians aged 18-75 years. Of these, 1,244 have at least one credit card. Quotas were set up to ensure the final sample is representative of the Australian population by age groups, gender and state, data was weighed to the latest ABS population data (Census 2011). Fieldwork was administered and managed by GMI-Lightspeed who is a member of AMSRS and abides strictly to codes of conduct for market research and panel management in Australia. Fieldwork commenced on 23rd July, 2015 and completed on 29th June, 2015. Data has been significance tested at 95% confidence level.

<sup>22</sup> Paragraph 4.18 "...helping consumers accurately and easily value and compare credit cards is an important factor in improving the ability and incidence of consumers pursuing better value credit card options. Empowering consumers in this manner is also likely to help create a stronger competitive focus on the pricing of credit cards." , Senate Economics Committee (2015), *Interest rates and informed choice in the Australian credit card market* [http://www.aph.gov.au/Parliamentary\\_Business/Committees/Senate/Economics/Credit\\_Card\\_Interest/Report](http://www.aph.gov.au/Parliamentary_Business/Committees/Senate/Economics/Credit_Card_Interest/Report)

There is no one solution to this problem; instead a series of interventions are needed to stimulate demand-side competition. Reforms should make it easier for consumers to compare the true cost of credit card products, to understand their costs each month and to make it easier to switch cards.

## Improving consumer understanding of credit cards

Treasury has proposed a series of tests and interventions to improve consumer understanding of credit card products. For example, currently most credit card products don't include information about interest rates and annual fees in advertisements or prominently on statements. To address this, Treasury has proposed tests to require card issuers to give better information about the annual costs and to clearly display annual fees on statements and disclose interest rates and annual fees in advertising.<sup>24</sup>

CHOICE is extremely supportive of Treasury's recommendations. In particular, CHOICE supports Treasury's consideration of the adequacy of credit card minimum repayments. Currently, credit card providers assess whether a consumer can afford to pay minimum repayments on credit card debt (typically 2% or \$20, although there is no required standard). This leads to many consumers being saddled with high-cost, high-interest debt that they can service without going bankrupt but will be stuck with for years or decades. Assessments of suitability for credit cards should instead be based on whether a consumer can afford to repay the full credit limit in a reasonable period without suffering significant financial hardship.

To CHOICE's knowledge, work on credit card reforms hasn't progressed since mid-2016. Treasury needs to release information on the progress of reforms as soon as possible and begin to test and implement permanent reforms.

## Recommendation:

- Treasury prioritise work on credit card information reforms and release Final Assessment Regulation Impact Statement (RIS) associated with the proposed reforms as soon as possible.

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<sup>23</sup> Treasury (2016), *Credit cards: improving consumer outcomes and enhancing competition*, p.8-10.

<sup>24</sup> Treasury (2016), *Credit cards: improving consumer outcomes and enhancing competition*.

## Designing products to allow switching and card cancellation

Right now, it is quite easy for consumers to get into debt with a credit card but disproportionately hard to get out of debt. The big four banks have quick online application forms to get a credit card or increase debt limits, sometimes with answers provided in sixty-seconds, yet none offer comparable online cancellation options. It appears banks have deliberately left cancellation systems in a pre-internet era to act as a barrier to switching.

Bank	Steps needed to cancel a credit card
ANZ	<ul style="list-style-type: none"> <li>• Call or write to ANZ.</li> <li>• Return the card: “ANZ will only cancel the credit card when the account holder has returned it to ANZ cut diagonally in half (including any chip on the card) or has taken all reasonable steps to return it to ANZ.”<sup>25</sup></li> <li>• Any additional funds will be returned by bank cheque.</li> </ul>
CBA	<p>No instructions are provided for card cancellations in the CBA credit card conditions of use document.<sup>26</sup> Customer service representatives instructed CHOICE to call the credit card team to cancel. The team can only be contacted between Monday-Friday 9am – 5.30pm.</p> <p>CBA has announced that they are developing an online cancellation option.</p>
NAB	<ul style="list-style-type: none"> <li>• Call, write “or otherwise advise NAB in a manner acceptable to NAB”.</li> <li>• Cut the card diagonally in half.</li> <li>• Additional funds will be returned by bank cheque. NAB will charge its “usual fee” for issuing the cheque. Cash out is only available for amounts under \$5.<sup>27</sup></li> </ul>
Westpac	<ul style="list-style-type: none"> <li>• Call, write or visit a Westpac branch.</li> <li>• Promise to destroy the card.</li> <li>• Additional funds are paid by bank cheque or directed into another account by direct debit.<sup>28</sup></li> </ul>

Although it isn’t specified in the NAB terms and conditions, NAB claims it also offers an online cancellation option – this is an online form that allows users to send an email to the bank on a

<sup>25</sup> Clause 31, ANZ Credit Cards Conditions of Use updated 20.6.2016, <https://www.anz.com.au/content/dam/anzcomau/documents/pdf/anz-creditcards-conditions-of-use.pdf>

<sup>26</sup> Commbank Credit Card Conditions of Use, updated 1.12.2016 <https://www.commbank.com.au/content/dam/commbank/personal/apply-online/download-printed-forms/CC2-01062010.pdf>

<sup>27</sup> Clause 17, NAB Credit Card Terms and Conditions, updated 07.11.2016 <https://www.nab.com.au/content/dam/nabrdw/personal/banking/documents/nab-credit-cards-ics.pdf>

<sup>28</sup> Clause 13.1, Westpac Combined Conditions of Use Credit Guide, updated 28.10.2016 [https://www.westpac.com.au/content/dam/public/wbc/documents/pdf/pb/Consumer\\_Conditions\\_of\\_use.pdf](https://www.westpac.com.au/content/dam/public/wbc/documents/pdf/pb/Consumer_Conditions_of_use.pdf)

range of topics. A response is promised within three days. This is not equivalent to the online application process that offers an answer in sixty-seconds.

Customers end up paying when they don't cancel a card, even if they aren't using it. The average annual fee for a credit card is \$118 but on a big four credit card it is \$146. The average annual fee for a mutual or customer owned bank card is much lower at \$58.<sup>29</sup>

CHOICE identified the cancellation trap for credit cards in August 2015. The Treasurer announced reforms to require banks to offer online credit card cancellation on 6 May 2016.<sup>30</sup> Given that banks have had close to two years to voluntarily address the online cancellation issue, we believe it is now time for the Federal Government to act and introduce legislation that will require banks to offer online cancellation options to customers.

Consumers also need to be given support when switching credit card accounts through initiatives to cancel or move direct debits on credit cards. Currently, if someone wants to switch credit cards, they need to contact all businesses they have direct debit arrangements with to notify each one of the change. Card providers should accept requests directly from customers to cancel direct debits at any time and provide an automated option to transfer all direct debits. A 'tick and flick' process for direct debit transfers was introduced for transaction accounts in 2012. It is rarely used as it is not promoted by banks. To combat this problem, we recommend testing the impact of requiring information about switching credit card products, including direct debit transfers, on a credit card statement and in other key pieces of communication to a customer.

## Recommendation:

- That the Federal Government introduce legislation to facilitate online credit card cancellation. We suggest an amendment to sections 133BA-133BR of the National Consumer Credit Protection Act 2009 that states:
  - Cancellation of credit card contracts
    - (1) Credit card contracts must be able to be cancelled through a one-step process.

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<sup>29</sup> Data provided by Mozo.

<sup>30</sup> Treasury (2016), *Credit cards: improving consumer outcomes and enhancing competition*.

- (2) The cancellation process must be provided on any platform that the card provider offers card services including websites and online applications.
- The Federal Government pursues a suite of initiatives to allow consumers to cancel or easily switch direct debits on credit cards, including:
  - legislation to establish a ‘tick and flick’ switching process to allow customers to easily transfer direct debits to a new credit card. The process should be offered online and in-branch.
  - test a requirement that credit card statements include information about direct debit cancellation and switching processes.

## Access to data to stimulate competition

Access to data is a major game-changer for consumer interaction with all banking products, and particularly credit cards. The Productivity Commission is currently considering recommending the creation of a new legal right that would let consumers access the transaction and consumption data held about them. If this is provided in a secure and sharable format, consumers can work with third-parties to better understand their products or switch to better options.

For example, third party services could address one of the main reasons why consumers don’t switch credit card products: they want to keep all accounts in the one place. 26% of people said the most important factor behind their current choice of credit card was that it was provided by the same bank they had other accounts with. 24% haven’t switched cards because they want to keep all accounts with the one bank.<sup>31</sup> A growth in services that let consumers aggregate data about multiple products in one secure place online would address this concern about switching.

To facilitate these kind of services, two changes are needed. First, consumers need a legislated right to access data held about them as proposed by the Productivity Commission. Second, regulations need to be updated to guarantee security for consumers using trusted services. ASIC’s epayment code is currently voluntary. There is a strong case for mandating the code as it outlines essential protections for consumers in an online world, such as who is responsible in the case of a security breach.<sup>32</sup> In addition, the code currently leaves consumers

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<sup>31</sup> CHOICE, survey into consumer use and understanding of credit cards, July 2015. This

<sup>32</sup> <http://asic.gov.au/regulatory-resources/financial-services/epayments-code/>



in a grey-area with security protections if they share their banking information, even with trusted and secure third-party services. Currently, consumers may not receive protections under the epayments code if they share their banking details with services that their bank does not endorse. Banks are unlikely to endorse third-party services that introduce greater competition into the credit card or other aspects of the personal banking market. To address this, ASIC should create a list of third-party services that meet security standards that consumers should be able to share their details with without losing security protections.

## Recommendations:

- The epayments Code is reformed from a voluntary code of practice to a mandatory code of conduct for all parties offering payment services.
- The epayments Code is amended to clarify that consumers can share their information with an ASIC approved list of secure third-party services.
- Consumers are given a legal right to access their own transaction and consumption data in a useful format.

## 2. LIFTING PROFESSIONAL STANDARDS AND REMOVING CONFLICTS

Consumers rely on information and advice to navigate the complexities of the financial system. This can range from information about what's covered with an insurance product to assistance obtaining a home loan to personal financial advice about investing. These interactions are essential to bridge the information gap between consumer and product provider, but as the interactions are often between a consumer and a salesperson (or at least a party that stands to gain financially), consumers frequently receive information and advice that is not in their best interests.

To address this, the Federal Government needs to intervene to lift the behaviour of professionals in the financial sector and to address conflicts that pit consumer interests against those purporting to assist them.

The financial services sector is riddled with conflicts that work against consumer interests. Some are being addressed through discreet reviews or legislative reform, but others are not. This section outlines major gaps in current protections and proposed interventions. However, there is one system-wide gap that leaves consumers exceptionally vulnerable: there is no 'product safety' system for financial services. Right now, there generally aren't protections to stop the sale of objectively poor value products or products that are poorly designed or sold to an audience that will be harmed by that sale.

Currently, the Treasury is consulting on the detail of new powers for ASIC Product Intervention Powers (PIP) and Design and Distribution Obligations (DADO) that would require product creators and issuers to take greater responsibility for what they sell. It is essential that these reforms progress quickly and that the powers apply to the broadest possible range of products and institutions in the financial sector. This would progress protections in the financial sector from the disclosure-driven regime we have today, where it is up to consumers to figure out if they are being sold a harmful product, to a new regime that holds financial institutions accountable for the products they issue.

## Financial advice

Financial advice must be a service, not a sales pipeline. CHOICE considers the current level of consumer protections for financial advice to be the minimum required. The *Corporations Act 2001* (the Act) provides the following protections for consumers seeking financial advice:<sup>33</sup>

- A requirement that advisers act in a client's best interest.<sup>34</sup>
- A ban on most, but not all, forms of conflicted remuneration that distort the recommendations made by advisers.<sup>35</sup>
- A ban on misleading, deceptive or dishonest behaviour.<sup>36</sup>
- A requirement for advisers to contact their clients every two years to determine if they wish to continue to pay ongoing fees for advice (known as the opt-in requirement) and to issue annual fee statements.<sup>37</sup>
- A requirement to disclose information to consumers about the services available and the advice received.<sup>38</sup>

Most protections were introduced or strengthened by the Future of Financial Advice (FoFA) reforms. More recently, the Federal Government has passed legislation to lift professional standards in the advice sector and limit some aspects of remaining commission payments. Still, there remain several gaps in the consumer protection framework for financial advice that should be strengthened.

## Life insurance advice

A notable gap in current protections is the exception that allows advisers to receive commissions on life insurance. A 2014 ASIC review of retail life insurance advice found high levels of churn. 37% of advice failed to prioritise the needs of the client and comply with the law. High up-front commissions are strongly correlated with poor advice; 45% of advisers who were paid through up front commissions failed to comply with the law.<sup>39</sup>

Advisers selling life insurance can receive commissions as high as 120% of the product value. As a result, consumers are frequently sold life insurance products that don't meet their needs.

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<sup>33</sup> In addition to legislative requirements advisers also have obligations to clients under the general law tort of negligence and fiduciary obligations.

<sup>34</sup> This is primarily located in s961B of the Corporations Act 2001 but further defined in s961E and regulatory guidance. See ASIC (2014), *Regulatory Guide 175, Licensing: Financial product advisers Conduct and disclosure (RG175)*.

<sup>35</sup> Part 7.7A, Division 4 of the Act.

<sup>36</sup> See s1041E-H of the Act.

<sup>37</sup> Largely contained in s962 and s1317 of the Act.

<sup>38</sup> Part 7.7 of the Act.

<sup>39</sup> ASIC (2014), *Report 413: Review of retail life insurance advice*, pp. 5-7.

The Federal Government has passed new legislation that as it is phased in will reduce, but not eliminate, these commissions. What consumers need now is a clear plan to remove commissions from life insurance advice all together.

## Clarity about adviser connections to financial institutions

Consumers also remain confused about adviser independence. A 2014 Roy Morgan study found that consumers are extremely confused by multi-branding of financial advice businesses. 55% of clients of Financial Wisdom, owned by CBA, thought their adviser was independent. Similarly, 50% of clients of Godfrey Pembroke (NAB), 48% of clients of Charter FO (AMP) and 37% of clients of RetireInvest (ANZ) perceived their adviser to be independent.<sup>40</sup>

Surprisingly, 13% of ANZ, 20% of St George and 14% of Commonwealth clients perceived their advisers to be independent even though they clearly work for a major institution.<sup>41</sup> This likely links to how advisers represent themselves and their services. Financial advisers often present as professionals able to guide consumers through difficult decisions and meet financial goals. Major institutions state that they offer the best and most effective advice, implying that the full range of products across the market and strategies beyond product recommendation are considered when this may not be the case.

Because of the greater likelihood of being steered into an aligned product, there must be greater clarity for consumers regarding the differences between independent and aligned advisers. One option is for Australia to adopt the UK system of labeling advisers either restricted or independent. CHOICE believes that this move could greatly benefit consumers but to find the most meaningful term for Australian consumers, CHOICE would like to see independent consumer testing of any changes to the way in which advice is labeled. At minimum, the Committee should call for better transparency and disclosure of aligned advice through increased public branding, as suggested by the Final Report of the Financial System Inquiry.<sup>42</sup>

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<sup>40</sup> Roy Morgan Research, August 2014, *Confusion with Financial Planner Independence Continues*: <http://www.roymorgan.com/findings/5716-confusion-with-financial-planner-independence-201408040221>

<sup>41</sup> Ibid.

<sup>42</sup> FSI Final Report, Rec 40 p 27.

## Ongoing (or grandfathered) commission arrangements

Grandfathered commissions are commissions from arrangements that pre-date the FoFA reforms. On average, one third of financial advice licensees' total income in 2014 came from grandfathered benefits. This income tends to be a greater proportion of the revenue of large licensees like the big four banks.

Advice firms continue to receive substantial funds from 'grandfathered benefits' including trail commissions. On average, one-third of financial advice licensees' total income in 2014 came from grandfathered benefits and this income tends to be a greater proportion of large licensees' revenue streams.<sup>43</sup> To put this into perspective, in 2014 Commonwealth Bank financial planning businesses made a total income of \$829 million.<sup>44</sup> A third of this income equates to \$273.6 million. Action is needed to address this ongoing harm – the longer it continues, the more consumers will lose for fees for no service.

## Ongoing conflicted remuneration: asset-based fees

Asset-based fees are ongoing fees calculated as a percentage of the total funds under advice. Financial advisers are currently allowed to receive asset-based fees but these fees encourage advisers to direct clients into certain types of investments over others, such as managed investment schemes over real estate. They are significantly less transparent than fixed fees for advice and encourage business models in which a client continues to pay a fee long after they have received advice. Fixed fees for advice, either hourly rates or lump sums, remove these failings, as demonstrated in the table below.

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<sup>43</sup> ASIC (2014), *Report 407: Review of the financial advice industry's implementation of the FOFA reforms*, p. 31. Note, this figure is based on a limited sample of 48 licensees but it is the only publicly available data on grandfathered income.

<sup>44</sup> See Commonwealth Bank (2014), *Annual Report 2014* p. 15. NB: Colonial First State income incorporates all income from financial planning businesses at CBA.

<b>Failing</b>	<b>Level of Risk</b>		
	<b>Commissions</b>	<b>Asset-based fees</b>	<b>Fixed fees</b>
Adviser incentivised to recommend sale of non-financial assets (like real estate) to invest in financial assets	High	High	None
Adviser incentivised to recommend gearing	High	High	None
Adviser biased against liquid/safe assets which pay low or no commissions	High	Moderate	None
Lack of transparency in total remuneration to the adviser	High	Moderate	None
Value of advice relative to the cost of the advice is difficult for client to determine	High	Moderate	None
Adviser incentivised to recommend inappropriate products with big commissions	High	None	None

To protect consumers and strengthen industry, all remuneration-based conflicts of interest should be removed from financial advice. CHOICE believes that commissions, soft-dollar payments, asset-based fees, and any other form of remuneration that incentivises advisers to recommend a product or volume of products must be removed. As a starting point, current exemptions to the conflicted remuneration ban should be removed from the Corporations Act.<sup>45</sup> The Committee should recommend an extension of the ban on conflicted remuneration to asset-based fees.

## Recommendations

- ASIC develops a plan to completely phase-out commissions for personal advice on life insurance.
- The Federal Government should legislate to require that advisers prominently disclose whether they are truly independent or aligned with a financial organisation. The exact terms for disclosure should be based on consumer testing.

<sup>45</sup> As defined in s963B(a-b), s963C(a), s963D of the Act.



- The Federal Government mandates a phase-out period for commissions that were grandfathered under the FoFA legislation and regulation.
- Current exemptions to the conflicted remuneration ban should be removed from the Corporations Act and the ban extended to cover asset-based fees received by advisers.

## Property investment advice

Currently, property investment advice is not considered to be personal financial advice. It is not covered by the Corporations Act and consumers don't have equivalent protections against poor behaviour from spruikers. This issue has been the subject of more than two decades of state, federal and multi-jurisdiction reviews in Australia, most recently summarised in the report from the Scrutiny of Financial Advice Inquiry from the Senate Economics Committee.<sup>46</sup>

It's still common to see property investment seminars offering free "education" or "wealth creation" strategies, often a thinly veiled strategy to lure customers into high pressure selling events. The property spruiking sector is so detrimental to consumers that Australian regulators recommend that consumers do not attend seminars.<sup>47</sup>

Property can be a sensible investment option. But because property investment is not regulated like other kinds of investments, consumers are left exposed to shonky behaviour with little protection.

CHOICE supports the recommendations from the Scrutiny of Financial Advice Inquiry and calls for legislative change to treat property investment advice like all other investment advice under the Corporations Act. Property investment advisers should be required to hold a licence, meet basic education and professional standards, belong to an external dispute resolution service, not accept harmful conflicted remuneration and to act in the best interests of their clients when providing personal financial advice.

## Recommendations:

- That the Federal Government, in consultation with the states and territories, brings the regulation of the property investment industry into line with regulations applicable to the financial investment industry by:

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<sup>46</sup> Senate Economics Committee (2017), *Scrutiny of Financial Advice, Report 1*:  
[http://www.aph.gov.au/Parliamentary\\_Business/Committees/Senate/Economics/Scrutiny\\_of\\_Financial\\_Advice/Report/c08](http://www.aph.gov.au/Parliamentary_Business/Committees/Senate/Economics/Scrutiny_of_Financial_Advice/Report/c08)

<sup>47</sup> <http://consumerlaw.gov.au/spruikers/>

- making the regulation of property investment advice a Commonwealth responsibility (recognising that services provided by licensed real estate agents would remain under state and territory regulation);
- inserting a definition of property investment advice into the Corporations Act and the Australian Securities and Investments Commission Act; and
- requiring that anyone providing property investment advice should hold an Australian Financial Services Licence.

## Mortgage broking

CHOICE is concerned that some consumers do not get the service they expect when they visit a mortgage broker. Advertisements for brokers claim that they will find customers the right loan, provide tailored advice or get a great loan for the client. However, their actual obligation to clients is quite low – brokers have to help arrange a ‘not unsuitable’ loan. We believe this standard needs to be lifted, especially as mortgage brokers are involved with a growing share of the home lending market.

At the time of writing, ASIC has not released its upcoming report into the impact of mortgage broker commissions. This report should be considered by the Committee to determine if remuneration arrangements for brokers lead to poor consumer outcomes and if regulatory or legislative intervention is required.

## CHOICE research shows brokers may be putting clients at risk

Preliminary research from CHOICE indicates that some brokers are not recommending good quality loans and may be providing advice to customers well beyond what’s needed to arrange a home loan.

In 2015, CHOICE conducted a shadow shopping exercise where we sent five customers looking for a home loan to three brokers each (15 brokers total). We found:

- Risky borrowing suggestions – one broker advised a home owner who wanted to refinance her home loan and is in an unsecure employment situation to use the equity in her home to invest in new property or go on a holiday. Another broker advised a couple to borrow \$1 million against their home when they only needed \$600,000 to buy an investment property.
- Recommendations weren’t always based on quality – one broker pushed his own company’s product even while acknowledging that other lenders offered a cheaper loan.

- Poor disclosure - only two of the fifteen brokers explained unprompted that they received commissions and which lenders they deal with.
- Little discussion of long-term risk - no broker had a conversation about capacity to pay should interest rates rise.

This shadow shop indicates that there are problems for consumers, likely stemming from broker commission arrangements or institutional ownership.

Following the shadow shop, in July 2016, we asked a nationally representative sample of Australians if they had seen a mortgage broker in the last six years. We asked those people who had seen a broker about their experience.<sup>48</sup> We note that the sample size of this research is relatively small: 280 people had seen a broker in the last six years, the majority (170) had seen a broker in the last two years. Given this, these findings should be taken as an indication of likely behaviour from brokers but not definitive percentages of the activity.

	Yes	No	Don't recall
The mortgage broker told me how they were paid	48%	35%	17%
The mortgage broker gave me information about how loans work	58%	28%	14%
The mortgage broker explained the risks of different kinds of rate options (e. g. fixed, variable, interest-only)	53%	35%	12%
I trusted that the mortgage broker was acting in my best interests	61%	25%	14%
The mortgage broker gave me advice about finding a property that met my needs	41%	45%	13%
The mortgage broker gave me advice about how much I could afford to borrow	64%	25%	10%
The mortgage broker gave me advice about non-property investments	24%	60%	15%
The mortgage broker helped me create a long-term strategy to buy investment properties	33%	54%	13%
The mortgage broker helped me use my superannuation to buy property	20%	65%	15%
The mortgage broker advised me on how to use investment property to manage my money in retirement	30%	56%	15%

<sup>48</sup> This question was asked as part of CHOICE's Consumer Pulse study. Consumer Pulse is a study conducted by CHOICE among a sample of 1025 respondents aged 18-75 years. The sample is a nationally representative of the Australian population, based on the 2011 ABS Census data. The study was conducted via an online self-complete survey in partnership with The ORU. The ORU is an ISO 20252 / ISO 26362 accredited panel provider and full AMSRO member. Fieldwork was undertaken from 21 to 29 July 2016.

The results are concerning. Many people appear to have been given limited information. About a third of people said a broker did not tell them how they were paid. We are also worried about the nature of the information provided by mortgage brokers to consumers. Some brokers appear to have a financial advice-style relationship with their clients – they were discussing non-property investments (24%), long-term investment strategies (33%) and helping people make financial decisions linked to superannuation (20%) and retirement (30%).

Unless a broker is also a qualified financial adviser they should only be arranging a loan for consumers; they are not able to provide financial advice on or related to other financial products. It is incredibly worrying to see that some consumers are receiving guidance from brokers about non-property investments. It is also worrying, but perhaps less surprising, to find that some mortgage brokers are having conversations with their clients about superannuation, retirement and long-term financial security given the importance of housing to Australian's long-term financial well-being.

At minimum, we need to know much more about the nature of conversations between consumers and mortgage brokers. CHOICE recommends that ASIC conducts a much larger shadow shopping exercise to determine the scope of discussions that brokers have with clients as well as the quality of information and recommendations provided.

## Standards for mortgage broker behaviour must be lifted

Mortgage brokers must meet obligations *National Consumer Credit Protection Act 2009* (the Act).<sup>49</sup> A comparison of the obligations under this Act compared to the required behaviour for financial advisers under the Corporations Act shows that brokers are being held to a relatively low standard.

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<sup>49</sup> Section 8 of the Act defines the process of credit assistance as where a person suggests a consumer apply for, increase or remain in a particular credit contract or assists the consumer with an application or increase. Section 9 defines instances where a person 'acts as an intermediary' between credit providers and consumers. Both terms include the primary roles of a mortgage broker. For clarity, this paper uses the term 'mortgage broker' where the legislation refers to 'credit assistance providers' or 'intermediary'.

Financial advisers must...	Mortgage brokers must...
Be licensed or work for or be a representative of a financial services licensee.	Be licensed or work for or be a representative of a credit licensee. <sup>50</sup>
Gather detailed information to understand the financial situation of their client as well as their goals.	Make reasonable inquiries into client's requirements and financial situation, focusing on a client's ability to meet repayments (income and expenditure). <sup>51</sup>
Act in the client's best interests.	Make a preliminary assessment about whether a loan would be "not unsuitable (the client can afford to pay the loan without substantial hardship)" <sup>52</sup>
Disclose how they are paid but there are many restrictions on remuneration models known to cause consumer harm, like commissions.	Disclose how they are paid, although practically this may occur at the end of the loan arrangement process. <sup>53</sup>
Be members of an external dispute resolution system (such as CIO or FOS).	Be members of an external dispute resolution system (such as CIO or FOS).

Some industry associations do place additional requirements on their members but association membership is not compulsory for brokers. The major associations are the Mortgage and Finance Association of Australia (MFAA) and the Finance Brokers Association of Australia (FBAA). The FBAA Code includes a requirement for brokers to "Act in the best interest of the Client but in a manner consistent with the Finance Broker's appointment document and this Code".<sup>54</sup> It is unclear how this requirement applies to product recommendations, for example, if it requires brokers to arrange a high quality or the best loan for the client. The MFAA code has no requirement for brokers to act in the best interests of clients. It instead requires that brokers meet the lower standard of acting in good faith and adhering to the reasonable instructions of customers.<sup>55</sup> Both codes rely on complaints to address issues rather than a more comprehensive system of monitoring and enforcement.

<sup>50</sup> S 26 of the NCCP Act and Regulation 22, [http://www.comlaw.gov.au/Details/C2014C00411/Html/Text#\\_Toc393444815](http://www.comlaw.gov.au/Details/C2014C00411/Html/Text#_Toc393444815)

<sup>51</sup> s 117 of the NCCP Act.

<sup>52</sup> s 115, 123, 138 and 146 of the NCCP Act.

<sup>53</sup> s 113, 114, 121, 136, 137 and 144 of the NCCP Act.

<sup>54</sup> <https://www.fbba.com.au/wp-content/uploads/2016/10/Code-of-Conduct-2016-08-11.pdf>

<sup>55</sup> <https://www.mfaa.com.au/AboutUs/Governance/Documents/MFAA%20Code%20of%20Practice%20160904.pdf>

Consumers use brokers as guides for what is often their life's most significant financial decision - buying a home. Getting a poor loan, even if customers can afford to pay it, can have significant financial consequences, with consumers paying tens of thousands or even hundreds of thousands of dollars more over the life of a mortgage.

Given the important role that brokers play, they should all be held to a higher standard than arranging a "not unsuitable" loan for their customers. They should be required to arrange a good quality loan, preferably one in the best interests of their customers. This would require first clearly defining a mortgage broker in the National Consumer Credit Protection Act and then articulating new obligations that brokers would need to meet.

## Recommendations:

- ASIC conducts a large shadow shopping exercise to determine the scope of discussions that brokers have with clients as well as the quality of information and recommendations provided.
- The Committee considers lifting requirements for mortgage brokers. Specifically, the requirement to arrange a 'not unsuitable loan' should be lifted to require so that brokers have to arrange a loan in the best interests of their client.

## Remuneration for front-line staff

Australia's largest banks are financial services behemoths. Their business includes retail banking, card payments and services, mortgage broking, wealth management, and often, subsidiary brands.

When bank staff members are paid to sell, they will prioritise sales over service and customer care. Vertical integration exacerbates institutions' incentives to inappropriately cross-sell products as there are more opportunities to introduce different customer segments to different offers.

Inappropriate incentive schemes or performance measures that prioritise sales lead to consumer harm as people are sold products that they can't use, don't meet their needs or are high cost. Harm is exacerbated when consumers are sold products during service-based interactions, for example, when they call to ask a question about credit card cancellation but get told to upgrade to a card with more features, or when customers try to get service at a branch but are cross-sold insurance or credit products. These interactions are essentially unsolicited sales, as people are unprepared to assess information about products. Beyond



individual consumer outcomes, a sales-focused culture in banking encourages risk-taking and short-term outcomes, a contributing factor to mis-selling scandals and banking crises.

The Australian Banking Association is currently reviewing remuneration in retail banking. The interim report of the Retail Remuneration Review has found that “the risk of outcomes adverse to customers’ interests is more likely to be higher when targets are sales related than when they are genuinely service related.”<sup>56</sup>

The review cited examples of extremely worrying remuneration practices in unidentified banks that would lead to staff prioritising aggressive sales tactics over service. The most worrying practices outlined in the report were:

- One Manager scorecard entirely comprises financial targets. A weight of 50% is assigned to state sales, with the remainder related to the performance of the Manager’s own team. In relation to the Manager’s own team, the bonus is unavailable unless 60% of the team achieve or exceed their personal sales target with a further 20% achieving at least 80% of their personal target.
- One plan awards the individual \$45 for every percentage point achieved above the sales target and \$30 for every product that is cross sold above a cross-selling target
- An individual can receive up to \$500 per quarter solely by meeting cross-selling targets for Consumer Credit Insurance (CCI) and General Insurance (GI) products
- One customer-facing role can receive up to \$1,600 per quarter if their branch achieves two of the branch’s product sales targets and cross-selling targets. Unless the branch meets its targets, however, each individual will be denied the reward they would otherwise receive for having met their individual sales targets (that includes cross-selling targets). The relevant Manager also receives a reward payment if the branch’s product sales and cross-selling targets are met.

Specific institutions are not identified in the interim Remuneration Review report. This means that there is little opportunity to assess whether the actual remuneration structures link to specific consumer outcomes.

At minimum, financial services providers should be required to report on performance indicators and incentive structures for staff with a customer facing role and their direct supervisor. This report should occur at least annually and be released publicly, preferably by a third-party like a regulator to allow comparisons between the data. This transparency will

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<sup>56</sup> Sedgwick, Ian (2017), *Retail Remuneration Review: Issues Paper*, p.41. <http://retailbankingremreview.com.au/wp-content/uploads/2017/01/Issues-Paper-Retail-banking-remuneration-review.pdf>

ensure that banks and other major institutions are held publicly accountable in the long-term for the culture they create, whether that's a sales focused culture or a service focused culture. The transparency will also allow other parties, such as regulators or groups like CHOICE that review products, services and institutions, to incorporate information about staff incentives into assessments of institutions and their products.

### Recommendation:

- Financial services providers should be required to publicly report on performance indicators and incentive structures for staff with a customer facing role and their direct supervisor

## 3. SUPPORT SERVICES FOR CONSUMERS

### Funding for not-for-profit support services

The not-for-profit sector provides essential support services for consumers who have been harmed by poor conduct from financial institutions. The most essential services are financial counselling and legal assistance through community legal centres. Across Australia, these services are relatively underfunded and many consumers who need assistance are turned away or put on waiting lists for help.

Support for community legal services and financial counselling could be bolstered by extending the proposed industry levy system for ASIC funding. The UK provides a credible international precedent for the funding of financial literacy and counselling services through a levy on financial service providers. In 2015-16, the UK Money Advice Service (MAS) allocated 40.7 million pounds to community based debt advice services across the UK.<sup>57</sup> These funds were derived from an industry levy collected by the Financial Conduct Authority. This model draws a direct link between the funding source of services (the financial services industry) and the use of that funding (customers of the financial services industry, who are in financial difficulty).

### Recommendation:

- Expand the proposed industry-funding model for ASIC to include funding for financial counselling and community legal services to assist consumers experiencing harm caused by the financial sector.

### Last resort compensation scheme

It is important that consumers can expect fair redress when a financial service provider breaks the law. There remain a number of instances where consumers have received a positive outcome through a court or ombudsman scheme like the Financial Ombudsman Schemes (FOS) but compensation has been not paid. A last resort compensation scheme is needed to

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<sup>57</sup> The Money Advice Service Annual Report and Accounts for the year ended 31 March 2016 p. 45. Available at: <https://www.moneyadviceservice.org.uk/en/corporate/publications#corporate-publications>

provide redress to consumers with a positive ombudsman determination or court action who could not receive funds from the financial services provider or through insurance.

CHOICE has consistently argued for establishment of a last resort compensation scheme, to provide compensation for consumers who have unpaid determinations from EDR bodies, and for other consumers who have experienced harm within the financial system without adequate redress. We note that this is currently being considered as part of the Ramsay Review.

## Recommendation

- That a compensation scheme of last resort for the financial sector is established.