

Chapter 4

Issues raised in the inquiry

4.1 This chapter provides an overview of some of the major issues raised in the inquiry about consumer protections in general and about specific sectors of the banking, insurance and financial services industry. These issues are considered in the context of evidence provided to the Financial Services Royal Commission and arguments put forward in its interim report. It should be noted that the list of issues arising from evidence as outlined in this chapter is by no means comprehensive; rather, the issues were selected to provide a 'snapshot' of areas in the industry that may require reform.

Issues in the consumer protection system as a whole

4.2 A number of the issues outlined in evidence to this inquiry concerned the consumer protection system as a whole. These included:

- insufficient professional indemnity insurance held by financial entities;
- the importance of resourcing financial counselling and legal services used by people from lower socio-economic backgrounds;
- a lack of documentation, whether written or phone records, outlining consumers' interactions with financial entities; and
- a lack of enforcement on the part of regulators.

Insufficient professional indemnity insurance

4.3 At the 22 February 2018 hearing in Melbourne, the committee heard from a number of representatives from the Holt Norman Ashman Baker Action Group, representing victims of firms associated with Peter Holt.¹ In 2012, the Australian Securities and Investments Commission (ASIC) banned Mr Holt from providing financial services for three years after it found that he had failed to comply with financial services regulations.² Mr Mark Korda, Managing Partner, Registered Liquidator, KordaMentha, noted that 'the principals in the business went into bankruptcy and the professional indemnity insurance was woefully inadequate to compensate the victims of that financial services practice'.³

1 See Ms Naomi Halpern, Private capacity, and Ms Susan Henry, Chair, Holt Norman Ashman Baker Action Group, *Committee Hansard*, 22 February 2018, pp. 35–44.

2 Australian Securities and Investments Commission (ASIC), '12-236MR ASIC Bans Victorian Financial Adviser for Failing to Comply with Financial Services Laws', *Media release 12-236MR*, 25 September 2012.

3 Mr Mark Korda, Managing Partner, Registered Liquidator, KordaMentha, *Committee Hansard*, 22 February 2018, p. 45; Holt Norman Ashmen Baker Action Group, *Submission 124*, pp. 25–26. See also, for example, Ms Carolyn Thomson, *Submission 78*, p. 7.

4.4 Some submitters suggested that expanded professional indemnity insurance could prevent problems arising, such as those faced by members of the Holt Norman Ashman Baker Action Group, because a financial services provider had held inadequate professional indemnity insurance.⁴

4.5 However, the Association of Financial Advisers argued that increasing professional indemnity insurance would lead to increased costs on the part of clients:

...the cost of operating under higher jurisdictional limits will ultimately be borne by advised clients. Raise the cost of providing advice too much...and you risk that the people who need financial advice most will not be able to afford it. This raises the spectre of possibility that accessibility to Ombudsman dispute resolution services may become more for the wealthy as wealthy people will only be able to afford to engage financial advisers in future.⁵

4.6 ASIC stated that although professional indemnity insurance does provide some buffer should a licensee be unable to pay claims because of insufficient funds, it is subject to 'significant limitations, including where there are insolvency issues or multiple claims against a single licensee'.⁶

4.7 The Financial Services Royal Commission's interim report did not discuss professional indemnity insurance. However, the Australian Financial Review has noted that misconduct in the financial sector has ignited:

...calls in some quarters for an independent oversight of remediation programs as well as the introduction of a compensation scheme of last resort for those who fall through the cracks when a licensee closes or the professional indemnity insurance cover is inadequate.⁷

Financial counselling and legal services

4.8 Evidence to the inquiry emphasised the importance of properly resourcing financial counselling and community legal services dealing directly with consumers experiencing failures in the consumer protection system.⁸ Ms Katherine Lane from the Financial Rights Legal Centre stated that financial counsellors often deal with the most vulnerable and disadvantaged members of the community who may need

4 See, for example, Australian Bankers' Association (ABA), *Submission 15*, p. 3; Ms Naomi Halpern, *Submission 123*, p. 25.

5 Association of Financial Advisers (AFA), *Submission 14*, p. 12.

6 ASIC, *Submission 36*, p. 98.

7 Adele Ferguson, 'Bank compensation schemes need scrutiny too', *Australian Financial Review*, 7 October 2018, <https://www.afr.com/business/banking-and-finance/bank-compo-schemes-need-scrutiny-too-20181006-h16ba3> (accessed 25 October 2018).

8 CHOICE, *Submission 19*, p. 7; Consumer Action Law Centre, *Submission 46*, pp. 26–27; Financial Ombudsman Service Australia, *Submission 51*, p. 8; Financial Rights Legal Centre, *Submission 52*, pp. 121–126; Broome Circle Financial Management Program, *Submission 54*, pp. 4–5; Name Withheld, *Submission 81*, p. 5.

assistance to make complaints online or over the phone to external dispute resolution (EDR) schemes.⁹ She described the case load of her insurance law service as follows:

As it stands...we cannot get to 50 per cent of calls, and for the national debt helpline we do not get to about 10 to 15 per cent. It is just hard to keep up with the demand. Community legal centres are going to be very busy in coming times. We have got to properly fund access to justice, and that includes legal aid as well.¹⁰

4.9 The Financial Rights Legal Centre submitted that all community legal services 'are currently working to capacity to provide assistance'.¹¹ The National Debt Hotline, which is run by the Financial Rights Legal Centre, received close to 25,000 calls from individuals seeking advice and assistance during the 2015–16 financial year. Matters related to insurance accounted for 7,500 calls and the remaining 17,000 calls were related to credit and debt problems, with credit card debt the most common cause of concern. This was followed by home loans, personal loans, car loans and energy debts.¹²

4.10 ASIC noted the importance of financial counselling and consumer casework services to its own work, given that these services identify problems in the market, take complaints directly to ASIC or the relevant EDR schemes, contribute to law reform and policy development, and directly engage with ASIC's stakeholder teams and in ASIC's Consumer Advisory Panel.¹³

4.11 Submitters stated that should consumers choose to take legal action against financial entities, including in instances where claims may be above the threshold permitted by an EDR scheme (such as in the case of small businesses and farm finance), legal costs may be prohibitive.¹⁴ One submitter argued that there are 'insurmountable obstacles against these behemoth financial institutions, which have the capacity to throw their limitless resources' into fighting consumer claims.¹⁵

Lack of documentation

4.12 A number of submitters stated that a lack of evidence such as documents or phone recordings following their interactions with financial entities had negatively

9 Community Legal Centres Queensland, Community Legal Centres New South Wales, South Australian Council of Community Legal Services, Federation of Community Legal Centres (Vic), Community Legal Centres Tasmania and Community Legal Centres Association (WA), *Submission 10*, p. 2; Caxton Legal Centre, *Submission 5*, p. 5.

10 Ms Katherine Lane, Co-Principal Solicitor, Financial Rights Legal Centre, *Senate Hansard*, 26 April 2017, p. 39.

11 Financial Rights Legal Centre, *Submission 52*, p. 126.

12 Financial Services Royal Commission, *Interim Report*, Volume 1, September 2018, p. 52.

13 ASIC, *Submission 36*, p. 100.

14 For example, Ms Michelle Matheson, *Submission 75*, p. 2; Ms Carolyn Thomson, *Submission 78*, pp. 7–8; Name Withheld, *Submission 89*, p. 5.

15 Mr Nicholas Wright, *Submission 139*, p. 2.

impacted their attempts to fairly resolve their disputes.¹⁶ In some instances, after pressure from government regulators, financial entities subsequently provided the documents requested. Other submitters and witnesses stated that their signatures had been forged, or that they had signed blank documents, incomplete documents or documents without sufficient explanation about what they were signing, making it difficult for them to dispute that they had never seen or understood documents when they raised complaints about misconduct.¹⁷

4.13 The Financial Services Royal Commission's interim report also made note of this issue. It discussed how effective auditing is undermined without a 'complete and accurate file recording the dealings between adviser and client' and that 'there can be no effective audit if the adviser keeps control of the file and will not release it to the licensee'. In addition, it stated that '[t]oo often, bad audit results have had no, or no significant, consequences for the adviser'.¹⁸

Enforcement

4.14 Witnesses and submitters raised concerns about the lack of resources for agencies tasked with enforcing consumer protection laws. For example, Caxton Legal Centre argued a 'general lack of resourcing for enforcement across both the regulatory sector and the consumer advocacy sector' has led to a 'persistent frustration that breaches of the existing regulatory regime so often go unchecked'. Caxton Legal Centre added that consumers are often being 'restrained, by lack of resources, from seeking redress' and '[w]ithout better resourcing for regulation and advocacy, good policy and good law can only achieve so much'.¹⁹

4.15 LF Economics placed blame on the regulators for the lack of enforcement, stating that there is an intentional disregard by regulators to investigate and enforce Australian law and serious financial crimes committed by 'politically and economically powerful lenders'. Their disregard meant 'Australians face a high risk of becoming victims of financial crime'.²⁰ The Consumer Action Law Centre identified a lack of resources and insufficient penalties as the problem, and called for additional resources and powers to ensure that ASIC 'can tackle the challenges ahead'.²¹

16 For example, Mr Mohsen Alirezai, *Submission 31*, p. 5; Name withheld, *Submission 34*, p. 1.

17 For example, Mr Brendan James, Shareholder, Cleveland Mining, *Committee Hansard*, 22 February 2018, pp. 18–19; Individuals who provided comments through CHOICE online tool, *Submission 59*, p. 123; Ms Michelle Matheson, *Submission 75*, p. 2; Ms Carolyn Thomson, *Submission 78*, p. 3; Mr John Wilmott, *Submission 83*, p. 1; Dr Evan Jones, *Submission 87*, p. 7; Banking and Finance Consumers Support Association (Inc), *Submission 94*, pp. 31, 33; Ms Naomi Halpern, *Submission 123*, p. 9.

18 Financial Services Royal Commission, *Interim Report*, Volume 1, September 2018, p. 145.

19 Caxton Legal Centre, *Submission 5*, p. 2.

20 LF Economics, *Submission 18*, p. 3.

21 Consumer Action Law Centre, *Submission 46*, p 18.

4.16 The Financial Rights Legal Centre did not question the adequacy of the regulations, stating that Australia has 'the best responsible lending laws in the world'. However, its Co-Principal Solicitor, Ms Katherine Lane, opined:

What has failed here is enforcement, although ASIC is now taking action. I do not want to go against ASIC, but it is a long time coming. We have a failure of enforcement; it has taken a long time.²²

4.17 Ms Lane further stated there is 'a general lack of resourcing for enforcement across both the regulatory sector and the consumer advocacy sector', and noted that 'breaches of the existing regulatory regime so often go unchecked and our clients are restrained, by lack of resources, from seeking redress'.²³ At the time, Ms Lane called for ASIC to receive long-term and enhanced funding, based on an industry funding model²⁴ to enable ASIC to 'attract and keep good-quality staff' and adapt to the changing financial sector landscape.²⁵

4.18 While there were criticisms of the enforcement regime, the Association of Financial Advisers held the view that 'Australia has some of the most rigorous regulation, policing and protections of consumers of financial and credit services in the world'.²⁶

4.19 In October 2016, before the commencement of the committee's inquiry, the Hon. Kelly O'Dwyer MP, the Minister for Revenue and Financial Services, announced a taskforce to investigate ASIC's enforcement regime. In April 2018, the taskforce's report was released in conjunction with the Commonwealth Government's response.²⁷ The Taskforce's recommendations covered self-reporting of misconduct by financial services and credit licensees; harmonising and enhancing search warrant powers; ASIC approval of industry codes; and strengthening ASIC's licensing powers, its ability to ban individuals, its directions powers and penalties for misconduct.²⁸ In response, the Australian government agreed or agreed-in-principle to all of the

22 Ms Katherine Lane, Co-Principal Solicitor, Financial Rights Legal Centre, *Senate Hansard*, 26 April 2017, pp. 35, 38.

23 Caxton Legal Centre, *Submission 5*, p. 2.

24 Introduced in 2017. See ASIC, *ASIC industry funding*, <https://asic.gov.au/about-asic/what-we-do/how-we-operate/asic-industry-funding/> (accessed 1 November 2018).

25 Ms Katherine Lane, Co-Principal Solicitor, Financial Rights Legal Centre, *Senate Hansard*, 26 April 2017, p. 41.

26 Association of Financial Advisers (AFA), *Submission 14*, p. 2.

27 The Treasury, *Taskforce report*, <https://treasury.gov.au/review/asic-enforcement-review/r2018-282438/> (accessed 1 November 2018).

28 The Treasury, *Taskforce report*, <https://treasury.gov.au/review/asic-enforcement-review/r2018-282438/> (accessed 1 November 2018).

recommendations, but deferred implementation of several until the conclusion of the Financial Services Royal Commission.²⁹

Financial Services Royal Commission

4.20 The Financial Services Royal Commission reinforced the concerns expressed to the committee about enforcement in the financial sector. The interim report identified significant deficiencies with regulatory oversight of the sector and was critical of ASIC which, it stated, 'rarely went to court to seek public denunciation of and punishment for misconduct', and the prudential regulator, APRA, which never went to court.³⁰ The interim report noted inaction when misconduct was revealed, and explained that:

...little happened beyond an apology from the entity, a drawn out remediation program and protracted negotiation with ASIC of a media release, an infringement notice, or an enforceable undertaking that acknowledged no more than that ASIC had reasonable 'concerns' about the entity's conduct.³¹

4.21 The interim report added that infringement notices issued against the large banks imposed immaterial penalties, and if a community benefit payment was required, 'the amount was far less than the penalty that ASIC could properly have asked a court to impose'.³²

4.22 ASIC has recently responded to the observations made by the Royal Commission in its interim report. On 19 October 2018, the Chair of ASIC, Mr James Shipton, appeared at a hearing of the Parliamentary Joint Committee on Corporations and Financial Services (PJCCFS). Mr Shipton recognised that the Financial Services Royal Commission had 'appropriately questioned and commented on the role of regulators in preventing or dealing with poor conduct'.³³ In particular, he emphasised criticisms of 'ASIC's approach, especially in relation to court based enforcement'.³⁴

29 Australian Government, *Australian Government Response to the ASIC Enforcement Review Taskforce Report*, April 2018, <https://static.treasury.gov.au/uploads/sites/1/2018/04/Aus-Gov-response-ASIC-Enforcement-Review-Taskforce-Report.pdf> (accessed 6 July 2018).

30 Financial Services Royal Commission, *Interim Report*, Volume 1, September 2018, p. xix.

31 Financial Services Royal Commission, *Interim Report*, Volume 1, September 2018, p. xix.

32 Financial Services Royal Commission, *Interim Report*, Volume 1, September 2018, p. xix.

33 Mr James Shipton, Chair, ASIC, Parliamentary Joint Committee on Corporations and Financial Services, Oversight of ASIC, the Takeovers Panel and the Corporations Legislation No.1 of the 45th Parliament (Oversight of ASIC), *Committee Hansard*, 19 October 2018, p. 2.

34 Mr James Shipton, Chair, ASIC, Parliamentary Joint Committee on Corporations and Financial Services, Oversight of ASIC, *Committee Hansard*, 19 October 2018, p. 2.

4.23 Mr Shipton reassured the PJCCFS that ASIC has 'always been committed, and dedicated to preventing misconduct in the industry'; however, it accepted that changes need to occur to 'deliver more effective deterrence'.³⁵

4.24 Mr Shipton acknowledged comments by leaders from the financial sector about change, but expressed concern that change was not happening as quickly as it should, referring to the financial institutions' slow, delayed and overly technical responses to ASIC's queries. Although recognising that due process was important, Mr Shipton reminded financial institutions that they were professionally obliged to be 'timely, open and honest in their dealings with regulators'. Further, he warned that if:

...institutions lie or are otherwise dishonest with us, we will use every power available to us to punish that behaviour. I am a firm believer in the importance and effectiveness of court based enforcement tools.³⁶

4.25 ASIC explained there would be a further review of its enforcement processes, to identify any changes that need to be made to its enforcement policies.³⁷ In addition, ASIC announced it would review matters relevant to the enforcement of law using criminal and civil proceedings or other regulatory options, as well as the 'effectiveness and timeliness of the conduct of litigation and of enforcement outcomes'.³⁸

4.26 Whilst acknowledging the importance of internal strategic and structural reforms, ASIC emphasised that external changes are also required for ASIC to meet community expectations. Mr Shipton made specific reference to 'increased penalties and regulatory powers', such as product intervention powers, design and distribution obligations and direction powers, and subsequently called for the Parliament to pass these laws as soon as possible.³⁹ Further, Mr Shipton argued that the size and resourcing⁴⁰ of ASIC needed to be considered, within the context of:

35 Mr James Shipton, Chair, ASIC, Parliamentary Joint Committee on Corporations and Financial Services, Oversight of ASIC, *Committee Hansard*, 19 October 2018, p. 2.

36 Mr James Shipton, Chair, ASIC, Parliamentary Joint Committee on Corporations and Financial Services, Oversight of ASIC, *Committee Hansard*, 19 October 2018, p. 2.

37 ASIC, *Review of ASIC's Enforcement Policies, Processes and Decision-Making Procedures*, 17 October 2018, <https://download.asic.gov.au/media/4910547/terms-of-reference-review-of-asic-s-enforcement-policies-processes-and-decision-making-procedures.pdf> (accessed 25 October 2018).

38 ASIC, *Review of ASIC's Enforcement Policies, Processes and Decision-Making Procedures*, 17 October 2018, p. 2.

39 Mr James Shipton, Chair, ASIC, Parliamentary Joint Committee on Corporations and Financial Services, Oversight of ASIC, *Committee Hansard*, 19 October 2018, p. 3.

40 Specific topics listed included: a new industry funding model; the unique characteristics of Australia's financial system; the size of the financial market; the number of financial consumers; the number of people engaged in financial services; and the expectations of the Australian community. See Mr James Shipton, Chair, ASIC, Parliamentary Joint Committee on Corporations and Financial Services, Oversight of ASIC, *Committee Hansard*, 19 October 2018, p. 3.

...how ASIC has been designed over the arc of its history and how Australia's financial system has evolved over the years to have its own unique characteristics. Accordingly, with the introduction of a new industry funding regime (this financial year), now is the right time to ask whether ASIC should be resourced differently to meet the community's expectations and the unique challenges of Australia's financial system.⁴¹

4.27 On 25 October 2018, the House of Representatives (HoR) Senate Economics Legislation Committee heard from APRA's Chairman, Mr Wayne Byres. The Chairman explained that APRA was re-examining its enforcement decisions, including its use of court-based sanctions and the 'potential for greater use of enforcement powers to achieve general deterrence across the industry'.⁴²

Issues in specific sectors

4.28 The committee also received evidence raising concerns about issues in particular sectors of the banking, insurance and financial services industry. These issues concerned:

- financial advice;
- conflicted remuneration arrangements and grandfathered commissions;
- mortgage brokers;
- fraudulent home loan applications and irresponsible lending;
- valuations and foreclosure;
- insurance;
- engagement with Aboriginal and Torres Strait Islander groups;
- credit cards;
- gambling limits and credit;
- consumer leases and payday loans;
- debt management firms; and
- receivers, administrators and liquidators.

Financial advice

4.29 ASIC noted in its submission that 'there is still an unacceptable level of poor-quality advice in Australia'.⁴³ The Insurance Council of Australia emphasised that the greatest risk of consumers not being paid compensation is in the financial advice

41 Mr James Shipton, Chair, ASIC, Parliamentary Joint Committee on Corporations and Financial Services, Oversight of ASIC, *Committee Hansard*, 19 October 2018, p. 3.

42 Australian Prudential Regulation Authority (APRA), Opening Statement – 25 October 2018, *Speeches*, <https://www.apra.gov.au/media-centre/speeches/opening-statement-25-october-2018> (accessed 25 October 2018).

43 Australian Securities and Investments Commission (ASIC), *Submission 36*, p. 17.

industry.⁴⁴ The Financial Ombudsman Service also recognised this in its figures outlining which sector has the most unpaid determinations, with 57 per cent of non-compliant financial entities being financial planners and advisers.⁴⁵

4.30 The Association of Financial Advisers addressed the issue of noncompliance of financial advisers with determinations, suggesting that:

The corporations law system makes it too easy for the directors of licensees to choose noncompliance with Determinations – incentivising directors of licensees to elect to place their company into administration despite a rigorous investigation and finding of misconduct by an Ombudsman scheme about the actions of representatives of the licensee.⁴⁶

4.31 The Australian Institute of Superannuation Trustees suggested that retail superannuation funds may be exploiting a current gap in the regulatory system, in which the requirement that advisers or sales staff must act in the best interests of their customers is not applicable if they can prove that they provided general advice.⁴⁷ The Financial Planning Association of Australia also drew attention to issues with current definitions of personal and general financial advice. It argued that:

Framing 'general advice' as advice plays into the behavioural aspects of financial decision-making by giving the impression that the advice has a reasonable basis or is appropriate for the client...Anecdotal evidence shows that it is common for individuals to interpret general advice as personal advice because it is relevant to their circumstances at the time it is provided.⁴⁸

4.32 ASIC outlined that in the first half of 2018, it intended to give attention to instances where financial services licensees claimed to provide general advice to retail clients to avoid the best interests duty but had actually provided personal advice.⁴⁹

4.33 The committee also heard concerns about the regulation of financial advice given to sophisticated investors and wholesale clients. The *Corporations Act 2001* (Cth) sets out a framework for disclosure prior to the sale of a financial product. Within that framework, in certain circumstances that are specified in the Act, an offeror of the security or issuer of a financial product does not need to meet the disclosure requirements for, among others, sophisticated investors.

44 Insurance Council of Australia, *Submission 8*, p. 13.

45 Financial Ombudsman Service Australia, *The Financial Ombudsman Service Circular: Unpaid Determinations Update*, Issue 28 – February 2017, <https://www.fos.org.au/fos-circular-28-home/fos-news/unpaid-determinations-update/> (accessed 27 June 2018).

46 Association of Financial Advisers (AFA), *Submission 14*, p. 9.

47 Australian Institute of Superannuation Trustees (AIST), *Submission 9*, p. 29.

48 Financial Planning Association of Australia (FPA), *Submission 3*, p. 7.

49 Australian Securities and Investments Commission (ASIC), *ASIC Enforcement Outcomes: July to December 2017*, Report 568, February 2018, p. 13. See also ASIC, *Submission 36*, p. 66.

4.34 Depending on the type of financial product being offered, the definition of sophisticated investor, wholesale investor and professional investor varies.⁵⁰ In particular, sophisticated investors are certified by a qualified accountant. A qualified accountant must not certify that a person is a sophisticated investor unless that investor:

- had an income of more than \$250,000 over the past two financial years; or
- has net assets amounting to more than \$2.5 million in value.⁵¹

4.35 One witness said he did not consider himself to be a sophisticated investor despite meeting the requirements of the test outlined above. He argued that the definition of sophisticated investor should be based instead on a consumer's knowledge of a particular industry.⁵²

4.36 ASIC expressed concerns about the current distinction between wholesale and retail clients which forms the basis of the types of obligations financial advisers have to their clients. It highlighted 'the ease with which today's investors can satisfy the wealth tests, compared to when the tests were originally introduced'.⁵³ The Financial Planning Association stated that it 'strongly supports a review into the definitions of retail, sophisticated and wholesale investors' in the Corporations Act, arguing that current definitions are based on an investor's wealth, rather than their financial literacy, and 'when paired with a disclosure based system of regulation, the definition encourages documentary compliance with little consumer protection benefit'.⁵⁴

4.37 Issues concerning financial advice were referenced in the Financial Services Royal Commission's interim report. Its focus concerned four topics:

- fees being charged to clients for financial advice that was not provided;
- inappropriate financial advice that does not comply with regulation (for example, the 'best interests' obligation under the Corporations Act) or advice that does not account for a client's circumstances;
- improper conduct by financial advisers (for example, the falsification of documentation, the misappropriation of customer funds and misleading or deceptive conduct); and

50 See, for example, *Corporations Act 2001* (Cth), s 761GA for an alternate definition of 'sophisticated investor'.

51 *Corporations Act 2001* (Cth), s 708(8). Alternatively, an investor who is a company or trust controlled by a person meeting these requirements – s 708(10).

52 Mr Brendan James, Shareholder, Cleveland Mining, *Committee Hansard*, 22 February 2018, pp. 16–17.

53 ASIC, *Submission 36*, p. 27.

54 Financial Planning Association of Australia (FPA), *Submission 3*, pp. 8–9.

- issues concerning disciplinary matters.⁵⁵

4.38 The interim report made clear that the prevalence and persistence of dishonesty and greed within the financial advice industry has resulted in these cultural, regulatory and structural issues.⁵⁶

Conflicted remuneration and grandfathered commissions

4.39 The committee received evidence asserting that despite a ban on conflicted remuneration, significant exemptions remain. These may include commissions for bank staff and financial advisers to recommend that customers switch to retail superannuation funds, and conflicted remuneration for property investment advice, unless this is in the context of using self-managed super funds to purchase property.⁵⁷

4.40 The Association of Financial Advisers outlined that conflicted remuneration is permitted where financial advice is given to a wholesale client, or where the financial services representative can prove that they gave only factual information to a retail client, or what is termed 'general advice'.⁵⁸ The Association called for exemptions to the ban on conflicted remuneration for general advice to be overturned.⁵⁹

4.41 ASIC stated in its submission provided in March 2017 that the ban on conflicted remuneration did not apply to some products or forms of advice, such as some life insurance and general insurance products, while other products have been 'grandfathered' – that is, because the client invested in the product or platform before 1 July 2014, provisions on conflicted remuneration that came into force after that date do not apply.⁶⁰ ASIC emphasised that the 'impact of adviser conflicts of interest on the quality of life insurance advice is an industry-wide problem'.⁶¹

4.42 In December 2017, ASIC published an updated guide on conflicted and other types of banned remuneration outlining recent regulatory reforms that remove the general exclusion for life insurance products. However, the guide noted that 'a benefit

55 Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry (Financial Services Royal Commission), *Interim Report*, Volume 1, September 2018, p. 73

56 Financial Services Royal Commission, *Interim Report*, Volume 1, September 2018, p. 74.

57 Australian Institute of Superannuation Trustees (AIST), *Submission 9*, pp. 6, 28–29; CHOICE, *Submission 19*, p. 27; Ben Butler and Michael Roddan, 'Planners pocket commissions, even as advice falls short', *The Australian*, 11 December 2017, <https://www.theaustralian.com.au/business/financial-services/ombudsman-clears-adviser-despite-secret-25k-commission/news-story/a6c93717a97c6b9de60a3429ceec259e> (accessed 2 July 2018); Australian Securities and Investments Commission (ASIC), *Regulatory Guide 246: Conflicted and Other Banned Remuneration*, December 2017, p. 14.

58 Association of Financial Advisers (AFA), *Submission 14*, p. 14.

59 Association of Financial Advisers (AFA), *Submission 14*, p. 16. See also Financial Planning Association of Australia, *Submission 3*, p. 8.

60 ASIC, *Submission 36*, p. 20.

61 ASIC, *Submission 36*, p. 84.

is not conflicted remuneration if it only influences advice provided to wholesale clients'.⁶²

4.43 CHOICE expressed concerns about the extent of grandfathered commissions. It stated that in 2014, on average a third of the total income of financial advice licensees 'came from grandfathered benefits. This income tends to be a greater proportion of the revenue of large licensees like the big four banks'.⁶³

4.44 In April 2017, Mr Stephen Sedgwick released his review into retail banking remuneration. This review was initiated by the Australian Bankers' Association (ABA), and examined remuneration practices in retail banking not affected by the Future of Financial Advice reforms.⁶⁴ In that report, Mr Sedgwick recommended that in 2020 the ABA independently review the adoption of its recommendations to determine 'whether further regulatory or legislative change is required'.⁶⁵ Pending the outcome of that review, the report also recommended that:

...any post implementation review of the operations of the proposed product intervention power for ASIC examine whether the government should legislate to extend ASIC's intervention powers to address conflicted remuneration in circumstances in which the industry cannot or does not address [remuneration and governance of mortgage brokers⁶⁶] adequately without such an intervention.⁶⁷

4.45 Although welcoming the recommendations of the Sedgwick review, and expressing surprise at the banks announcing they would implement Mr Sedgwick's recommendations, CHOICE reminded the committee that even after Mr Sedgwick's review, banks continue to police themselves and as demonstrated from 'multiple inquiries into the banking sector, constant public pressure is needed to make sure that reforms go through'.⁶⁸

4.46 With the release of the Sedgwick review, the ABA announced 'Australia's banks will change the way they pay and reward their retail staff to deliver better banking for customers' and that it intended to 'implement [the recommendations] in

62 ASIC, *Regulatory Guide 246: Conflicted and Other Banned Remuneration*, December 2017, p. 6.

63 CHOICE, *Submission 19*, p. 25.

64 Mr Stephen Sedgwick, private capacity, *Committee Hansard*, 28 June 2017, p. 10.

65 Stephen Sedgwick AO, *Retail Banking Remuneration Review* (Sedgwick review), April 2017, p. 28.

66 See recommendations 16, 17 and 18 of Stephen Sedgwick, AO, Sedgwick review, April 2017, pp. 34–38.

67 Stephen Sedgwick AO, Sedgwick review, April 2017, p. 38 (Recommendation 19).

68 Mr Erin Turner, Acting Director, CHOICE, *Committee Hansard*, 26 April 2017, p. 24.

full as quickly as possible'.⁶⁹ However, the issue of conflicted remuneration was not adequately addressed until the onset of the Financial Services Royal Commission.

4.47 ASIC in its submission to the Financial Services Royal Commission in May 2018 called for the grandfathering of commissions to 'cease as soon as reasonably practicable and to the maximum possible extent'.⁷⁰ The Financial Services Royal Commission's interim report noted that despite the Future of Financial Advice reforms, conflicted remuneration for financial advice has continued under 'grandfathering' provisions of the Corporations Regulations 2001 (Cth).⁷¹

4.48 The interim report questioned the justification for grandfathering provisions to remain, and considered stakeholders' arguments on this matter, including ASIC's principle point that 'any exemption to the ban on conflicted remuneration, by definition, has the ability to create misaligned incentives, which can lead to inappropriate advice'.⁷²

4.49 Since the Financial Services Royal Commission hearings about financial advice, Westpac, Macquarie, NAB and ANZ have announced they would cease paying grandfathered commissions to advisers these entities employ.⁷³ On 10 October 2018, the ABA announced that it would 'seek new legislation to end grandfathered payments and trail commissions for financial advisers'. The CEO of the ABA, Anna Bligh, commented that the removal of 'grandfathering provisions in relation to financial advice' is an 'important piece in the puzzle of ensuring there are no conflicts for advisers'.⁷⁴

Mortgage brokers

4.50 ASIC expressed concern about the current model of upfront and trail commissions for mortgage brokers, leading to conflicts of interest because 'commissions are linked to the size of the loan, so the more money a consumer borrows, the more the broker will be paid'. It also noted bonus commissions from lenders to mortgage brokers may increase poor consumer outcomes.⁷⁵

69 ABA, 'Banks to change the way they pay their staff', *Media release*, 29 April 2017, <https://www.ausbanking.org.au/media/media-releases/media-release-2017/banks-to-change-the-way-they-pay-their-staff> (accessed 19 October 2018).

70 ASIC, *Submission to Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry: Round 2: Financial Advice*, 7 May 2018, p. 3, <https://financialservices.royalcommission.gov.au/public-hearings/Documents/Round-2-written-submissions/asic.pdf> (accessed 2 July 2018).

71 Financial Services Royal Commission, *Interim Report*, Volume 1, September 2018, p. 94.

72 Financial Services Royal Commission, *Interim Report*, Volume 1, September 2018, p. 97.

73 Financial Services Royal Commission, *Interim Report*, Volume 1, September 2018, p. 96.

74 ABA, 'Ending fees for no service, grandfathered payments', *Media release*, 10 October 2018, <https://www.ausbanking.org.au/media/media-releases/media-release-2018/ending-fees-for-no-service-grandfathered-payments> (accessed 19 October 2018).

75 ASIC, *Submission 36*, pp. 87–88. See also Mr Philip Field, Lead Ombudsman, Banking and Finance, Financial Ombudsman Service Australia, *Committee Hansard*, 26 April 2017,

4.51 These concerns were shared by other submitters and witnesses.⁷⁶ For example, the CEO of CHOICE, Mr Alan Kirkland, called for changes to the minimum obligation that lenders and brokers only be required to determine that a loan is 'not unsuitable' for a customer. He described this as 'an unacceptably low bar' that 'creates massive risks for consumers [who] are then embedded in their long-term banking relationships'.⁷⁷

4.52 The Financial Services Royal Commission's interim report looked at matters related to intermediaries, including mortgage brokers. With regard to misconduct in connection to home loans, the interim report identified two primary concerns: first, for 'whom do intermediaries in the home loan market act and second, what are the effects of value-based remuneration for intermediaries?'⁷⁸ Both are considered briefly below.

Intermediary representation

4.53 The interim report acknowledged the complexity of this legal question, but pointed out that the intermediary is paid by the lender, not the borrower. The relationships between the broker, aggregator and the lender are regulated by a contract, which contains 'no agency' provisions.⁷⁹ Subsequently, the interim report considered questions about representation that relate to the beliefs and expectations held by the borrower,⁸⁰ and outlined key issues such as:

- intermediaries owing 'no general duty to the borrower to seek out the best and most appropriate deal for the borrower';
- obscured relationships between brokers and borrowers, and the negotiation of unsuitable loans; and
- the expectation that the 'broker's task is to sell...[the] lender's products'.⁸¹

Remuneration

4.54 The interim report identified evidence that revealed ways in which remuneration affects the outcome of a loan and advice about mortgages. Further, the report highlighted that:

...value- and volume-based remuneration for intermediaries in the home loan industry has been an important contributor to misconduct and conduct

pp. 31–32.

76 See, for example, Consumer Action Law Centre, *Submission 46*, pp. 3, 15; Financial Rights Legal Centre, *Submission 52*, pp. 16, 112–114.

77 Mr Alan Kirkland, Chief Executive Officer, CHOICE, *Committee Hansard*, 26 April 2017, p. 18; CHOICE, *Submission 19*, p. 32.

78 Financial Services Royal Commission, *Interim Report*, Volume 1, September 2018, p. 56.

79 Financial Services Royal Commission, *Interim Report*, Volume 1, September 2018, p. 57.

80 Financial Services Royal Commission, *Interim Report*, Volume 1, September 2018, p. 57.

81 Financial Services Royal Commission, *Interim Report*, Volume 1, September 2018, pp. 57–58.

falling short of community standards and expectations and poor customer outcomes.⁸²

Fraudulent home loan applications and irresponsible lending

4.55 The committee heard that calculations of living expenses used to determine the amount that someone can borrow for a home loan may not be an accurate estimate of a household's living expenses. Indeed, on some occasions, these expenses may be grossly underestimated.⁸³

4.56 LF Economics noted 'many claims by alleged victims' that lenders had fraudulently tampered with their loan application forms. It argued that because the internal processes of lenders should enable them to detect and deny a loan with incorrect details, 'mortgage fraud should therefore be all but non-existent. It is the lenders themselves, however, who are the prime instigators of mortgage fraud'.⁸⁴

4.57 The Financial Services Royal Commission considered the issue of irresponsible lending practices.⁸⁵ It examined responsible lending for consumers (such as home loans, car loans and credit cards) and businesses⁸⁶ (such as small to medium enterprises, agricultural businesses and guarantors of business loans). The interim report highlighted the importance of the responsible lending provisions under the *National Consumer Credit Protection Act 2009* (NCCP Act), in particular the requirement for credit licensees to determine whether a 'credit contract will be unsuitable'⁸⁷ for the consumer if the contract is made or (in the case of a credit limit increase) the limit is increased'.⁸⁸

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- 82 Financial Services Royal Commission, *Interim Report*, Volume 1, September 2018, pp. 61–62.
- 83 Ms Katherine Lane, Co-Principal Solicitor, Financial Rights Legal Centre, *Senate Hansard*, 26 April 2017, p. 37; Mr David Carson, Corporate Regulatory Adviser, and Mr Peter James White, Executive Director, Finance Brokers Association of Australia, *Committee Hansard*, 26 April 2017, pp. 54–55. See also Mr Mark Newberry, *Submission 42*, p. 2 for concerns about home loans granted in momentarily profitable times with little due diligence conducted.
- 84 LF Economics, *Submission 18*, pp. 3, 6.
- 85 For home loans, car loans, credit cards and add-on insurance.
- 86 Responsible lending provisions under the *National Consumer Credit Protection Act 2009* (NCCP Act) do not apply to lending for business purposes. The exclusion of small business is in 'recognition of the need to ensure...access to reasonably affordable and available credit'. The interim report noted reluctance across the banking and small business sector to adopt increased protection. See Financial Services Royal Commission, *Interim Report*, Volume 1, September 2018, pp. 162–163.
- 87 A licensee will determine a consumer is unsuitable if it is likely that the applicant is unable to comply with the financial obligations under a contract, or could only comply with substantial hardship. The NCCP Act establishes necessary steps that a licensee must take before proceeding with a credit contract, such as making reasonable inquiries about the consumer's requirements and objectives and the consumer's financial situation, and verifying the consumer's financial situation. See Financial Services Royal Commission, *Interim Report*, Volume 1, September 2018, pp. 22–30 for further details about the NCCP Act requirements.
- 88 Financial Services Royal Commission, *Interim report*, Volume 1, September 2018, p. 22.

4.58 The interim report detailed breaches of responsible lending requirements,⁸⁹ and determined that this issue is related to entities' 'interpretation and application of obligations imposed by the [NCCP Act]' to verify a customer's financial situation.⁹⁰ Subsequently, the interim report listed questions on this matter, such as:

- What steps should be taken by a lender to verify a borrower's expenses that are consistent with responsible lending obligations?
- What processes do entities have in place to verify that a borrower's expenses meet the requirements of the NCCP Act, and do those processes meet the requirements?
- Should the Household Expenditure Measure (HEM) continue to be used as a benchmark for borrowers' living expenses?⁹¹

Issues with valuations and foreclosure

4.59 Some evidence concerned issues with foreclosure. The Australian Small Business and Family Enterprise Ombudsman stated that banks may require customers in default on their loan repayments to pay the fees of valuers or investigating accountants to assess business operations or the value of assets. The Ombudsman submitted that many banks then refuse to provide the customer with copies of valuations or accountant reports, despite the customer paying for these. Customers who approach the valuer or investigative accountant directly may be told that the documents are confidential and cannot be shared because the bank requested the report, not the customer.⁹²

4.60 In its 2016 report on the impairment of customer loans, the Parliamentary Joint Committee on Corporations and Financial Services devoted an entire chapter to the issue of property valuations. The committee suggested that if the banks and the ABA did not address 'matters as simple as providing borrowers with copies of valuation reports...the government should bring forward appropriate legislation or regulation' to require banks to provide borrowers with copies of valuation reports and valuation instructions as soon as these become available.⁹³ It noted that customers may not be aware of EDR arrangements for loan valuations and that the valuation industry did 'not have appropriate compliance and dispute resolution arrangements in place' in any case.⁹⁴ The committee recommended that 'nationally consistent arrangements be put in place for...the professional standards and conduct of

89 For matters related to home loans see Financial Services Royal Commission, *Interim Report*, Volume 1, September 2018, pp. 43–45.

90 Financial Services Royal Commission, *Interim Report*, Volume 1, September 2018, p. 70.

91 Financial Services Royal Commission, *Interim Report*, Volume 1, September 2018, p. 71.

92 Australian Small Business and Family Enterprise Ombudsman, *Submission 11*, pp. 5–6.

93 Parliamentary Joint Committee on Corporations and Financial Services, *Impairment of customer loans*, May 2016, p. 101.

94 Parliamentary Joint Committee on Corporations and Financial Services, *Impairment of customer loans*, May 2016, p. 104.

valuations in relation to small business loans'.⁹⁵ The Government is yet to respond to the report's recommendations.

4.61 The new ABA Banking Code of Practice, which ASIC approved in July 2018, explicitly addresses the issue of external property valuers, including a commitment that 'We will provide copies of property valuations and valuer instructions (except when enforcement action has already commenced)'.⁹⁶ The ABA's Chief Executive Officer, Anna Bligh, stated in the Code's foreword that 'the high standards of behaviour and service set out in this Code are enforceable rights for customers'.⁹⁷

Insurance

4.62 The Financial Rights Legal Centre described the insurance sector as being 'at least 20 years behind the banking sector in terms of addressing basic consumer issues', from claims handling, to unfair contract terms, to problems with disclosure, some products and business models.⁹⁸

4.63 The Insurance Council of Australia stated it was committed to 'continually enhancing outcomes for consumers buying general insurance'.⁹⁹ The Council argued that because of prior and imminent reforms to the regulatory framework governing insurance:

...the focus must be on identifying whether there are examples of poor consumer outcomes that remain without a remedy. The Insurance Council is not aware of any issues that are not being actively addressed.¹⁰⁰

4.64 Several submitters outlined concerns about add-on insurance products.¹⁰¹ ASIC echoed this, suggesting that 'consumers are being sold expensive, poor value products that give them very little to no benefit, in a sales environment with pressure selling, high commissions and conflicts of interest'.¹⁰² ASIC noted that one of its

95 Parliamentary Joint Committee on Corporations and Financial Services, *Impairment of customer loans*, May 2016, p. 137, Recommendation 6.

96 Australian Banking Association, *Banking Code of Practice*, commencing 1 July 2019, p. 31, cl. 90, https://www.ausbanking.org.au/images/uploads/Banking_Code_of_Practice_2019_web.pdf (accessed 8 November 2018); Australian Securities & Investments Commission, '18-223MR ASIC approves the Banking Code of Practice', 31 July 2018, <https://asic.gov.au/about-asic/news-centre/find-a-media-release/2018-releases/18-223mr-asic-approves-the-banking-code-of-practice/> (accessed 8 November 2018).

97 Australian Banking Association, *Banking Code of Practice*, commencing 1 July 2019, p. 1, https://www.ausbanking.org.au/images/uploads/Banking_Code_of_Practice_2019_web.pdf (accessed 8 November 2018).

98 Financial Rights Legal Centre, *Submission 52*, pp. 5, 54.

99 Insurance Council of Australia, *Submission 8*, p. 3.

100 Insurance Council of Australia, *Submission 8*, p. 4.

101 Consumer Action Law Centre, *Submission 46*, pp. 6–8; Financial Rights Legal Centre, *Submission 52*, pp. 43–45.

102 ASIC, *Submission 36*, p. 39.

reports found that car dealers earned four times more in commissions from add-on insurance policies than consumers received in claims.¹⁰³

4.65 The magnitude of the problem of add-on insurance has been highlighted by the Financial Services Royal Commission. The interim report specified that between 1 July 2010 and 28 February 2018, financial service entities paid consumers over \$128 million in remediation due to conduct connected to add-on insurance. Approximately \$117 million of this total was paid for car loan add-on insurance remediation, and \$10 million for credit card add-on insurance. Approximately \$900,000 was paid for home loan add-on insurance remediation.¹⁰⁴

4.66 Some submitters highlighted difficulties experienced by people with a mental health condition accessing insurance products.¹⁰⁵ For example, Beyondblue submitted that:

Empirical evidence and anecdotal reports demonstrate that many people with a mental health condition experience significant difficulties in obtaining and claiming on different types of insurance products, compared to the rest of the population. These difficulties occur across the general and life insurance industries for products such as travel insurance, income protection, total and permanent disability (TPD) and life insurance.¹⁰⁶

4.67 Beyondblue argued that the 'insurance industry treats all mental health conditions as a single group', with 'blanket mental health exclusions' in insurance products.¹⁰⁷ The Public Interest Advocacy Centre asserted that insurers had avoided paying out policies by relying on medical records to impute medical conditions that did not exist at the time of applying for insurance, particularly mental illness.¹⁰⁸ Such practices led a former insurance executive to call in March 2018 for the Financial Services Royal Commission to examine how insurers treat customers with mental illness.¹⁰⁹

4.68 Round 6 of the Financial Services Royal Commission focused on issues with the insurance industry treatment of customers with mental health conditions;¹¹⁰ however, because of the timing of this round of hearings, evidence relating to this

103 ASIC, *Submission 36*, pp. 84–85. See also Ms Susan Quinn, Senior Policy Officer, Consumer Action Law Centre, *Committee Hansard*, 26 April 2017, pp. 33–34.

104 Financial Services Royal Commission, *Interim Report*, Volume 1, September 2018, p. 37.

105 Public Interest Advocacy Centre Ltd, *Submission 25*, p. 1.

106 Beyondblue, *Submission 20*, p. 3.

107 Beyondblue, *Submission 20*, pp. 5, 9.

108 Public Interest Advocacy Centre Ltd, *Submission 25*, pp. 27–29.

109 Pat McGrath, 'Former insurance executive wants probe into treatment of customers with mental illness', *ABC News*, 14 March 2018, <http://www.abc.net.au/news/2018-03-14/former-insurance-exec-probe-treatment-customers-mental-illness/9542496> (accessed 8 November 2018).

110 See, Financial Services Royal Commission, *Transcripts and Witness list*, Round 6, <https://financialservices.royalcommission.gov.au/public-hearings/Pages/transcripts.aspx> (accessed 29 October 2018).

issue was not referenced or reflected upon in the interim report. The Royal Commission is scheduled to submit its final report to the Governor-General by 1 February 2019.

Engagement with Aboriginal and Torres Strait Islander groups

4.69 A number of submitters highlighted concerns about funeral insurance sold to Indigenous people.¹¹¹ The Financial Rights Legal Centre focused on funeral insurance as a particular example of an instance where financial entities have been engaged in misselling of products.¹¹²

4.70 The Broome Circle Financial Management Program noted that a 'lack of cultural and geographical awareness from frontline customer service staff' exacerbated the difficulties that many Indigenous clients experience engaging with financial entities, particularly those from remote Aboriginal communities. These difficulties may include language, staff being unable to understand customers, or customers being unable to provide sufficient identification.¹¹³

4.71 Round 4 of the Financial Services Royal Commission's hearings focused on issues faced by remote communities, in particular Indigenous Australians. The interim report referenced issues concerning basic accounts, informal overdrafts, dishonour fees and identification issues as primary matters of concern, and examined efforts by financial services and regulatory bodies to address these issues.¹¹⁴

4.72 The Financial Services Royal Commission also received evidence on funeral insurance. The interim report observed that evidence pointed 'to predatory behaviour by insurers and salespeople' and proposed questions to develop policy on how best to regulate funeral insurance.¹¹⁵

4.73 More broadly, the interim report identified that a common issue is the use of 'culturally appropriate communication, a lack of which aggravated the existing difficulties in the interaction between entity and customer'.¹¹⁶

Credit cards

4.74 Some submitters focused on the issue of credit card repayments.¹¹⁷ A representative from CHOICE in the inquiry's public hearing on 26 April 2017 argued

111 ASIC, *Submission 36*, p. 41; Financial Counselling Australia (FCA), *Submission 91*, p. 11; Financial Rights Legal Centre, *Submission 52*, p. 23.

112 Financial Rights Legal Centre, *Submission 52*, pp. 23, 41.

113 Broome Circle Financial Management Program, *Submission 54*, pp. 4–5.

114 Financial Services Royal Commission, *Interim Report*, Volume 1, September 2018, pp. 259–262.

115 Financial Services Royal Commission, *Interim Report*, Volume 1, September 2018, pp. 264.

116 Financial Services Royal Commission, *Interim Report*, Volume 1, September 2018, pp. 265.

117 For example, Care Inc. Financial Counselling Service, *Submission 21*, pp. 3, 6; CHOICE, *Submission 19*, p. 17.

that 'credit cards are where we see real, extreme consumer harm'.¹¹⁸ Ms Susan Quinn, a Senior Policy Officer with the Consumer Action Law Centre, told the committee that each week the Centre receives 'at least one call from a person with credit card debt exceeding \$100,000'.¹¹⁹ The Financial Rights Legal Centre and a representative from the Consumer Action Law Centre argued that credit cards should only be issued if it is clear that the customer is able to pay back the full limit within three years.¹²⁰

4.75 ASIC released a report in July 2018 with findings from its review of credit card lending between 2012 and 2017. The report found that 18.5 per cent of consumers with a credit card—or one in six consumers who own a credit card—met at least one problematic debt indicator. These indicators were that the consumer had made repeated low repayments, the account showed persistent debt, the account was at least 60 days overdue, or the account had been written off. The report found that 'few credit providers take proactive steps to address persistent debt, low repayments or products that are unsuited'. It also noted the work of the Senate Economics References Committee in its inquiry into credit cards, highlighting that ASIC's findings 'suggest that the "debt trap" risk for balance transfers noted by the Senate Inquiry exists and affects a substantial proportion of consumers'.¹²¹

4.76 Evidence provided by ASIC to the Financial Services Royal Commission revealed that between 1 July 2010 and 28 February 2018, more than 34,000 customers of financial services received over \$11 million in remediation payments 'in response to breaches of responsible lending obligations in connection with credit cards'.¹²² In response to these matters, the four major banks¹²³ had all:

...disclosed that they had identified a range of misconduct and conduct falling short of community standards and expectations in connection with home loans, car loans, credit cards, add-on insurance and so-called 'processing errors'.¹²⁴

4.77 A further concern expressed by the Financial Services Royal Commission related to unsolicited offers of credit card limit increases. The interim report linked this practice to the banks' pursuit of profit above all other concerns, and stated:

118 Ms Erin Turner, Acting Director – Content, Campaigns and Communications, CHOICE, *Committee Hansard*, 26 April 2017, p. 19.

119 Ms Susan Quinn, Senior Policy Officer, Consumer Action Law Centre, *Committee Hansard*, 26 April 2017, p. 33.

120 Financial Rights Legal Centre, *Submission 52*, p. 97; Ms Katherine Temple, Senior Policy Officer, Consumer Action Law Centre, *Committee Hansard*, 26 April 2017, p. 36.

121 ASIC, *Report 580: Credit Card Lending in Australia*, July 2018, pp. 7, 9, 10; Senate Economics References Committee, *Interest rates and informed choice in the Australian credit card market*, December 2015.

122 Financial Services Royal Commission, *Interim Report*, Volume 1, September 2018, p. 36.

123 The Australia and New Zealand Banking Group, the Commonwealth Bank of Australia, National Australia Bank and Westpac.

124 Financial Services Royal Commission, *Interim Report*, Volume 1, September 2018, p. 42.

Despite being told plainly by ASIC that it considered that practices of the kind followed by Westpac did not comply with the responsible lending provisions, Westpac chose to continue those practices until ASIC threatened legal action. And Westpac chose not to seek, at any time in the intervening two years, to tell ASIC that it proposed to continue with its previous practices or to persuade ASIC that ASIC's stated views of the law were wrong.¹²⁵

4.78 The Financial Services Royal Commission heard that credit card debt is the primary reason for consumers accessing support services, 'especially those people on low incomes or who are otherwise marginalised or vulnerable'.¹²⁶

Gambling limits and credit

4.79 Some submitters expressed concern about the ease with which consumers are able to access credit for gambling.¹²⁷ Financial Counselling Australia argued that consumers 'struggling with gambling addiction present a unique and important test of whether consumer protections in the finance industry are adequate'. It stated that credit provided by financial entities for gambling purposes caused considerable harm, and was unaddressed by government reform. However, it did note that some banks 'already prohibit gambling transactions on their credit cards', and several of the big four banks may be considering whether to limit the use of credit cards for online gambling.¹²⁸

4.80 The Financial Services Royal Commission heard evidence from one witness, Mr David Harris, who detailed the consequences of the Commonwealth Bank of Australia (CBA) issuing credit increases despite Mr Harris advising the CBA of his gambling problem.¹²⁹ Issues relating to access to credit for gambling were, in the Financial Services Royal Commission's view, 'traced to [financial] entities preferring pursuit of profit to pursuit of any other purpose'.¹³⁰

Consumer leases and payday loans

4.81 Several submitters stated their concerns about payday loans and 'rent now, buy later' consumer leases targeting customers from lower socio-economic groups.¹³¹ Such products, Financial Counselling Australia suggested, were a 'major cause of financial harm for people on low incomes'.¹³² ASIC stated that under consumer leases,

125 Financial Services Royal Commission, *Interim Report*, Volume 1, September 2018, p. 69.

126 Financial Services Royal Commission, *Interim Report*, Volume 1, September 2018, pp. 52–53.

127 Care Inc. Financial Counselling Service, *Submission 21*, p. 13.

128 Financial Counselling Australia (FCA), *Submission 91*, pp. 2, 3.

129 Financial Services Royal Commission, *Interim Report*, Volume 1, September 2018, p. 54.

130 Financial Services Royal Commission, *Interim Report*, Volume 1, September 2018, p. 54.

131 Consumer Action Law Centre, *Submission 46*, pp. 15–18; Financial Rights Legal Centre, *Submission 52*, p. 23; Broome Circle Financial Management Program, *Submission 54*, pp. 2–4.

132 Financial Counselling Australia (FCA), *Submission 91*, p. 11; ASIC, *Submission 36*, p. 50; Care Inc. Financial Counselling Service, *Submission 21*, pp. 11–12;

consumers 'will pay significantly more than the retail price of the goods and be charged more than a lender is permitted to charge under a small amount credit contract'.¹³³

4.82 The Financial Services Royal Commission did not examine consumer leases, payday loans or in-store credit arrangements, as it considered that these areas are outside its terms of reference.¹³⁴

Debt management firms

4.83 Financial Counselling Australia contended that debt management firms constitute a problem among lower socio-economic groups because they 'target vulnerable and financially desperate consumers with high, front-loaded and opaque fees and promise a lot more than they can deliver'.¹³⁵ Types of debt management firms include credit repairers, debt negotiators and budgeting services.¹³⁶

4.84 ASIC stated that it agreed with the recommendation of the 2017 Ramsay review of the EDR framework that debt management firms should be required to become members of an EDR scheme, with the provision that additional conduct obligations be required of this type of entity.¹³⁷

4.85 Debt management firms were not examined as part of the Financial Services Royal Commission; however, this matter falls within the terms of reference of the committee's inquiry into credit and financial services targeted at Australians at risk of financial hardship.

Receivers, administrators and liquidators

4.86 This inquiry received a small amount of evidence concerning the conduct of liquidators that managed outstanding debts of insolvent companies, such as Timbercorp, as well as receivers and insolvency practitioners.¹³⁸

4.87 The Parliamentary Joint Committee on Corporations and Financial Services in its report on the impairment of customer loans, tabled in May 2016, dedicated a chapter to issues raised about receivers and investigative accountants. These issues included allegations that receivers sold properties and assets under value, that they did not consider or take up sale options put forward by borrowers, that there was a lack of

133 ASIC, *Submission 36*, p. 50.

134 Financial Services Royal Commission, final transcript for Day 35, Ms Rowena Orr, 2 July 2018, p. 3695, ln 26–33.

135 Financial Counselling Australia (FCA), *Submission 91*, p. 4. See also Financial Rights Legal Centre, *Submission 52*, pp. 26–28.

136 Financial Counselling Australia (FCA), *Submission 91*, p. 7.

137 ASIC, *Submission 36*, pp. 64–65; The Treasury, *Review of the Financial System External Dispute Resolution and Complaints Framework: Final Report*, April 2017, p. 17.

138 See Ms Naomi Halpern, Private capacity, and Ms Susan Henry, Chair, Holt Norman Ashman Baker Action Group, *Committee Hansard*, 22 February 2018, pp. 35–44; Dr Evan Jones, *Submission 87*, p. 9; Name Withheld, *Submission 89*; Name Withheld, *Submission 92*; Name Withheld, *Submission 118*; Mr Lynton Freeman, *Submission 128*, p. 19.

information provided to borrowers by receivers, and there was a lack of effective dispute resolution services.¹³⁹

4.88 The committee expressed its concern that 'there is no clearly established requirement for receivers to be part of an industry-wide independent external dispute resolution scheme supported by internal dispute resolution procedures'.¹⁴⁰ It recommended that receivers be 'required to take every reasonable step' to ensure that 'assets are sold at or as close to listed market value as possible' in accordance with Prudential Standard APS 220. The committee also recommended that ASIC administer a strong penalty regime for breaches of section 420A of the Corporations Act, which requires assets be sold for fair market value.¹⁴¹

4.89 The Financial Services Royal Commission's interim report identified that a central complaint about the conduct of receivers 'was that receivers appointed by banks did not realise fair value for the assets under management' and called into question the behaviour of receivers 'when taking possession of assets or when in possession of those assets'.¹⁴² Despite submissions identifying concerns with the conduct of this sector, the Financial Services Royal Commission considered that these matters were outside its terms of reference. However, the interim report did consider evidence that related to the conduct of financial institutions that appoint a receiver.

4.90 The interim report made note of NAB's statement that it is not in the interest of the customer or the bank to appoint an external administrator, and that this step is viewed by those in the banking sector as an option of last resort.¹⁴³ With regard to misconduct, questions were raised concerning the use of administrators in connection with agricultural loans.¹⁴⁴

Committee view

4.91 The evidence provided to this inquiry about the consumer protection system in general highlighted issues with insufficient professional indemnity insurance, record keeping and sharing of records by financial entities, and under-resourcing of financial counselling and legal services. The committee holds concerns that weaknesses in current legislative and regulatory requirements, monitoring and enforcement arrangements have exposed consumers to harm. In particular, the under-resourcing of financial counselling and legal services may especially impact

139 Parliamentary Joint Committee on Corporations and Financial Services, *Impairment of customer loans*, May 2016, p. 107.

140 Parliamentary Joint Committee on Corporations and Financial Services, *Impairment of customer loans*, May 2016, p. 119.

141 Parliamentary Joint Committee on Corporations and Financial Services, *Impairment of customer loans*, May 2016, p. 123, Recommendation 9; Australian Prudential Regulation Authority, *Prudential Standard APS 220: Credit Quality*, January 2015, <https://www.apra.gov.au/sites/default/files/141120-APS-220.pdf> (accessed 8 November 2018).

142 Financial Services Royal Commission, *Interim Report*, Volume 1, September 2018, p. 238.

143 Financial Services Royal Commission, *Interim Report*, Volume 1, September 2018, p. 239.

144 Financial Services Royal Commission, *Interim Report*, Volume 1, September 2018, p. 241.

vulnerable Australians, who often make use of these services and may be targeted by providers offering low-quality and/or low value for money products with high interest rates to the people who can least afford to repay them.

4.92 Many of the industry-specific issues identified by the committee during this inquiry have aligned with those raised in the Financial Services Royal Commission. The impact of these revelations has already been felt. For example, moves have been made by the banking sector to address some of these issues, including the removal of grandfathered commissions and an announcement by the Australian Banking Association to seek new legislation to ban this practice. The committee is supportive of proactive action made by the financial services industry to address these matters of concern, but notes that these efforts are very recent.

4.93 The committee acknowledges that a number of issues remain outside of the Financial Services Royal Commission's terms of reference and subsequently have not received necessary scrutiny. These matters include consumer leases and payday loans, debt management firms, and administrators, receivers and liquidators. For this reason, the Senate has referred an inquiry to the committee into credit and financial services targeted at Australians at risk of financial hardship, which will provide further scrutiny of matters such as consumer leases, payday loans and debt management firms.

4.94 Given the ongoing work of the Financial Services Royal Commission, the committee has determined that it will refrain from making specific policy recommendations; however, it will closely monitor the work of the Financial Services Royal Commission and its forthcoming recommendations, particularly as these relate to the issues specified in this report. Chapter 5 outlines the committee's conclusions and recommendations regarding the Royal Commission's work to date and its terms of reference.