

The Senate

Economics
References Committee

Regulatory framework for the protection of
consumers in the banking, insurance and
financial services sector

November 2018

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Senate Economics References Committee

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Abbreviations

ABA	Australian Bankers' Association
ACCC	Australian Competition and Consumer Commission
AFCA	Australian Financial Complaints Authority
AFS	Australian financial services
ANZ	Australian and New Zealand Banking Group Limited
APRA	Australian Prudential Regulation Authority
ASIC	Australian Securities and Investments Commission
CBA	Commonwealth Bank of Australia
CEO	Chief Executive Officer
CIO	Credit and Investments Ombudsman
Cth	Commonwealth
EDR	External dispute resolution
FOS	Financial Ombudsman Service
HEM	Household Expenditure Measure
Hon.	Honourable
HoR	House of Representatives
NAB	National Australia Bank
NCCP Act	<i>National Consumer Credit Protection Act 2009</i>
PJCCFS	Parliamentary Joint Committee on Corporations and Financial Services
SCT	Superannuation Complaints Tribunal

List of recommendations

Recommendation 1

5.34 The committee recommends that the Commonwealth Government give the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry an extension of time to report.

Recommendation 2

5.38 The committee recommends that the Commonwealth Government provide a response to the Parliamentary Joint Committee on Corporations and Financial Services' inquiry into the impairment of customer loans.

Recommendation 3

5.40 The committee recommends that the Commonwealth Government consider increased funding for community legal and financial counselling services dealing with victims of financial misconduct.

Chapter 1

Introduction

Referral and conduct of the inquiry

1.1 On 29 November 2016, the Senate referred the following matters to the Senate Economics References Committee (the committee) for inquiry and report by 28 March 2018:

The regulatory framework for the protection of consumers, including small businesses, in the banking, insurance and financial services sector (including Managed Investment Schemes), with particular reference to:

- a. any failures that are evident in the:
 - i. current laws and regulatory framework, and
 - ii. enforcement of the current laws and regulatory framework, including those arising from resourcing and administration;
- b. the impact of misconduct in the sector on victims and on consumers;
- c. the impact on consumer outcomes of:
 - i. executive and non-executive remuneration,
 - ii. incentive-based commission structures, and
 - iii. fee-for-no-service or recurring fee structures;
- d. the culture and chain of responsibility in relation to misconduct within entities within the sector;
- e. the availability and adequacy of:
 - i. redress and compensation to victims of misconduct, including options for a retrospective compensation scheme of last resort, and
 - ii. legal advice and representation for consumers and victims of misconduct, including their standing in the conduct of bankruptcy and insolvency processes;
- f. the social impacts of consumer protection failures in the sector, including through increased reliance of victims on community and government services;
- g. options to support the prioritisation of consumer protection and associated practices within the sector; and
- h. any related matters.

1.2 On 14 February 2018, the Senate granted the committee an extension of time to report by 26 June 2018.¹ On 25 June 2018, the Senate granted the committee a further extension to report by 15 November 2018.²

1 *Journals of the Senate*, No. 86, 14 February 2018, p. 2717.

1.3 The committee held three public hearings, in Sydney on 26 April 2017 and 28 June 2017, and Melbourne on 22 February 2018.

1.4 Submissions to the inquiry closed on 7 March 2017. The committee received 147 submissions, including 22 confidential submissions.

Scope and structure of the report

1.5 For most of the course of this inquiry, external dispute resolution services were provided by the government through the Financial Ombudsman Service, the Credit and Investments Ombudsman and the Superannuation Complaints Tribunal. As such, this report focuses, where relevant, on the prior external dispute resolution arrangements. From 1 November 2018, the newly-established Australian Financial Complaints Authority replaced these dispute resolution bodies.³

1.6 This report focuses on a number of key issues in the current consumer protection system. The list of key issues is not intended to be comprehensive; rather, the report provides a 'snapshot' of concerns raised in evidence about consumer protections, or the lack thereof, in particular areas of the banking, insurance and financial services sector. Where relevant, the report references work undertaken to date by the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry.

1.7 The report consists of five chapters:

- Chapter 1 (this chapter) provides an overview of the conduct of the inquiry;
- Chapter 2 details previous and current inquiries relevant to this inquiry's terms of reference;
- Chapter 3 outlines the current legislative and regulatory frameworks governing the protection of consumers in the banking, insurance and financial services sector, as well as government bodies responsible for oversight and external dispute resolution;
- Chapter 4 gives a snapshot of issues raised in evidence in relation to the consumer protection system and specific sectors of the banking, insurance and financial services industry; and
- Chapter 5 outlines the work of the Royal Commission into the Banking, Superannuation and Financial Services Industry, the committee's conclusions, and recommendations arising from the inquiry.

2 *Journals of the Senate*, No. 102, 25 June 2018, p. 3271.

3 In March 2018, the *Treasury Laws Amendment (Putting Consumers First – Establishment of the Australian Financial Complaints Authority) Act 2018* was enacted to create the Australian Financial Complaints Authority (AFCA). See *Corporations Act 2001*, Sect 761A; the Hon Kelly O'Dwyer MP, Minister for Revenue and Financial Services, 'Putting Consumers First: Australian Financial Complaints Authority Takes Shape', *Media release*, 1 May 2018. See also Australian Financial Complaints Authority, *About AFCA*, <https://www.afca.org.au/about-afca/> (accessed 1 November 2018).

Acknowledgements

1.8 The committee thanks all submitters and witnesses who provided evidence to the inquiry. The committee also recognises that many submitters and witnesses have experienced considerable impacts as a result of their experiences engaging with previous and current consumer protection systems in the banking, insurance and financial services sector. The majority of submissions provided to the inquiry concerned individual complaints against financial service providers or external dispute resolution services. Unfortunately, the committee is not in a position to resolve individual disputes. However, this evidence was invaluable in identifying problems in the consumer protection system, and has helped to inform the committee's conclusions.

Chapter 2

Previous inquiries

2.1 This inquiry arose in the midst of a range of other inquiries investigating misconduct in the banking, superannuation and financial services industry, most of which have now been completed. It preceded the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry (Financial Services Royal Commission), and has some cross-over with the Royal Commission in terms of issues identified during the course of the inquiry.

2.2 This chapter outlines a number of the key inquiries that have been held since 2009, or are ongoing at the time of this report tabling. The chapter is divided into inquiries that have investigated or reviewed the system as a whole, inquiries that have looked at issues in particular sectors, and a brief overview of the work of the Financial Services Royal Commission. The chapter concludes with the committee view.

System-wide inquiries and reviews

2.3 Several previous inquiries examined aspects of the financial system as a whole, including consumer protections. These system-wide inquiries and reviews are outlined in Table 2.1.

Table 2.1: System-wide inquiries and reviews

Year	Author	Title
2017–present	The Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry	The Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry
2017	Senate Economics References Committee	Criminal, Civil and Administrative Penalties for White Collar Crime
2017	Parliamentary Joint Committee on Corporations and Financial Services	Whistleblower Protections in the Corporate, Public and Not-for-Profit Sectors
2017	Consumer Affairs Australia and New Zealand	Australian Consumer Law Review
2017	Professor Ian Ramsay et al.	Review of the Financial System External Dispute Resolution and Complaints Framework
2014	David Murray et al.	Financial System Inquiry

Inquiries into specific areas of the banking, insurance and financial services sector

2.4 Recent inquiries into specific aspects of the banking, insurance and financial services sector have covered the following areas:

- The regulatory framework underpinning the Australian Securities and Investments Commission (ASIC);
- Retail banking;
- Financial advice;
- General and life insurance;
- Managed investment schemes; and
- Loans and credit contracts.

Australian Securities and Investments Commission (ASIC) performance

2.5 As outlined in Chapter 3, the Australian Securities and Investments Commission (ASIC) is Australia's regulator of the corporate, financial services and consumer credit sectors. Several recent inquiries have directly and indirectly examined ASIC's performance. In 2016–17, a government appointed taskforce examined ASIC's enforcement regime. The Government agreed or agreed-in-principle with all of the inquiry's recommendations in April 2018, stating its intent to introduce some recommendations through legislation and to defer implementation of other recommendations until the Financial Services Royal Commission releases its findings.¹

Table 2.2: Inquiries into the Australian Securities and Investments Commission (ASIC)

Year	Author	Title
2017	Department of the Treasury	ASIC Enforcement Review
2016-present	Parliamentary Joint Committee on Corporations and Financial Services	Oversight of ASIC, the Takeovers Panel and the Corporations Legislation No.1 of the 45 th Parliament
2014	Senate Economics References Committee	The Performance of the Australian Securities and Investments Commission

1 See 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 25 June 2018).

Retail banking

2.6 A number of recent inquiries into retail banking outlined considerable concerns held among customers about consumer protections available to them when engaging with the sector. Areas of concerns raised in these inquiries included lack of competition in Australia's banking sector, remuneration for bank employees selling products to customers, and credit card interest, as outlined in the Senate Economics References Committee's inquiry in the 44th Parliament into credit card interest rates. The Australian Bankers' Association has recently commissioned two major reviews into the banking industry: the Retail Banking Remuneration Review (Sedgwick Review), and an independent review of the Code of Banking Practice.

Table 2.3: Inquiries into areas related to retail banking

Year	Author	Title
2017	Stephen Sedgwick	Retail Banking Remuneration Review
2017	Phil Khoury	Independent Review of the Code of Banking Practice
2016–present	House of Representatives Economics Committee	Review of the Four Major Banks
2015	Senate Economics References Committee	Matters Relating to Credit Card Interest Rates
2011	Senate Economics References Committee	Competition within the Australian Banking Sector

Financial advice

2.7 Other inquiries have examined consumer protections or lack thereof in the provision of financial advice, particularly in relation to conflicts of interest between the advice offered by financial service providers and their own remuneration structures.

2.8 Major inquiries into this area since 2009 are outlined in Table 2.4, including the Senate Economics References Committee's 2016 inquiry into agribusiness managed investment schemes, which examined the role of some financial advisers in promoting and selling forestry managed investment schemes.²

2 See Senate Economics References Committee, *Agribusiness Managed Investment Schemes: Bitter Harvest*, March 2016.

Table 2.4: Inquiries into financial advice

Year	Author	Title
2017	Senate Economics References Committee	Scrutiny of Financial Advice
2016	Senate Economics References Committee	Agribusiness Managed Investment Schemes
2014	Parliamentary Joint Committee on Corporations and Financial Services	Inquiry into Proposals to Lift the Professional, Ethical and Education Standards in the Financial Services Industry
2012	Richard St John	Compensation Arrangements for Consumers of Financial Services
2009	Parliamentary Joint Committee on Corporations and Financial Services	Financial Products and Services in Australia (Ripoll Inquiry)

Life and general insurance

2.9 General insurance covers motor vehicle, home and contents, consumer credit and travel insurance. Life insurance contracts provide for payments in the event of death, personal accident, disability or serious illness.³ Some forms of superannuation include provisions for life insurance cover.

2.10 This committee previously examined the issue of general insurance and expressed concerns about the lack of transparency in the industry with regard to product disclosure.⁴ The Insurance Council of Australia released a final report from its review of its General Insurance Code of Practice in June 2018. Recommendations included revising the Code to 'include enhanced protections for consumers experiencing Financial Hardship' and to require that insurers provide claimants with clarity about claims processes and reasons for decisions.⁵ Best Practice Principles included in the report noted that product disclosure statements were 'seen by consumers as too detailed and inaccessible' and proposed that insurers 'explore and

3 *Life Insurance Act 1995*, s. 9(1).

4 Senate Economics References Committee, *Australia's General Insurance Industry: Sapping Consumers of the Will to Compare*, August 2017, p. 41

5 Insurance Council of Australia, *Final Report: Review of the General Insurance Code of Practice*, June 2018, pp. 6, 10.

adopt new forms of electronic disclosure' to ensure that consumers understand the products they are purchasing.⁶

2.11 Several previous inquiries have identified upfront commissions for individuals selling policies as a major issue because of the link between high upfront commissions and poor consumer outcomes, particularly in the context of life insurance.⁷

2.12 The Chair's foreword to the Parliamentary Joint Committee on Corporations and Financial Services' report on the life insurance industry, tabled in March 2018, concluded that the 'consumer protections that currently apply to life insurance are substantially weaker than the consumer protections that apply to other financial and non-financial services'.⁸ The report particularly drew attention to 'grossly inadequate' consumer protections in the life insurance sector because of a 'very large number of exemptions' related to consumer protections in the legal framework regulating the sector.⁹ Table 2.5 outlines major recent inquiries into life insurance.

Table 2.5: Inquiries into life insurance

Year	Author	Title
2018	Parliamentary Joint Committee on Corporations and Financial Services	Inquiry into the Life Insurance Industry
2015	John Trowbridge	Report on Retail Life Insurance Advice
2014	Australian Securities and Investments Commission	Review of Retail Life Insurance Advice

Superannuation

2.13 Superannuation includes the following:

- retail super funds, run by banks or investment companies;
- industry super funds, run by entities catering to a specific industry; and

6 Insurance Council of Australia, *Final Report: Review of the General Insurance Code of Practice*, June 2018, p. 100.

7 Australian Securities and Investments Commission, *Report 413: Review of Retail Life Insurance Advice*, October 2014, p. 5; David Murray, *Financial System Inquiry: Final Report*, November 2014, p. 217; John Trowbridge, *Review of Retail Life Insurance Advice: Final Report*, March 2015, p. 6.

8 Parliamentary Joint Committee on Corporations and Financial Services, *Life Insurance Industry*, March 2018, p. ix.

9 Parliamentary Joint Committee on Corporations and Financial Services, *Life Insurance Industry*, March 2018, p. 47.

- self-managed super funds, which are subject to different regulations than other forms of superannuation.¹⁰

2.14 Recent reforms introduced by the Government in response to recommendations arising from past inquiries into superannuation include the introduction of MySuper, a default superannuation system intended to be 'simple' and 'cost-effective'.¹¹ From July 2017, all member accounts in default investment options were required to be invested in MySuper products.

2.15 In 2017, this committee examined the failure of some employers to pay compulsory superannuation into superannuation accounts for employees. The committee made 32 recommendations with a focus on enhancing transparency and compliance.¹² As of November 2018, the Government is yet to respond to the report's recommendations.

Table 2.6: Inquiries into superannuation

Year	Author	Title
2017	Senate Economics References Committee	Wage Theft and Non-Compliance of the Superannuation Guarantee
2016	Productivity Commission	Competitiveness and Efficiency of Superannuation
2015	Department of the Treasury	Super System Review

Loans and credit contracts

2.16 A number of inquiries have examined loans and credit contracts, including farm finance, small business loans and small amount credit contracts (see Table 2.7). A common theme running through these inquiries is the asymmetrical power relationship between lenders and borrowers considered to be in financial difficulty. For example, the Parliamentary Joint Committee on Corporations and Financial Services found in its inquiry into the impairment of customer loans that in some of the cases it examined, there was 'a persistent pattern of abuse of the almost complete asymmetry of power in the relationship between lender and borrower'.¹³ In particular, the inquiry's report dedicated a chapter to the role of property valuers in relation to

10 ASIC's Money Smart, *Types of super funds*, 18 October 2017, <https://www.moneysmart.gov.au/superannuation-and-retirement/how-super-works/choosing-a-super-fund/types-of-super-funds> (accessed 22 June 2018).

11 Treasury, *MySuper*, <https://treasury.gov.au/programs-and-initiatives-superannuation/mysuper/> (accessed 25 June 2018).

12 Senate Economics References Committee, *Superbad – Wage Theft and Non-Compliance of the Superannuation Guarantee*, May 2017.

13 Parliamentary Joint Committee on Corporations and Financial Services, *Impairment of Customer Loans*, May 2016, p. ix. See also Australian Small Business and Family Enterprise Ombudsman, *Inquiry into Small Business Loans*, December 2016, p. 6; Select Committee on Lending to Primary Production Customers, *Final Report*, December 2017, p. 43.

bank loan re-valuations, and a chapter to issues raised about receivers and investigative accountants. The Government is yet to provide a response to the committee's recommendations.

Table 2.7: Inquiries into loans and credit contracts

Year	Author	Title
2017	Senate Select Committee on Lending to Primary Production Customers	Lending to Primary Production Customers
2016	Australian Small Business and Family Enterprise Ombudsman	Inquiry into Small Business Loans (Carnell Report)
2016	Department of the Treasury	Review of the Small Amount Credit Contract Laws
2016	Parliamentary Joint Committee on Corporations and Financial Services	The Impairment of Customer Loans

Other relevant inquiries

2.17 Other recent relevant inquiries include:

- The Senate Economics References Committee's inquiry into agribusiness managed investment schemes, tabled March 2016;
- ASIC's review of mortgage broker remuneration (2017);
- This committee's inquiry into Australia's general insurance industry (2017); and
- This committee's inquiry into credit and financial services targeted at Australians at risk of financial hardship (ongoing).

Financial Services Royal Commission

2.18 The Financial Services Royal Commission was established on 14 December 2017. Commissioner the Hon. Kenneth Hayne AC QC tabled an interim report on the Financial Services Royal Commission's work on 28 September 2018.

2.19 The Financial Services Royal Commission's interim report summarised seven key issues, each of which is briefly outlined below:

- Concerns about consumer lending, such as the role of intermediaries (mortgage brokers, mortgage aggregators, financial advisers and financial services licensees), communication with customers and responsible lending practices.¹⁴

14 Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry (Financial Services Royal Commission), *Interim Report*, Volume 1, September 2018, p. 327.

- Issue relating to financial advice, specifically the culture and incentives, conflicts of interest and duty (including confusion of roles) and the effectiveness of regulators.¹⁵
- General issues concerning lending practices to small and medium enterprises – specifically, questions concerning the legal framework that governs lending to these enterprises – as well as the content of Code of Banking Practice obligations, third party guarantors and dispute resolution approaches by the Financial Ombudsman Service and the Australian Financial Complaints Authority.¹⁶
- Matters relating to the lending practices to the agriculture sector. The interim report identified four issues, which relate to the revaluation of securities, access to banking services and support, changes to conditions of lending and 'enforcement by appointment of external administrators'.¹⁷
- The response of financial services to the needs and vulnerabilities experienced by Indigenous Australians, in particular those living in remote communities. The interim report noted issues relating to access to services, account fees and the application of standard identification requirements, along with concerns about funeral insurance and predatory behaviour by insurers and salespersons.¹⁸
- Consideration of the laws that govern financial services entities and their conduct, and ways in which the regulators (ASIC and the Australian Prudential Regulation Authority) had responded to matters raised during the Financial Services Royal Commission.¹⁹
- Concerns that the misconduct identified and criticised during the Financial Services Royal Commission 'was conduct that provided a financial benefit to the individuals and entities concerned' and that the 'governance and risk management practices of the entities did not prevent the conduct'. Further, the 'culture and conduct of the banks was driven by, and was reflected in, their remuneration practices and policies'.²⁰

2.20 The interim report considered each of these issues and listed a series of questions to be addressed in the final phase of the Royal Commission's investigation.

2.21 At the release of the interim report, the Financial Services Royal Commission had received 10,140 submissions, with 61 per cent related to the banking sector, 12 per cent related to superannuation and nine per cent related to financial advice. The

15 Financial Services Royal Commission, *Interim Report*, Volume 1, September 2018, p. 329.

16 Financial Services Royal Commission, *Interim Report*, Volume 1, September 2018, p. 333.

17 Financial Services Royal Commission, *Interim Report*, Volume 1, September 2018, p. 335.

18 Financial Services Royal Commission, *Interim Report*, Volume 1, September 2018, p. 337.

19 Financial Services Royal Commission, *Interim Report*, Volume 1, September 2018, p. 339.

20 Financial Services Royal Commission, *Interim Report*, Volume 1, September 2018, p. 340.

Financial Services Royal Commission has also published 29 background papers on its website, covering, for example, mortgage broking, everyday consumer lending, the legal framework governing financial advice, small business loans, general insurance, and Aboriginal and Torres Strait Islander consumers of financial products.

2.22 Areas that the Financial Services Royal Commission has covered in its public hearings up to October 2018 included consumer lending, financial advice, loans to small and medium enterprises, and farm finance (see Table 2.8). On 19 November 2018, the Financial Services Royal Commission will commence its final round of hearings, which will consider the policy questions arising from the interim report and the first six rounds of hearings. The final report is scheduled to be issued by 1 February 2019. Chapter 5 of this report provides further details on the events leading to the establishment of the Royal Commission.

Table 2.8: Issues addressed in the Financial Services Royal Commission hearings as of 29 October 2018²¹

Round	Date	Issues
Round 1	13–23 March 2018	Consumer lending practices, including residential mortgages, car finance, credit cards, add-on insurance, credit offers and account administration
Round 2	16–27 April 2018	Financial advice, including fees for no service, investment platform fees, inappropriate financial advice, improper conduct by financial advisers and the disciplinary regime for the financial advice profession
Round 3	21 May–1 June 2018	Loans to small and medium enterprises, including responsible lending to small businesses, bank enforcement, management and monitoring of business loans, unfair contract terms and the Code of Banking Practice
Round 4	25 June–6 July 2018	Issues affecting Australians in remote and regional communities, including farming finance and interactions between Aboriginal and Torres Strait Islander people and financial service entities

21 See Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry, *Public Hearings* (as at 29 October 2018), <https://financialservices.royalcommission.gov.au/public-hearings/Pages/default.aspx> (accessed 29 October 2018).

Round 5	6–17 August 2018	How registrable superannuation entities licensees fulfil their duties of regulated superannuation funds, and how structural or governance arrangements affect the fulfilment of those duties
Round 6	10–21 September 2018	Issues related to the sale and design of life insurance and other general insurance products, including the handling of claims under life insurance and general insurance policies, and life insurance administration by superannuation trustees

Committee view

2.23 The number of recent inquiries into the banking, insurance and financial services sector indicates that there are significant problems in the current system, particularly in the context of consumer protections that are in place to prevent or mitigate harm caused by misconduct and unethical actions of financial entities. The breadth and extent of issues that the Financial Services Royal Commission has brought to light demonstrate that despite the reforms arising from the inquiries outlined above, major systemic and structural issues remain in the system as a whole, and these continue to negatively impact consumers.

2.24 While the committee remains optimistic about the work of the Royal Commission, there are areas that the Royal Commission is unable to investigate, given time constraints and its terms of reference. Further, it is not yet clear to what extent the Financial Services Royal Commission will recommend structural changes to the system as a whole and whether these recommendations will address deficiencies in current consumer protections systems. The committee anticipates the Financial Services Royal Commission's final report, and commends Royal Commissioner Kenneth Hayne AC QC and his team for their work.

2.25 In addition to the Financial Services Royal Commission, the committee has commenced an inquiry into credit and financial services targeted at Australians at risk of financial hardship to further address and support those who have suffered from the actions of the financial services sector.

Chapter 3

Regulation and oversight of the current consumer protection system

3.1 Australian financial services licensees are required by law to meet particular product and service standards, such as disclosure of terms and conditions and their own remuneration structures, as well as to ensure, in particular instances, that they are working in a client's best interests. In instances where consumers believe that an entity has engaged in misconduct or behaved unethically, financial services licensees must have their own internal dispute resolution procedures in place that meet particular regulatory requirements, and they must be members of an approved external dispute resolution (EDR) scheme.

3.2 This chapter outlines the key legislation that provides consumer protections in the banking, insurance and financial sectors. It also discusses the government bodies responsible for oversight and the features of government-approved EDR schemes to which consumers can turn should they be unhappy with the resolution of complaints via the internal dispute resolution schemes of financial services licensees. The chapter ends with the view of the committee concerning the EDR system.

3.3 It should be noted that the three EDR schemes that existed for most of the course of this inquiry merged and were replaced by the Australian Financial Complaints Authority on 1 November 2018.¹

Legislation

3.4 Australia's consumer protection system for the banking, insurance and financial sectors is underpinned by legislation intended to regulate the relevant industries. This legislation sets out:

- how entities are required to engage and interact with consumers;
- how disputes between consumers and entities should be resolved; and
- the powers of government-established bodies responsible for oversight and external dispute resolution.

3.5 The primary pieces of Commonwealth legislation setting out consumer rights and obligations for entities include, among others, the *Corporations Act 2001* (Corporations Act) and the Australian Consumer Law, as set out in the *Competition*

1 In March 2018, the *Treasury Laws Amendment (Putting Consumers First – Establishment of the Australian Financial Complaints Authority) Act 2018* was enacted to create the Australian Financial Complaints Authority (AFCA). See *Corporations Act 2001*, Sect 761A; and the Hon Kelly O'Dwyer MP, Minister for Revenue and Financial Services, 'Putting Consumers First: Australian Financial Complaints Authority Takes Shape', *Media release*, 1 May 2018. See also Australian Financial Complaints Authority, *About AFCA*, <https://www.afca.org.au/about-afca/> (accessed 1 November 2018).

and Consumer Act 2010.² The Corporations Act requires financial services licensees with retail clients to have an internal dispute resolution system in place, to hold adequate professional indemnity insurance and to be a member of at least one EDR scheme approved by the Australian Securities and Investments Commission (ASIC).³

3.6 Other legislation that sets out consumer protections in specific industries or areas of the banking, insurance and financial sector includes:

- *National Consumer Credit Protection Act 2009*, which also includes the National Credit Code
- *Superannuation (Resolution of Complaints) Act 1993*
- *Superannuation Industry (Supervision) Act 1993*
- *Insurance Contracts Act 1984*
- *Insurance Act 1973*
- *Life Insurance Act 1995*.⁴

Government bodies responsible for oversight

3.7 Three government-established bodies are responsible for ensuring that industry complies with legislation and regulations governing the banking, insurance and financial services sector. Two of these, ASIC and the Australian Prudential Regulation Authority (APRA), were established in 1998 in response to the 1997 Financial System Inquiry, which proposed the creation of a dual regulatory system with APRA responsible for prudential regulation and ASIC responsible for regulating corporations, financial market integrity and financial consumer protection.⁵ The third body, the Australian Taxation Office, is responsible for regulating self-managed super funds.⁶

3.8 It should be noted that the Australian Competition and Consumer Commission (ACCC) is responsible for promoting competition and fair trading and provision of

2 Australian Consumer Law, *Legislation: The Australian Consumer Law*, <http://consumerlaw.gov.au/the-australian-consumer-law/legislation/> (accessed 30 October 2018).

3 *Corporations Act 2001*, para 912A(2)(c); Corporations Regulations, section 7.6.02AAA(1).

4 For a complete list, see APRA, *Enabling legislation*, <https://www.apra.gov.au/enabling-legislation> (accessed 30 October 2018); Australian Securities and Investments Commission, *Laws we administer*, <https://asic.gov.au/about-asic/what-we-do/laws-we-administer/> (accessed 30 October 2018).

5 Australian Institute of Superannuation Trustees (AIST), *Submission 9*, pp. 13–14; Stan Wallis, *Financial System Inquiry*, March 1997, Recommendations 1 and 31.

6 Australian Taxation Office, *How your SMSF is regulated*, 16 June 2015, <https://www.ato.gov.au/Super/Self-managed-super-funds/Administering-and-reporting/How-we-help-and-regulate-SMSFs/How-your-SMSF-is-regulated/> (accessed 30 October 2018).

consumer protection in financial markets as a whole.⁷ Primary responsibility for oversight and regulatory activities in relation to consumer protections in the corporate, credit and financial services sector rests with ASIC. Because of the overlap of their activities, ASIC and the ACCC have a memorandum of understanding in place to share information and consult where appropriate on 'recent judgements, current law reform, policy issues, media releases and other matters of mutual interest'.⁸

Australian Prudential Regulation Authority (APRA)

3.9 APRA is the prudential regulator of the Australian financial services industry – that is, its role is to ensure that financial entities are able to manage risks and have sufficient capital to meet their obligations.⁹ APRA is responsible for prudential supervision of all authorised deposit-taking institutions (including banks, building societies and credit unions), private health insurers, life and general insurance companies, and most of the superannuation industry, excluding self-managed superannuation funds.¹⁰

Australian Securities and Investments Commission (ASIC)

3.10 ASIC was established under the *Australian Securities and Investments Commission Act 2001*. ASIC described itself as 'Australia's corporate, markets, financial services and consumer credit regulator'. Its primary purpose is to monitor and promote 'market integrity and consumer protection in relation to the Australian financial system'.¹¹

3.11 ASIC's functions include:

- protecting consumers from poor conduct;
- sanctioning or removing individuals or firms that breach the law in ways that harm consumers; and
- providing consumers with information that will help them to make better financial decisions.¹²

7 *Memorandum of Understanding between the Australian Securities and Investments Commission and the Australian Competition and Consumer Commission*, p. 1, <https://download.asic.gov.au/media/2065149/mou-acc-asic.pdf> (accessed 30 October 2018).

8 *Memorandum of Understanding between the Australian Securities and Investments Commission and the Australian Competition and Consumer Commission*, p. 2, <https://download.asic.gov.au/media/2065149/mou-acc-asic.pdf> (accessed 30 October 2018).

9 APRA, *About APRA*, <https://www.apra.gov.au/about-apra> (accessed 30 October 2018); Treasury, *Australian Prudential Regulation Authority: Section 1: Agency Overview and Resources*, Portfolio Budget Statements 2011–12, <https://treasury.gov.au/publication/portfolio-budget-statements-2011-12/portfolio-budget-statements-2011-12/australian-prudential-regulation-authority/> (accessed 30 October 2018).

10 APRA, *Industry supervision*, <https://www.apra.gov.au/supervision> (accessed 30 October 2018).

11 Australian Securities and Investments Commission (ASIC), *Submission 36*, p. 3.

12 Australian Securities and Investments Commission (ASIC), *Submission 36*, p. 3.

3.12 ASIC requires the internal dispute resolution procedures of financial services entities to meet particular standards or requirements that ASIC sets, such as maximum timeframes to resolve disputes.¹³

3.13 Where ASIC discovers breaches of the law and misconduct on the part of entities, it may negotiate outcomes with industry, such as an enforceable undertaking, or 'a written undertaking...that an entity or person will operate in a certain way'. It is also able to take the following measures:

- enforcement action, including criminal action;
- civil action, such as civil penalty proceedings; and
- administrative action, such as banning or disqualifying individuals from the financial services sector.¹⁴

3.14 ASIC is empowered to take compensatory action, or recover compensation on behalf of consumers. However, ASIC stated in its submission that 'recovery of compensation is ordinarily left to private litigation and class actions'.¹⁵ ASIC can undertake a class action to obtain compensation for a group of consumers or investors who have suffered loss from the same type of misconduct, if it determines that it is in the public interest to do so.¹⁶

3.15 ASIC emphasised that its 'regulatory role does not involve preventing all consumer losses or ensuring full compensation for consumers in all instances where losses arise'.¹⁷ In some instances, ASIC may make a determination requiring a firm to pay compensation for consumer losses, but the firm may be insolvent and unable to pay.

3.16 Until 1 November 2018, with the establishment of the Australian Financial Complaints Authority, ASIC was also responsible for oversight of two EDR schemes: the Financial Ombudsman Service and the Credit and Investments Ombudsman. These are outlined later in this chapter. ASIC's oversight of these schemes did not extend to reviews of individual cases or scheme decisions.¹⁸

Australian Financial Services scheme

3.17 ASIC administers the Australian financial services (AFS) scheme, which requires all businesses providing financial services to hold an AFS licence, except authorised representatives of AFS licensees and those with exemptions.

13 Australian Securities and Investments Commission, *Regulatory Guide 165: Licensing: Internal and External Dispute Resolution*, February 2018.

14 Australian Securities and Investments Commission (ASIC), *Submission 36*, pp. 4–5.

15 Australian Securities and Investments Commission (ASIC), *Submission 36*, p. 5, 97.

16 Australian Securities and Investments Commission (ASIC), *Submission 36*, p. 73.

17 Australian Securities and Investments Commission (ASIC), *Submission 36*, p. 71.

18 Australian Securities and Investments Commission (ASIC), *Submission 36*, p. 62.

3.18 As outlined above, all AFS licensees, as well as credit licensees and trustee companies, must have in place:

(a) a dispute resolution system, which includes an IDR [internal dispute resolution] procedure and membership of an ASIC-approved EDR scheme; and

(b) arrangements for compensating retail clients and consumers for loss or damage due to breaches of the financial services or credit laws. Unless the licensee is exempt (i.e. because they are prudentially regulated) they must generally hold adequate professional indemnity insurance cover.¹⁹

External dispute resolution schemes

3.19 The two non-government ASIC-approved EDR schemes, prior to November 2018, were the Financial Ombudsman Service (FOS) and the Credit and Investments Ombudsman (CIO). A third scheme, the Superannuation Complaints Tribunal (SCT), was not subject to ASIC oversight.²⁰ In the second half of 2018, existing EDR schemes shifted to the Australian Financial Complaints Authority, which began receiving complaints on 1 November 2018. The evidence received in this inquiry concerned the prior schemes; as such, the following section begins by describing the functions of FOS, CIO and the SCT, before outlining the details of the new scheme.

3.20 The ability of consumers to make a complaint to a particular scheme depended on which scheme the particular financial services provider or credit service provider had joined.²¹

3.21 Between them, FOS and CIO dealt with around 40,000 disputes each year. ASIC's oversight of the two schemes focused on determining whether 'they operate[d] in accordance with the principles of independence, fairness, efficiency, effectiveness, and accountability', and did not involve ASIC reviewing individual cases or scheme decisions.²²

Financial Ombudsman Service (FOS)

3.22 FOS, as of April 2017, handled 87 per cent of complaints lodged with the three EDR bodies. Its jurisdiction covered 99 per cent of the categories of dispute.²³

3.23 FOS was based on an industry Ombudsman model and funded by industry, with an independent board of consumer representatives and financial services industry

19 Australian Securities and Investments Commission (ASIC), *Submission 36*, p. 62.

20 Australian Securities and Investments Commission (ASIC), *Submission 36*, p. 63; Australian Securities and Investments Commission (ASIC), *Regulatory Guide 139: Approval and Oversight of External Dispute Resolution Schemes*, June 2013, p. 5.

21 Australian Securities and Investments Commission (ASIC), *Submission 36*, p. 73.

22 Australian Securities and Investments Commission (ASIC), *Submission 36*, p. 62.

23 Mr Shane Tregillis, Chief Ombudsman, Financial Ombudsman Service Australia, *Senate Hansard*, 26 April 2017, p. 27.

representatives monitoring its performance.²⁴ FOS outlined in its submission to the 2016 Review of the Financial System External Dispute Resolution Framework that industry Ombudsman models aim to provide 'independent, impartial and fair resolution of disputes arising from contracts and transactions between consumers and private businesses'. Such a model, FOS argued, provided consumers with accessible and free alternative sources of dispute resolution to courts.²⁵

3.24 FOS only dealt with disputes valued \$500,000 or less. Its compensation cap as of 1 January 2018 was \$323,500 for all disputes except general insurance broking (\$174,000), income stream life insurance (\$8,700 per month) and uninsured third party motor vehicle claims (\$5,000). There was also a cap on consequential financial losses of \$3,500 per claim and a cap on non-financial losses of \$3,000.²⁶

3.25 Mr Shane Tregillis, the Chief Ombudsman of FOS, emphasised that in the first instance, customers dealt directly with internal dispute resolution systems of the financial entities with which they had a dispute:

It is sometimes forgotten that FOS is not the primary resolver of customer complaints in the financial sector. This is the role of the financial services firms dealing directly with their customers. We continue to subscribe to the view that it is better for both parties if firms can resolve disputes and problems directly with their customers. Of course, it is even better to deal with the root causes of customer problems to avoid them occurring in the first place.²⁷

3.26 FOS outlined on its website that between 1 January 2010 and 31 December 2016, 35 financial service providers were unwilling or unable to comply with 143 FOS determinations, affecting 203 customers. Consumers received no payments at all from 105 determinations that FOS made in their favour. Slightly more than \$13 million of unpaid determinations remained outstanding. More than half (57 per cent) of non-compliant financial service providers were financial planners and advisers, followed by operators of managed investment schemes (11 per cent) and credit providers (9 per cent).²⁸

24 Financial Ombudsman Service Australia, *Our board*, <http://fos.org.au/about-us/our-board/> (accessed 26 June 2018).

25 Financial Ombudsman Service Australia, *Submission to Review of the Financial System External Dispute Resolution Framework*, October 2016, <http://fos.org.au/custom/files/docs/fos-submission-to-edr-review.pdf> (accessed 30 October 2018), p. 12.

26 Financial Ombudsman Service Australia, *Fact Sheet: How FOS Resolves Disputes and Our Terms of Reference*, https://www.fos.org.au/custom/files/docs/fact_sheet_our_dispute_process_and_terms_of_refere_ncepdf.pdf (accessed 30 October 2018), p. 2.

27 Mr Shane Tregillis, Chief Ombudsman, Financial Ombudsman Service Australia, *Senate Hansard*, 26 April 2017, p. 26.

28 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 30 October 2018).

3.27 Mr Tregillis noted in the April 2017 hearing that the inability of firms to pay compensation to victims of misconduct as determined in FOS decisions affected the reputation of the entire EDR system:

...we have something like \$13 million of unpaid determinations, largely because the firms involved have gone into administration or insolvency. It undermines credibility in the system if you are able to access dispute resolution and get compensation in your favour but you do not get paid.²⁹

3.28 Financial service providers were unable to pay for a range of reasons. For example, some were in administration or liquidation, or had insufficient funds to meet their obligations. FOS stated that 'Our experience is that professional indemnity insurance isn't an adequate compensation mechanism for consumers where companies have gone into administration or are insolvent'.³⁰

Credit and Investments Ombudsman (CIO)

3.29 CIO operated mainly in the credit sector, as insurers and banks were generally members of FOS. Like FOS, CIO was funded by industry membership and fees levied on its members. CIO's members included mortgage brokers, non-bank lenders, small amount lenders and time share operators, most of which were sole traders and small businesses.³¹

3.30 Similarly to FOS, CIO had a claim limit of \$500,000, and its monetary compensation limits for complaints, as of 1 January 2018, was \$323,500.³²

3.31 As of November 2016, CIO had unpaid determinations worth approximately \$414,443.³³ CIO noted in its submission to the Review into Dispute Resolution and Complaints Framework that over 80 per cent of its unpaid determinations resulted from two determinations against a single mortgage broker.³⁴

Superannuation Complaints Tribunal (SCT)

3.32 The SCT dealt with complaints against trustees and particular insurers as outlined in the *Superannuation (Resolution of Complaints) Act 1993*. It reviewed

29 Mr Shane Tregillis, Chief Ombudsman, Financial Ombudsman Service Australia, *Committee Hansard*, 26 April 2017, p. 30.

30 Financial Ombudsman Service Australia, *The Financial Ombudsman Service Circular: Unpaid determinations*, Special issue – April 2014, <https://www.fos.org.au/the-circular-special-issue-april-2014/fos-forum/unpaid-determinations/> (accessed 30 October 2018).

31 Credit and Investments Ombudsman Limited, *Submission 67*, pp. 1–2.

32 Credit & Investments Ombudsman, *CIO rules*, <https://www.cio.org.au/about-us/cio-rules.html> (accessed 27 June 2018); Credit and Investments Ombudsman Limited, *Credit and Investments Ombudsman Rules*, 10th edition, 15 August 2016, p. 7.

33 Australian Securities and Investments Commission (ASIC), *Submission 36*, p. 98.

34 Credit & Investments Ombudsman, *Submission to Review into Dispute Resolution and Complaints Framework*, pp. 6–7, <https://www.cio.org.au/assets/27886928/Submission%20-%20Last%20Resort%20Compensation%20Scheme%20-%20June%202017.pdf> (accessed 30 October 2018).

decisions and the conduct of superannuation providers of regulated superannuation funds, annuities and deferred annuities, and retirement savings accounts.³⁵ There was no limit on the monetary value of claims brought to the SCT.³⁶

3.33 The SCT was not required to provide ASIC with regular operational and disputes data, as ASIC was not responsible for oversight of the SCT, although ASIC noted that it did regularly meet with the SCT.³⁷

3.34 An issues paper released by the Treasury in September 2016 stated that because of 'the nature of prudential regulation in the superannuation system, the SCT does not have any unpaid determinations'.³⁸

Australian Financial Complaints Authority (AFCA)

3.35 In March 2018, the *Treasury Laws Amendment (Putting Consumers First – Establishment of the Australian Financial Complaints Authority) Act 2018* was enacted to create the Australian Financial Complaints Authority (AFCA). The AFCA replaced the SCT, FOS and the CIO and, as of 1 November 2018, deals with all consumer complaints about products and services provided by financial entities. AFCA is regulated by ASIC.³⁹

3.36 AFCA has the following monetary limits on complaints:

- a monetary limit of \$1 million per complaint except for complaints concerning superannuation, credit facilities provided to a small business where this complaint is lodged by a borrower (see below), and complaints to set aside a guarantee supported by security over the guarantor's primary place of residence; and
- a monetary limit of more \$5 million for complaints about a small business credit facility.⁴⁰

35 Superannuation Complaints Tribunal, *What we do*, <http://www.sct.gov.au/pages/about-us/what-we-do> (accessed 30 October 2018).

36 Australian Securities and Investments Commission (ASIC), *Submission 36*, p. 73.

37 Australian Securities and Investments Commission (ASIC), *Submission 36*, p. 63; Australian Securities and Investments Commission (ASIC), *Regulatory Guide 139: Approval and Oversight of External Dispute Resolution Schemes*, June 2013, p. 5.

38 The Treasury, *Review of the Financial System External Dispute Resolution Framework: Consultation on the Financial System External Dispute Resolution Framework*, September 2016, p. 24

39 Parliamentary Library, *Bills Digest No. 55, 2017–18: Treasury Laws Amendment (Putting Consumers First – Establishment of the Australian Financial Complaints Authority) Bill 2017*, 4 December 2017, p. 5.

40 Australian Financial Complaints Authority (AFCA), *Complaints Resolution Scheme Rules*, 1 November 2018, <https://www.afca.org.au/custom/files/docs/20180920-afca-rules.pdf> (accessed 30 October 2018), pp. 26–27.

3.37 AFCA has the following monetary limits that may be awarded for complaints other than superannuation complaints, which will be subject to indexation on 1 January 2021 and every three years after:

- Claims on life insurance or general insurance concerning income stream risk or advice about such a contract: \$13,400 per month;
- General insurance broking: \$250,000;
- Uninsured motor vehicle: \$15,000;
- Credit facility: variable, depending on the type of complainant and the type of loan;
- All other direct financial loss claims, excluding superannuation complaints: \$500,000;
- Claims for indirect financial loss: \$5,000; and
- Claims for non-financial loss: \$5,000.⁴¹

3.38 There is no monetary limit on the amount that may be awarded to a complainant who has made a superannuation complaint.⁴²

Committee view

3.39 The evidence provided to this inquiry about consumers' experiences with external dispute resolution (EDR) schemes concerned the three prior EDR schemes that existed when the inquiry took evidence: the Financial Ombudsman Service (FOS), the Credit and Investments Ombudsman (CIO) and the Superannuation Complaints Tribunal (SCT). Most submissions outlining issues with the current EDR system were related to FOS determinations.

3.40 The committee notes that in response to the recommendations of the 2017 Ramsay review of the external dispute resolution and complaints framework in the financial system, the government has established the Australian Financial Complaints Authority, which began receiving complaints on 1 November 2018.

3.41 The effectiveness of this new body, combining the work of FOS, CIO and the SCT, remains to be seen. The committee reserves its opinion, but notes that multiple previous inquiries, as well as much of the evidence in this inquiry, outlined significant concerns regarding the prior EDR schemes. It is hoped that the new scheme has taken steps to prevent similar concerns arising.

3.42 It should be remembered that if the financial sector as a whole were more robust in terms of its consumer protections, and if non-compliance with regulatory

41 Australian Financial Complaints Authority (AFCA), *Complaints Resolution Scheme Rules*, 1 November 2018, <https://www.afca.org.au/custom/files/docs/20180920-afca-rules.pdf> (accessed 30 October 2018), p. 35.

42 Australian Financial Complaints Authority (AFCA), *Complaints Resolution Scheme Rules*, 1 November 2018, <https://www.afca.org.au/custom/files/docs/20180920-afca-rules.pdf> (accessed 30 October 2018), p. 31.

requirements and unethical behaviour were rare exceptions to a culture of putting the interests of the consumer first, demands for any EDR body would be reduced. The work of this committee and of the Financial Services Royal Commission indicates the extent of misconduct and unethical behaviour on the part of financial service providers over the course of many years, despite reassurances to the contrary. EDR schemes are often a last resort for consumers unable to afford legal proceedings, and the evidence provided to this inquiry suggested that most consumers, when faced with the resources of large financial entities, do not choose to initiate legal proceedings in any case. EDR schemes should not work as a 'band-aid' to patch up a leaky broken system, but rather work effectively with regulation and penalties to ensure that financial entities are behaving ethically and according to the requirements of the law, and are incentivised to do so.

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

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.

Chapter 5

Conclusion

5.1 This inquiry arose in the midst of multiple inquiries into the banking, insurance and financial services sector. The inquiry accepted submissions until March 2017, and the first hearings were held in mid-2017. The evidence from this and other inquiries gave weight to the argument that a royal commission into the sector was urgently needed to investigate systemic issues and illuminate potential breaches of the law, misconduct and behaviour falling below community standards and expectations. The Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry (Financial Services Royal Commission) was established in December 2017.

5.2 This chapter outlines the circumstances that led to the announcement of the Financial Services Royal Commission, including industry and government positions. It then discusses some of the major themes arising from the Royal Commission's interim report. The chapter concludes with a reflection on the evidence provided to the committee, the committee's view on the work of the Royal Commission and the committee's recommendations.

Lack of industry and government support for a royal commission

5.3 The Financial Services Royal Commission commenced during the course of the committee's inquiry, and its preliminary findings correlate with many of the findings of the committee. As outlined in Chapter 2 and referenced throughout this report, the Financial Services Royal Commission's interim report identified systemic and cultural issues with the banking, superannuation and financial services sector and inadequacies in the regulatory system.

5.4 The issues outlined in this chapter, and those detailed in the Financial Services Royal Commission's interim report, conflict with the position formerly held by the banking industry and the Commonwealth Government.

Major banks

5.5 Prior to the announcement of the Financial Services Royal Commission, representatives from the major banks held the view that a royal commission into the banking industry was unnecessary and the banks were adequately addressing community concerns. The major banks made this case on numerous occasions during the House of Representatives (HoR) Standing Committee on Economics' review of Australia's four major banks. For example, on 8 March 2017, Westpac's Chief Executive Officer (CEO) Mr Brian Hartzler opined that a 'royal commission would be extremely expensive for everybody involved and would not have the benefit of immediate action' and that 'the best way to restore confidence is to address the very

real issues that are raised and take action on them to fix them'.¹ Mr Hartzler added that the industry is:

...operating in a highly regulated environment with tremendously active regulators, as we have seen, and we as an industry have demonstrated and will continue to demonstrate that we are taking these matters very seriously and we are taking action... We have never said there is nothing wrong, and I have nothing to hide.²

5.6 Mr Hartzler further argued that a royal commission would take unnecessary time and resources, and stated that the banks are 'an open book...we have demonstrated through our actions that the legitimate issues that have been raised by the community are being taken seriously and are being addressed'.³

5.7 The Australia and New Zealand Banking Group (ANZ) shared a similar sentiment. When asked whether it could see utility in a royal commission, its CEO Mr Shayne Elliott said that it is 'hard to know exactly what the benefit would be' and that:

...the conduct and the operation of the industry today is better than it was in the past and we're making real progress to restore the community's confidence and trust in our system. We have a very, very important role to play in the economy. I think that should be our primary focus. Yes, we should fix all these things. I personally believe that a royal commission would be distracting.⁴

5.8 In March 2017, the National Australia Bank (NAB) told the HoR Standing Committee on Economics that it did 'not believe a royal commission is necessary because the industry is well governed, well regulated, and is actually addressing the issues that need to be addressed'.⁵ Mr Ian Narev, the former CEO of the Commonwealth Bank of Australia (CBA), stated:

I think the message that the convening of a royal commission would send about policymakers over the last decade, regulators over the last decade and

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- 1 Mr Brian Hartzler, Chief Executive Officer (CEO) and Managing Director, Westpac Group, House of Representatives Standing Committee on Economics, Review of the four major banks (second report), *Committee Hansard*, 8 March 2017, p. 14.
 - 2 Mr Brian Hartzler, Chief Executive Officer (CEO) and Managing Director, Westpac Group, House of Representatives Standing Committee on Economics, Review of the four major banks (second report), *Committee Hansard*, 8 March 2017, p. 14.
 - 3 Mr Brian Hartzler, CEO and Managing Director, Westpac Group, House of Representatives Standing Committee on Economics, Review of the four major banks (third report), *Committee Hansard*, 11 October 2017, p. 28.
 - 4 Mr Shayne Elliott, CEO, Australia and New Zealand Banking Group (ANZ), House of Representatives Standing Committee on Economics, Review of the four major banks (third report), *Committee Hansard*, 11 October 2017, p. 59.
 - 5 Mr Andrew Thorburn, CEO, National Australia Bank (NAB), House of Representatives Standing Committee on Economics, Review of the four major banks (second report), *Committee Hansard*, 3 March 2017, p. 32.

bank management and governments over the last decade would not be positive for the industry, for strength and for the perception of our industry as unquestionably strong.⁶

The Australian Bankers' Association

5.9 The argument that the banking industry is addressing community concerns and is adequately addressing issues through self-regulation was also made by the Australian Bankers' Association (ABA). It submitted that the 'banking industry has heard the concerns of Australians and is committed to taking action so customers receive a better experience'.⁷ Further, the ABA explained that 'trust and confidence in the banking and financial services industry' is achieved through institutional leadership, self-regulation to strengthen accountability, transparency and ethical behaviour, and '[s]trong legal and regulatory obligations which protect consumer interests'.⁸

5.10 The ABA highlighted that Australia's banks 'recognise they haven't always lived up to the community's standards and need to do better' and for this reason, initiatives like the Banking Reform Program strengthen 'cultural and ethical standards and improve the delivery of products and services'.⁹ The Banking Reform Program, established in April 2016, was an initiative developed by the banking sector in partnership with key stakeholders and regulators, and sought to address community concern about governance, conduct and culture of the banking sector.¹⁰

5.11 On 8 March 2017, the HoR Standing Committee on Economics questioned the motivation and timing of the Banking Reform Program with the ABA. The ABA denied that the Banking Reform Program was developed to avoid a royal commission; however, it acknowledged that 'Labor's calls for a royal commission have galvanised the industry' and that the 'threat of a royal commission is...keeping the industry on its toes'.¹¹ The ABA added that it did not think a royal commission to be a good idea, and that it 'is both unnecessary and actually carries some risks'.¹²

6 Mr Ian Narev, former CEO, Commonwealth Bank of Australia (CBA), House of Representatives Standing Committee on Economics, Review of the four major banks (second report), *Committee Hansard*, 7 March 2017, p. 16.

7 Australian Bankers Association (ABA), *Submission 15*, p. 1.

8 ABA, *Submission 15*, p. 1.

9 ABA, *Submission 15*, p. 2.

10 ABA, *Independent Governance Expert Report*, Report 8, 17 April 2018, p. ii.

11 Mr Steve Munchenberg, CEO, ABA, House of Representatives Standing Committee on Economics, Review of the four major banks (second report), *Committee Hansard*, 8 March 2017, p. 43.

12 Mr Steve Munchenberg, CEO, ABA, House of Representatives Standing Committee on Economics, Review of the four major banks (second report), *Committee Hansard*, 8 March 2017, p. 44.

The Commonwealth Government

5.12 The Commonwealth Government also claimed a banking Royal Commission was unnecessary. The Minister for Finance, Senator the Hon. Mathias Cormann, had long maintained that a royal commission was unnecessary, and argued that 'it would recklessly and irresponsibly undermine confidence in our banking system, without actually achieving anything beneficial for bank customers with legitimate grievances'.¹³ Once the Commonwealth Government announced it would proceed with a Financial Services Royal Commission, the Minister for Finance declared it was regrettable that a royal commission had to happen.¹⁴

5.13 Ms Julia Banks MP, member of the HoR Standing Committee on Economics, declared that a 'longwinded royal commission' would only benefit 'banking lawyers' and argued the parliamentary review of the four major banks would 'find agile, flexible, immediate answers for consumers'.¹⁵ On 7 March 2017, Ms Banks asserted that a royal commission would destabilise the banking sector and that 'there will be no practical deliverable outcomes for bank consumers, and, basically, the only beneficiaries will be, quite frankly, the banking lawyers'.¹⁶

Establishment of the Financial Services Royal Commission

5.14 Sustained public calls from consumer advocates and victims of misconduct, multiple parliamentary, government and industry-initiated inquiries and political pressure for the Commonwealth Government to announce a royal commission built over the final months of 2017. Finally, on 30 November 2017, the leaders of Australia's major banks wrote a letter to the Treasurer, the Hon. Scott Morrison MP, stating that they had changed their position and supported a royal commission to end uncertainty and lack of confidence in the sector:

Our banks have consistently argued the view that further inquiries into the sector, including a Royal Commission, are unwarranted. They are costly and unnecessary distractions at a time when the finance sector faces significant challenges and disruption from technology and growing global macroeconomic uncertainty.

13 Senator the Honourable Mathias Cormann, Minister for Finance, Sky New – Sunday Agenda, 9 October 2016, <https://www.financeminister.gov.au/transcript/2016/10/09/sky-news-sunday-agenda> (accessed 22 October 2018).

14 Senator the Honourable Mathias Cormann, Minister for Finance, *Doorstop – Mural Hall*, 1 December 2017, <https://www.financeminister.gov.au/transcript/2017/12/01/doorstop-mural-hall> (accessed 22 October 2018).

15 Ms Julia Banks MP, House of Representatives Standing Committee on Economics, Review of the four major banks (second report), *Committee Hansard*, 8 March 2017, p. 48.

16 Ms Julia Banks MP, House of Representatives Standing Committee on Economics, Review of the four major banks (second report), *Committee Hansard*, 7 March 2017, pp. 22–23.

However, it is now in the national interest for the political uncertainty to end. It is hurting confidence in our financial services system, including in offshore markets, and has diminished trust and respect for our sector and people...

We now ask you and your government to act to ensure a properly constituted inquiry into the financial services sector is established to put an end to the uncertainty and restore trust, respect and confidence.¹⁷

5.15 The same day, the Turnbull Government announced the establishment of the Financial Services Royal Commission.¹⁸ The Royal Commission was officially established on 14 December 2017.¹⁹

5.16 Despite the Commonwealth Government's longstanding objection to a royal commission and claims it was unnecessary, the Royal Commission's findings to date have been profound and have revealed significant issues in the conduct and culture of financial services in Australia.

The Financial Services Royal Commission's interim findings

5.17 On 28 September 2018, the Royal Commission released an interim report outlining policy related issues from its first four rounds of hearings. The interim report made no recommendations, but rather raised questions about how particular issues identified to date could be resolved.

5.18 The interim report criticised the financial sector, declaring that misconduct was too often driven by greed and 'the pursuit of short term profit at the expense of basic standards of honesty'.²⁰ The interim report highlighted the inadequacies of

17 Joint CEOs and Chairs letter, 30 November 2017, <https://media.anz.com/posts/2017/11/joint-ceos-and-chairs-letter> (accessed 1 November 2018).

18 The Hon. Scott Morrison MP, Treasurer, 'Royal Commission – Banks and financial services: Joint media release with The Hon Malcolm Turnbull MP, Prime Minister,' *Media release*, 31 November 2017; Lucy Sweeney and Louise Yaxley, 'Malcolm Turnbull backflips on banking royal commission after big four call for inquiry to restore public faith', *ABC News*, 30 November 2017, <https://www.abc.net.au/news/2017-11-30/banking-royal-commission-announced-by-pm-after-big-four-letter/9209926> (accessed 1 November 2018).

19 David Chau and Emily Clark, 'Banking royal commission: How did we get here?', *ABC News*, 30 November 2017, <https://www.abc.net.au/news/2017-11-30/banking-royal-commission-how-did-we-get-here/9210248> (accessed 1 November 2018); SBS News, "'We've put customers first': PM defends not setting up banking royal commission sooner", *SBS News*, 22 April 2018, <https://www.sbs.com.au/news/we-ve-put-customers-first-pm-defends-not-setting-up-banking-royal-commission-sooner> (accessed 1 November 2018); Adele Ferguson, 'Nationals senator Barry O'Sullivan pushing on with banking royal commission bill', *Australian Financial Review*, 19 November 2017, <https://www.afr.com/business/banking-and-finance/nationals-senator-pushing-on-with-banking-royal-commission-bill-20171119-gzods2> (accessed 1 November 2018).

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

regulators, and explained cases of misconduct 'either went unpunished or the consequences did not meet the seriousness of what had been done'.²¹

5.19 A snapshot of revelations made since the commencement of the Financial Services Royal Commission is briefly outlined below:

- It was revealed that a CBA financial planning business had been charging deceased clients fees for financial planning advice, with at least five employees admitting they had knowingly done so.²²
- Issues were revealed relating to the lending practices of the banks, in particular for farmers²³ and people with gambling addiction.²⁴
- ASIC announced it would pursue the major banks and AMP as part of its 'fee-for-no-service' investigation. ASIC advised the Financial Services Royal Commission that so far \$260 million had been refunded to customers who were wrongly charged fees, with the expectation that total refunds would equate to over \$1 billion. ASIC confirmed the likelihood of legal proceedings over the matter.²⁵
- The effectiveness of the Australian Prudential Regulation Authority (APRA) and ASIC was questioned, including considerable delays by the banks to report significant breaches²⁶ and the lack of regulatory oversight dedicated to superannuation trustees. One example involved ANZ bank tellers selling superannuation products, which accrued \$3.6 billion in funds under ANZ's

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

22 Financial Services Royal Commission, *Interim Report*, Volume 1, September 2018, p. 122; Stephanie Chalmers, 'Commonwealth Bank charged fees to customers who had been dead for a decade, royal commission told', *ABC News*, 19 April 2018, <https://www.abc.net.au/news/2018-04-19/cba-charged-fees-to-customers-who-had-died-commission-hears/9675922> (accessed 5 November 2018).

23 Financial Services Royal Commission, *Interim Report*, Volume 1, September 2018, Chapter 6; Daniel Ziffer, 'Banking royal commission: ANZ "empathy" too late for farmers already forced off their land', *ABC News*, 1 July 2018, <https://www.abc.net.au/news/2018-07-01/banking-royal-commission-hears-the-pain-of-farmers/9924334> (accessed 22 October 2018).

24 Financial Services Royal Commission, *Interim Report*, Volume 1, September 2018, p. 54; Daniel Ziffer, 'Banking royal commission: Fees for the dead and cash bribes—the greatest shocks (so far)', *ABC News*, 8 September 2018, <https://www.abc.net.au/news/2018-09-08/banking-royal-commission-biggest-scandals/10214238> (accessed 22 October 2018).

25 Financial Services Royal Commission, final transcript for Day 35, P.R. Kell, p. 5254, ln 31–34, and p. 5255, ln 35–41; Sue Lannin, 'Banking royal commission: Banks and AMP face criminal charges and \$1b in fee-for-no-service scandal', *ABC News*, 17 August 2018, <https://www.abc.net.au/news/2018-08-17/apra-under-fire-for-failing-to-police-superannuation-industry/10129612> (accessed 22 October 2018).

26 Stephanie Chalmers, 'Banks take 1726 days to realise they've broken the law: ASIC', *ABC News*, 25 September 2018, <https://www.abc.net.au/news/2018-09-25/asic-reveals-how-long-banks-take-to-report-breaches/10302894> (accessed 22 October 2018).

management. ASIC forced the ANZ to stop this conduct, and issued a fine of only \$1.25 million.²⁷

Personal accounts—calls for an extension to the Royal Commission

5.20 The Financial Services Royal Commission generated significant interest in the community, and subsequently received 10,140 submissions as at 28 September 2018.²⁸ Despite the large number of submissions received, the Financial Services Royal Commission has only heard from a limited number of witnesses selected to provide personal accounts of their experiences with the banks. One of the primary concerns about the Financial Services Royal Commission's work is that it has not heard sufficient evidence from victims in regional areas.²⁹ For this reason, there have been calls for the Financial Services Royal Commission to be extended in order to hear from victims of financial sector misconduct.³⁰

The position of the banks after the release of the interim report

5.21 By October 2018, after the release of the Financial Services Royal Commission's interim report, the major banks had changed their position on the Royal Commission completely. On 11 October 2018, the HoR Standing Committee on Economics re-commenced its review of Australia's four major banks. This was the first time a parliamentary committee had heard from representatives from the major banks since the release of the Royal Commission's interim report.

5.22 The CBA explained that the Royal Commission had illuminated 'failures of judgement, failures of process, failures of leadership, and in some instances, greed'. It acknowledged that it was too slow to address these issues, and its 'capability has been inadequate in critical areas, particularly operations risk and compliance'.³¹ The CBA had consequently appointed six new executives, and those across the bank have:

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- 27 Daniel Ziffer, 'Banking royal commission: Super once-over scrapes off a truckload of dirt', *ABC News*, 27 August 2018, <https://www.abc.net.au/news/2018-08-27/royal-commission-super-once-over-scrapes-off-a-luck-of-muck/10168906> (accessed 22 October 2018).
- 28 Financial Services Royal Commission, *Public submissions – fast facts*, 28 September 2018, <https://financialservices.royalcommission.gov.au/Pages/default.aspx> (accessed 25 October 2018).
- 29 See, for example, The Hon. Bill Shorten MP, Opposition Leader, 'Labor Will Give Victims a Voice in Bank Reform', 2 October 2018, http://www.billshorten.com.au/labor_will_give_victims_a_voice_in_bank_reform_tuesday_2_october_2018 (accessed 1 November 2018); *Editorial*, 'Banking royal commission does not go far enough', *The Canberra Times*, 29 September 2018, <https://www.canberratimes.com.au/national/act/banking-royal-commission-does-not-go-far-enough-20180928-p506q7.html> (accessed 25 October 2018).
- 30 See, for example, *Editorial*, 'Banking royal commission does not go far enough', *The Canberra Times*, 29 September 2018, <https://www.canberratimes.com.au/national/act/banking-royal-commission-does-not-go-far-enough-20180928-p506q7.html> (accessed 25 October 2018).
- 31 Mr Matthew Comyn, CEO and Managing Director, CBA, House of Representatives Standing Committee on Economics, Review of the four major banks (fourth hearing), *Committee Hansard*, 11 October 2018, p. 1.

...faced consequences for our failures. Some have been terminated and there has been a \$100 million impact on remuneration. Accountability has not been clear enough inside the Commonwealth Bank. To address this, we have extended the government's new Banking Executive Accountability Regime across more than 90 executives.³²

5.23 Westpac's address to the committee referenced issues concerning remuneration, complaints handling, the fee-for-service model and culture in the banking sector. Its CEO, Mr Hartzler, who 12 months ago held the view that a royal commission 'would not have the benefit of immediate action',³³ admitted that 'we weren't quick enough to identify and fix the problems, and we accept the consequences of this delay'.³⁴

5.24 ANZ's CEO, Mr Elliot, who had once stated that the conduct of the banking sector was 'better than it was in the past'³⁵, acknowledged on 12 October 2018 that the:

...interim report lays out conduct of a standard below what the community expects and, at times, what the law requires. These observations have rightly dismayed and disappointed Australians. We have acknowledged to the commission that ANZ has engaged in misconduct and conduct falling below community standards and expectations.³⁶

5.25 On 19 October 2018, NAB's Group CEO and Managing Director Mr Andrew Thorburn admitted that industry has moved its primary focus away from customers and towards profits, has failed to plan long-term, has rewarded wrong behaviours and lost 'local connections we previously had with customers'.³⁷ Mr Thorburn disclosed that 700 employees have had a reduction in their variable pay, and

32 Mr Matthew Comyn, CEO and Managing Director, CBA, House of Representatives Standing Committee on Economics, Review of the four major banks (third report), *Committee Hansard*, 11 October 2018, p. 2.

33 Mr Brian Hartzler, CEO and Managing Director, Westpac Group, House of Representatives Standing Committee on Economics, Review of the four major banks (third report), *Committee Hansard*, 11 October 2017, p. 28.

34 Mr Brian Hartzler, CEO and Managing Director, Westpac Group, House of Representatives Standing Committee on Economics, Review of the four major banks (third report), *Committee Hansard*, 11 October 2018, p. 35.

35 Mr Shayne Elliott, CEO, Australia and New Zealand Banking Group (ANZ), House of Representatives Standing Committee on Economics, Review of the four major banks (third report), *Committee Hansard*, 11 October 2017, p. 59.

36 Mr Shayne Elliott, CEO, ANZ, House of Representatives Standing Committee on Economics, Review of Australia's four major banks (fourth hearing), *Committee Hansard*, 12 October 2018, p. 1.

37 Mr Andrew Thorburn, Group CEO and Managing Director, NAB, House of Representatives Standing Committee on Economics, Review of the four major banks (fourth hearing), *Committee Hansard*, 19 October 2018, p. 2.

over 300 have had their employment terminated, or have left as part of NAB's investigation into employee conduct.³⁸

Committee view

5.26 The large number of recent inquiries into the banking, insurance and financial services sector demonstrates the systemic problems inherent in the current system. This committee has been of the view since the beginning of the inquiry that the only solution to solving the fundamental flaws in the banking, insurance and financial services sector is a royal commission with the ability and the resources to examine the system as a whole and to make broad structural recommendations.

5.27 The issues raised in this inquiry regarding the current consumer protection system include: lack of funding for financial counselling and legal services; lack of documentation for consumers to prove misconduct; and lack of enforcement on the part of regulators and external dispute resolution services. Evidence raised allegations of misconduct in specific areas of the banking, insurance and financial services industry, including:

- financial advice;
- mortgage broking;
- loans and credit contracts;
- property valuations and foreclosure;
- insurance;
- the conduct of financial entities engaging with Aboriginal and Torres Strait Islander groups;
- credit card limits;
- gambling limits and credit;
- consumer leases and payday loans;
- debt management firms; and
- the conduct of receivers, administrators and liquidators.

5.28 The committee's findings in this report align with many of the issues that have been identified by the Financial Services Royal Commission to date. This outcome comes as no surprise to the committee; victims of banking misconduct have long advocated for a royal commission into the financial services sector, and the committee commenced this inquiry to add further weight to their arguments. However, despite their calls for action, banking representatives and the Commonwealth Government have continually objected to this demand.

38 Mr Andrew Thorburn, CEO and Managing Director, NAB, House of Representatives Standing Committee on Economics, Review of the four major banks (fourth hearing), *Committee Hansard*, 19 October 2018, p. 3.

5.29 Prior to its establishment, the CEOs of the four major banks all conveyed messages that a royal commission would have no benefit, and the banks had nothing to hide. They argued that a royal commission would be a distraction and that the industry was well regulated. The Australian Bankers' Association maintained that a royal commission was unnecessary and claimed that trust and confidence are achieved through institutional leadership and self-regulation, along with adherence to laws and regulatory obligations that protect consumers. Australia's major banks only admitted that a royal commission was necessary because 'political uncertainty' was 'hurting confidence' in the sector.

5.30 The Commonwealth Government, by delaying the decision to establish a royal commission and insisting until the last moment that such a commission of inquiry was unnecessary, has hindered efforts to address longstanding issues of misconduct in the financial services sector. At the commencement of this inquiry, the Commonwealth Government declared that it opposed the inquiry 'because the government has taken and continues to take strong action to improve consumer outcomes in the financial services sector'.³⁹ It also argued against a royal commission, claiming this would only benefit banking lawyers without producing any deliverable outcomes for consumers. The Minister for Finance contended that a royal commission was both reckless and irresponsible, and would not achieve anything for bank customers.

5.31 It was not the weight of substantial evidence that misconduct had occurred, nor the findings of multiple inquiries, nor calls from consumer advocates that led to the Commonwealth Government's decision to establish a major commission of inquiry into the financial services sector. Only internal political pressure from within the Government's own ranks and a letter from Australia's major banks calling for an end to uncertainty led, finally, to the Commonwealth Government announcing the establishment of the Royal Commission.

5.32 The long-held position by the banking sector and the Commonwealth Government that a royal commission was unnecessary has since been discredited by the work of the Financial Services Royal Commission and the consistency of its findings with the evidence provided to this committee. These investigations have revealed a culture of greed, misconduct and inadequate regulatory oversight. Subsequently, the major banks and the Commonwealth Government have had to backpedal, and now acknowledge that systemic problems exist. The Royal Commission's work has brought to light actions by some of the largest, most respected financial service providers in the country that may amount to misconduct, deliberate withholding of information from ASIC and even what may be, in some instances, breaches of the law. The regulatory and legal repercussions of the Financial Services Royal Commission are yet to manifest fully.

5.33 While delayed in its onset, the Financial Services Royal Commission appears to have taken a comprehensive and forensic approach, and taken into account a broad cross-section of consumers of various financial products and services. However, some

39 Senator James McGrath, *Senate Hansard*, 29 November 2016, p. 3568.

of the areas addressed in this inquiry have not yet been examined by the Royal Commission. It seems unlikely, given the extent of misconduct and behaviour below community standards that has been indicated in public evidence so far, that the Royal Commission will be able to adequately cover issues in the financial sector beyond more than a few brief snapshots in the time that it has been allocated and the small number of witnesses that it has called in public hearings. The committee notes that the Royal Commission has only heard from 27 victims even though it received over 10,000 submissions and has not held any hearings in South Australia, Western Australia and Tasmania. Given the extent of misconduct identified in the Royal Commission's work to date, the committee considers that the Royal Commission should be granted an extension of time beyond February 2019 to examine particular aspects of misconduct in greater detail.

Recommendation 1

5.34 The committee recommends that the Commonwealth Government give the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry an extension of time to report.

5.35 To date, the Royal Commission has stated that it will not be examining receivership, consumer leases, payday loans or in-store credit arrangements because these do not fall within the terms of reference of the Royal Commission, as they do not fit the definition of a financial services licensee or entity.⁴⁰ A number of financial counselling and legal services bodies highlighted in evidence to this inquiry that payday loans and consumer leases are a major issue for consumers from lower socio-economic backgrounds, who can least afford high interest rates and penalties. Because of the gap in the Royal Commission's terms of reference, the Senate has referred an inquiry to this committee to investigate these issues more closely. The committee will inquire into credit and financial services targeted at Australians at risk of financial hardship, in particular payday lenders and consumer lease providers, unlicensed financial service providers such as 'buy now, pay later' providers, debt management firms, debt negotiators, credit repair agencies and personal budgeting services. The committee is required to report by 22 February 2019.

5.36 Evidence provided to this inquiry also outlined concerns about administration, receivership and the practices of liquidators. The Parliamentary Joint Committee on Corporations and Financial Services tabled a report into the impairment of customer loans in May 2016. The Parliamentary Joint Committee recommended that if the banks and the Australian Banking Association did not address issues surrounding valuation reports, including providing borrowers with copies of these reports, the Government should introduce appropriate legislation and regulations. The Parliamentary Joint Committee also 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 the appropriate prudential standard, and that

40 Financial Services Royal Commission, final transcript for Day 35, Ms Rowena Orr, 2 July 2018, p. 3695, ln 26–33; Financial Services Royal Commission, final transcript for Day 30, Ms Rowena Orr, 25 June 2018, p. 3077, ln 41–44.

ASIC administer a strong penalty regime to govern breaches of section 420A of the *Corporations Act 2001*, which requires a controller to take all reasonable care to sell property for no less than its market value or, where this is not available, the best price that is reasonably available.⁴¹

5.37 This committee reiterates its support for these recommendations. The committee notes that the Australian Banking Association has expressly addressed the issue of valuations in its 2019 Banking Code of Practice. However, the Commonwealth Government is yet to respond to the Parliamentary Joint Committee's recommendations. The committee considers, given that two and a half years have passed since the report was tabled, and the Financial Services Royal Commission's terms of reference have excluded issues related to receivership, administration and the conduct of liquidators, there is no reason for the Government to have delayed responding to the report's recommendations.

Recommendation 2

5.38 The committee recommends that the Commonwealth Government provide a response to the Parliamentary Joint Committee on Corporations and Financial Services' inquiry into the impairment of customer loans.

5.39 Evidence provided to this inquiry emphasised the importance of adequately resourcing financial counselling and legal services. These services often deal directly with consumers experiencing failures in the consumer protection system and may assist consumers from lower socio-economic backgrounds, Aboriginal and Torres Strait Islanders and consumers who have limited literacy and resources to prepare applications for external dispute resolution. In other words, these services may assist consumers who are in severe financial distress and need to access dispute resolution the most. Further, these services often contribute to law reform and policy development and assist ASIC with identifying systemic problems. As a result, it is essential that community legal and financial counselling services be adequately funded, particularly while the work of the Royal Commission is still ongoing.

Recommendation 3

5.40 The committee recommends that the Commonwealth Government consider increased funding for community legal and financial counselling services dealing with victims of financial misconduct.

5.41 The work of the Financial Services Royal Commission is an important step in the right direction. The committee anticipates that the Royal Commission will make recommendations relevant to many of the areas of concern raised in this inquiry, and the committee will continue to observe the Royal Commission's work in those areas. It is for this reason that the committee has determined not to make specific policy recommendations, but iterates that there is a need for serious reform to the entire

41 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).

financial services system. Consumers must be properly protected from the endemic greed that has corrupted the financial services sector.

5.42 Previously, the common response from financial entities to proven instances of misconduct found by regulators was either that it was the fault of a few 'bad apples', or that misconduct may have occurred in the past but due to recent reforms and changes by the financial entities, protections for consumers are now greatly improved. These reforms and changes may have occurred, but they do not change the fact that misconduct and unethical behaviour by individuals and organisations has left a trail of ongoing destruction, featuring ruined businesses, impacts on health and relationships, financial problems and even bankruptcy on the part of affected consumers.

5.43 Finally, the committee recognises the considerable toll that negative experiences with the banking, insurance and financial services sector have had on consumers' physical, emotional and mental health, in addition to the financial losses that many submitters and witnesses outlined in their evidence. Many financial entities have systematically engaged in practices that amount to misconduct, fall below community expectations of ethical conduct and even contravene the law, in some instances.

5.44 Despite the Commonwealth Government's longstanding objection to a royal commission and claims that it was unnecessary, the Royal Commission's findings to date have been profound and have revealed significant issues in the conduct and culture of financial services in Australia. Ordinary Australians should never have had to bear the burden of this misconduct for so long; a royal commission was long overdue.

Senator Chris Ketter

Chair

Coalition Senators' Additional Comments

General comments

1.1 Coalition Senators acknowledge that the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry (Royal Commission) has shone a light on systemic problems in our financial system.

1.2 However, Coalition Senators disagree with the committee view that, since the inquiry was opened in 2016, 'the only solution to solving the fundamental flaws in the banking and financial services sector is a royal commission'. It must be stressed that, since its election in 2013, the Government has been proactively taking steps to reform the financial services sector, long before this inquiry was opened.

Financial System Inquiry – 'Murray Inquiry'

1.3 Coalition Senators commend the Government making good on their promise to undertake a broad-based review of Australia's financial system by commissioning the Financial System Inquiry (FSI) in 2013, barely three months after they were elected. The FSI was 'charged with examining how the financial system could be positioned to best meet Australia's evolving needs and support Australia's economic growth. Recommendations will be made that foster an efficient, competitive and flexible financial system, consistent with financial stability, prudence, public confidence and capacity to meet the needs of users'.¹

1.4 The FSI Final Report was released on Sunday, 7 December, 2014, and the Government's response to the inquiry was released on Tuesday, 20 October 2015.

1.5 Coalition Senators note that the Government accepted all but one of the 44 recommendations from the FSI, and began immediately to action a series of reforms to ensure Australia has a safe and stable world-leading financial system. Coalition Senators also note that the government's response included unprecedented improvements to consumer protection, banking stability, governance and supporting transparent technologies.

1.6 Coalition Senators are at pains to point out that Bill Shorten, as Assistant Treasurer (14 September 2010 to 14 December 2011) and as Minister for Financial Services and Superannuation (14 September 2010 – 1 July 2013), trenchantly opposed a financial system inquiry, despite its obvious deficiencies. This was despite consistent advice given to the Rudd-Gillard-Rudd Governments between 2009 and 2013 from both experts and its own Treasury that an inquiry into the financial services sector was necessary.

1.7 Coalition Senators wish to highlight that Mr. Shorten and the Gillard Government rejected the need for a sweeping inquiry into the banks despite being informed by Treasury that 'many countries are reviewing financial regulation

1 The Hon Mr Joe Jockey MP, [former] Treasurer, 'Financial System Inquiry', *Media release*, 20 December 2013.

frameworks and making substantial changes'.² It was the Commonwealth Government that recognized the need to have the inquiry and the assertion that it has 'had to backpedal, and now acknowledge that systemic problems exist' is false.

Competition Policy Review – 'Harper Review'

1.8 Coalition Senators also commend the Liberal-Nationals Government for commissioning the Competition Policy Review (Harper Review) on 4 December 2013. The Review's Final Report was handed down on 31 March 2015, and the Government released its response on 24 November 2015.

1.9 The Harper Review recommended that the misuse of market power prohibitions should be:

re-framed to prohibit a corporation that has a substantial degree of power in a market from engaging in conduct if the proposed conduct has the purpose, or would have or be likely to have the effect, of substantially lessening competition in that or any other market.³

1.10 Coalition Senators note the Turnbull Government's support and implementation of the recommendation through the Competition and Consumer Amendment (Misuse of Market Power) Act 2017, which came into effect on 23 August, 2017. This important reform has allowed the ACCC to be able to examine whether the process of vertical integration is anti-competitive. Coalition Senators wish to stress the importance of this reform, noting the public concerns expressed about potentially anti-competitive vertical integration in the banking sector.

Establishment of the Australian Financial Complaints Authority

1.11 Coalition Senators note that, back in April 2016, the Government established a panel of eminent persons to review the role, powers and governance of all of the financial system's external dispute resolution and complaints schemes and will assess the merits of better integrating these schemes to improve the handling of consumer complaints.

1.12 The panel's review (the Ramsay Review) found that:

- the existence of multiple external dispute resolution (EDR) schemes with overlapping jurisdictions means that it is difficult to achieve comparable outcomes for consumers with similar complaints;
- multiple EDR schemes give rise to a duplication in costs for both industry and ASIC;

2 Christopher Joye, 'Bill Shorten has unconvincing case for a royal commission', *Australian Financial Review*, April 11 2016. Available at <https://www.afr.com/business/banking-and-finance/bill-shorten-has-unconvincing-case-for-a-royal-commission-20160410-go2t9p> (accessed 15 November 2018).

3 Ian Harper, Peter Anderson, Su McCluskey and Michael O'Bryan, *Competition Policy Review*, Final report, March 2015, p. 62.

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- consumers and small businesses do not have adequate access to EDR as the existing monetary limits on access to EDR and the existing caps on compensation that can be awarded are too low; and
 - there are long-standing problems with the arrangements for resolving superannuation complaints in the SCT.

1.13 The Ramsay Review has led to the establishment of the Australian Financial Complaints Authority (AFCA). This new 'one stop shop' is a single EDR body to replace the Financial Ombudsman Service, the Credit and Investments Ombudsman, and the Superannuation Complaints Tribunal.

1.14 The AFCA opened for business on 1 November, 2018.

ASIC

1.15 Coalition Senators note that the Government commissioned a review into ASIC's capabilities in July 2015, from which all of the recommendations were accepted and implemented.

1.16 Coalition Senators note the Government's financial support package given to ASIC in 2016, long before this inquiry was opened, which gave them \$127.2 million for the purposes of better protecting Australia's consumers. The broad reform measures equipped ASIC with stronger powers and funding to enhance surveillance capabilities, better enabling our corporate watchdog to combat misconduct in Australia's financial services industry and bolster consumer confidence in the sector. The reform measures came as a response to the ASIC Capability Review.

Serious Financial Crime taskforce

1.17 Coalition Senators congratulate the Government on establishing the Serious Financial Crime Taskforce (SFCT).

1.18 Since the establishment of the SFCT in 2015, 740 reviews and audits have been completed, and liabilities have been raised in excess of \$562 million. Five people have received custodial sentences following prosecution and there are currently 30 criminal, civil and intelligence matters in progress.

Royal Commission

1.19 Coalition Senators note the abundance of testimony of misconduct from the Royal Commission which dates back to the previous Labor Government, who steadfastly opposed an inquiry into the financial system.

1.20 For example:

- 'Between 2011 and 2014, a car finance broker had arranged loans for customers that did not meet Esanda's lending criteria by writing the application in the name of an individual who did not own or have possession of the vehicle, but who agreed to guarantee the loan. ANZ accepted that the systems that Esanda had in place at the time were ineffective to detect this and therefore failed to meet community standards and expectations. ANZ has also

accepted, in litigation brought by ASIC, that it failed to take reasonable steps to verify the income figures.⁴

- 'NAB also acknowledged processing or administration errors in relation to consumer lending during the relevant period. For example, NAB acknowledged that on 24 November 2010 and 15 April 2011 two separate failures of the customer account processing systems occurred, with the 2011 incident resulting in approximately 70,000 customers not receiving expected payments into their accounts.⁵
- 'NAB acknowledged that between 2007 and 2010 customers with NAB Visa debit cards were being incorrectly charged reference or overdraft fees.⁶

Conclusion

1.21 Coalition Senators note the preponderance of evidence showing that the Government has been working diligently to implement greater consumer protection in the banking, insurance and financial sector.

1.22 These reform measures began long before there were calls for a Royal Commission, and long before this inquiry was opened to build political momentum for a Royal Commission.

1.23 Coalition Senators wish to highlight the hypocrisy of those who opened this inquiry, noting that they staunchly opposed a broad-based financial system inquiry while they were in government.

1.24 The Coalition Senators also want to reject the assertion that the Royal Commissioner is not satisfying his terms of reference by excluding South Australia, Western Australia and Tasmania from holding hearings. Further, Coalition Senators also reject that the Royal Commissioner has only heard from 27 victims.

1.25 The Royal Commissioner has absolute discretion to hold hearings in any state. The fact that he has chosen not to hold hearings in some states does not in any way suggest that the Commissioner is not fulfilling his terms of reference. The Coalition Senators reject any suggestion to the contrary.

1.26 Similarly, the suggestion that the Commissioner can only consider evidence orally does not make sense. The Commissioner has confirmed that every submission the Royal Commission has received has been read and is being considered as part of his final recommendations. Again, the Commissioner has absolute discretion as to how he is to receive evidence and Coalition Senators reject any suggestion that he has not considered the written submissions or that he has somehow erred in the way that he has decided to conduct the Commission.

4 Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry (Financial Services Royal Commission), *Interim Report*, Volume 1, September 2018, p. 45.

5 Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry (Financial Services Royal Commission), *Interim Report*, Volume 1, September 2018, p. 50.

6 Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry (Financial Services Royal Commission), *Interim Report*, Volume 1, September 2018, p. 50.

1.27 Coalition Senators note Recommendation 1 of the chair's report, which recommends that the Royal Commission be given an extension of time to report. The Coalition rejects this recommendation to the extent that it does not support the Commissioner asking for more time before more time is granted.

1.28 The Coalition note that in the response to the Parliamentary Joint Committee on Corporations and Financial Services report dated 4 May 2016 (Report), the Commonwealth Government announced that it had directed The Australian Small Business and Family Enterprise Ombudsman (ASBFEO) to undertake an inquiry into the adequacy of the law to address concerns raised by the Parliamentary Joint Committee on Corporations and Financial Services in its report, 'Impairment of Customer Loans'. The Government released and responded to ASBFEO's report on 2 February 2017.

1.29 Further, a number of the recommendations made by the PJC's report have subsequently been addressed by the 2019 Banking Code of Practice through requirements for:

- simplified, improved disclosure of loan terms and conditions and loan approval processes and outcomes for small businesses;
- increased notice periods for small businesses for enforcement proceedings and decisions on rollover;
- the introduction of 'covenant light' contracts to eligible loan products, which reduce the number of specific events of non-monetary defaults and remove financial indicator covenants as triggers for default; and
- improved arrangements to address conflict of interest issues between investigating accountants and receivers, and provision of information about entitlements to access dispute resolution.

1.30 A number of recommendations in the PJC report are being considered by the Royal Commission including:

- appropriateness of charging of default interest;
- circumstances where a lender may appoint an external administrator (such as a receiver, receiver and manager, or agent of the mortgagee in possession);
- gaps in protections in the 2019 Banking Code of practice as it relates to SMEs and Agri-business lending;
- the need for a national system for farm debt mediation; and
- valuation practices around agricultural lending.

1.31 The Coalition Senators also note that the terms of reference for the Royal Commission enable it to look at the conduct of financial services entities including the conduct of anyone acting on behalf of these entities which includes receiver, a receiver and manager and an agent for mortgagee in possession.

1.32 The Commission has looked into the appointment of receivers during its fourth round of hearings on remote and regional issues in respect of agri-business

lending and has sought submissions in relation to appropriate circumstances for the appointment of receivers in its Interim Report.

1.33 The Coalition Senators reject Recommendation 2 and given the timing of the Royal Commission, recommend waiting for its recommendations.

1.34 In relation to Recommendation 3 of the Chair's report, Coalition Senators wish to emphasise that the Commonwealth Government has already committed increased funding for community legal and financial counselling services dealing with victims of financial misconduct.

Senator Jane Hume

Deputy Chair

Australian Greens Senators' Dissenting Report

1.1 The Greens would like to place on record our thanks to those who participated in this inquiry. In particular, the Greens would like to thank the victims of financial industry misconduct who, on top of all of the loss and distress they have experienced as a result of this misconduct, have found the time and energy to participate in this inquiry. We thank you.

1.2 It is because of the loss and distress experienced by victims of financial industry misconduct, and because of the enormous and economy wide problems that are the root cause of this misconduct, that the Greens have dissented to the Chair's report. After an inquiry lasting two years, after taking 147 submissions from a range of people, and after having held three public hearings, all at the taxpayer's expense, this Chair's report is a joke. Three recommendations, none of which even hint at changes to the way the financial service industry is structured or regulated. This Chair's Report is disrespectful to those who took the time to participate in this inquiry and it reflects poorly on the Australian Senate and the otherwise well respected committee system.

1.3 The Greens have real concerns that there is a gulf developing between the rhetoric about reforming the financial sector, and the commitment to actually reforming the financial sector. Bank bashing is not an end unto itself. Policy reform is the goal. And this Chair's report fails terribly by that measure.

1.4 The best way to ensure victims of misconduct by the banks are not forgotten is to undertake reform to stop it happening again. This Dissenting Report by the Australian Greens is drawn from our submission to the Interim Report of the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry. It addresses two of the three recommendations of the Chair's report, and includes the kind of policy reforms that members of this parliament should be recommending if they were focused on doing their job rather than just grandstanding.

Introduction

1.5 The Commission has laid bare many of the problems in Australia's banking, superannuation and financial services industry. Misconduct involving varying levels of deception, lying and other forms of dishonesty have been shown to be widespread. Fraud and bribery has been uncovered within once venerable institutions.

1.6 When announcing the establishment of this Commission, the then Prime Minister, Malcolm Turnbull, said that it would not 'put capitalism on trial'.¹ That might be true, but the Commission has exposed the worst excesses of capitalism. After all, banks are the arteries of capital, and they have become fat and bloated.

1.7 As the Commission highlights, the misconduct uncovered has been driven by the pursuit of profit above customer interest. This is not just a problem of individuals.

¹ Department of the Prime Minister and Cabinet, PM Transcripts, 'Press Conference with the Hon. Scott Morrison MP, Treasurer', 30 November 2017.

It is not just 'a few bad apples' as the banks tried in vain to tell everyone for so many years. The misconduct uncovered by the Commission represents a systemic failure.

1.8 The problems in Australia's banks are emblematic of the problems in the financial industry the world over. Through globalisation, technology and blind faith in the wisdom of markets, the financial system has become too big, too complicated and too interwoven to properly serve the interests of consumers or the economy.

1.9 Australia has embraced this new order. We are one of the most heavily financialised economies in the world.² The banking and finance sector accounts for 9 per cent of GDP and is the largest single sector in the economy.³ But the increase in the size and scope of banking has not been matched by an increase in financial stability or an increase in the distribution of economic prosperity.

1.10 Overwhelmingly, financial complexity has been of more benefit to the finance industry than it has been to consumers or society.⁴ Beyond a certain point, an oversized banking and finance sector actually constrains the real economy.⁵ And the global financial crisis showed that no-one truly comprehends the level of interconnectedness between complex financial products and everyday life. Risk is everywhere and it's everyone's problem, whether you signed up for it or not.

1.11 The existence of this Royal Commission—the first of its kind since the 1935 inquiry into monetary and banking systems—is a seismic moment. In the lead-up to the announcement of this Commission, a common refrain from those opposing its establishment was that there had been a proliferation of inquiries into the financial system in recent years. While these inquiries have been worthwhile, the policy responses have been incremental and marginal, and have fallen short of what is needed to deal with the magnitude of the problem. The failure of previous inquiries to get to the bottom of the problem was a significant reason why the call for a Royal Commission was so persistent and so strong.

1.12 This Royal Commission must think big. In the same way the misconduct is systemic, the response must be systemic. The best way to ensure victims of misconduct by the banks are not forgotten is to undertake reform to stop it happening again.

Summary of Greens proposals

1.13 The Greens main proposals⁶ are:

- A government provider of everyday banking – a People's Bank.
- A more level playing field for non-major banks.

² R. Maddock, 'Is the Australian financial sector too big?' ANZ Bluenotes, 16 April 2014.

³ ABS 5204.0 – Australian System of National Accounts, 2016–17.

⁴ See John A. Kay, *Other People's Money: Masters of the Universe or Servants of the People?*, London, Profile Books, 2015.

⁵ See Stephen G. Cecchetti and Enisse Kharroubi, BIS Working Papers No 490, *Why does Financial Sector Growth Crowd out Real Economic Growth?* February 2015.

⁶ Some of the proposals included in this submission duplicate that detailed in the Greens' submission to the Round 5 hearings on superannuation.

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- Caps on executive pay.
 - An expanded scope for the Banking Executive Accountability Regime (BEAR).
 - Structural separation of financial institutions – break-up the banks.
 - Genuine income verification by mortgage lenders.
 - Restrictions on the ownership of retail grade intermediaries.
 - End all value-based commissions on retail grade products.
 - End the carve-outs from the best interest duties for retail grade products.
 - Re-establish the Australian Competition and Consumer Commission (ACCC) as the conduct regulator over retail grade products and services.
 - Elevate the standing of the Council of Financial Regulators.
 - Establish a Financial Regulators Assessment Board.
 - Report by February 2019 but extend so as to undertake further hearings.
 - Establish a last resort compensation scheme.
 - Increase funding for financial counselling and advocacy centres.

Competition and profit

1.14 Despite the promised benefits of privatisation and deregulation,⁷ and despite thirty-odd years with a largely privatised and deregulated banking system, competition among Australia's banks is far from vigorous. Consumers are paying more for products and services than they should, and banks' profits are well in excess of that which they have earned, either through effort or prudent management of risk. On the contrary, banks' profits have remained excessive in spite of their indifference to customers and their disregard for risk. The conclusion of the inquiry into the Commonwealth Bank commissioned by the Australian Prudential Regulation Authority (APRA) was that 'continued financial success dulled the senses of the institution', and that in this environment the 'voice' of customers and of risk were being drowned out.⁸

1.15 The Productivity Commission recently outlined why competition is so constrained:

Australia's banking sector is an established oligopoly with a long tail of smaller providers.

The four major banks as a group hold substantial market power, as a result of their size, strong brands and broad geographical reach. This is substantially supported by regulatory settings, which contribute to the major banks' structural advantages.

⁷ Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry (Financial Services Royal Commission), *Interim Report*, Volume 1, September 2018, p. 78.

⁸ APRA, *Prudential Inquiry into the Commonwealth Bank of Australia (CBA) – Final Report*, April 2018.

As a result, the major banks have the ability to pass on cost increases and set prices that maintain high levels of profitability — with minimal loss of market share.

The smaller banks and non-bank financial institutions typically follow the pricing trend set by the major banks, and are not a significant competitive constraint on the major banks' market power.⁹

1.16 The Productivity Commission's conclusion after an extensive inquiry into competition in the financial system was that 'price competition in the banking system is limited'.¹⁰

1.17 The ACCC has concluded similarly during an inquiry into residential mortgage prices.¹¹ ACCC Chair, Rod Sims, said at the launch of the interim findings that the major banks' interest rate behaviour 'resembles synchronised swimming more than it does vigorous competition'.¹² The major banks' 'front book/back book' strategy explored during this inquiry is a clear example of how the banks fail to compete on price and how they do this by taking existing customers for granted.

1.18 All of this is in keeping with the Commission's summary of the market and regulatory fundamentals that go towards explaining why misconduct has been so common and so widespread.¹³ While the Greens agree with the Commission's diagnosis, we disagree with the limitations of the following conclusion:

The law sets the bounds of permissible behaviour. If competitive pressures are absent, if there is little or no threat of enterprise failure, and if banks can and do mitigate the consequences of customers failing to meet obligations, only the regulator can mark and enforce those bounds.¹⁴

1.19 The Greens submit that, in response to the contempt shown for customers, the supremacy of profits, and so as to present some competitive pressures that might jolt the market out of its torpor, the Commission should consider a government-owned bank to 'mark' the bounds of permissible behaviour, as well as other measures that would create a more level playing field for other non-major banks. The Commission is asked to regard the impact of its recommendations on the economy, access to and cost of financial services, competition, and financial system stability.¹⁵ The Greens submit that consideration of the provision of products and services by government are relevant to these directions, as are consideration of the structural and regulatory impediments to competition.

A government provider

1.20 The Commissioner has rightly concluded that:

⁹ Productivity Commission, *Competition in the Australian Financial System – Final Report*, June 2018.

¹⁰ Ibid

¹¹ ACCC, *Residential Mortgage Price Inquiry – Interim Report*, March 2018.

¹² Rod Sims, 'Synchronised swimming versus competition in banking', Speech to AFR Banking and Wealth Summit, 5 April 2018.

¹³ Financial Services Royal Commission, *Interim Report*, Volume 1, September 2018, p. 268.

¹⁴ Financial Services Royal Commission, *Interim Report*, Volume 1, September 2018, pp. 269–70.

¹⁵ Terms of Reference, section k.

The conduct identified and criticised in this report was driven by the pursuit of profit – the entity's revenue and profit and the individual actor's profit. Employees of banks learned to treat sales, or revenue and profit, as the measure of their success.¹⁶

1.21 The problem of profit in the banking system is a perennial issue, and the provision of services by government has been a perennial response. In his dissenting statement to the Royal Commission into the Monetary and Banking System, Commissioner Ben Chifley stated that:

Banking differs from any other form of business, because any action, good or bad, by a banking system affects almost every phase of national life. A banking policy should have one aim – service for the general good of the community. The making of profit is not necessary to such a policy.¹⁷

1.22 The provision of not-for-profit banking services by the government is not a novel concept. From 1911 until 1991, the Commonwealth Bank was government owned and provided basic and essential banking services across the country. The *Banking Act 1947* (Cth) provided for the nationalisation of all banks. It passed both houses of parliament, although was subsequently ruled unconstitutional.

1.23 Across the Tasman Sea, the New Zealand Post Office Bank was established in 1867, sold in 1989, and then re-established in 2002. Elsewhere in the world, government provided banks are commonplace.¹⁸ Germany is the most notable advanced economy with a high proportion of banking undertaken through publicly owned institutions.¹⁹

1.24 In the immediate wake of the global financial crisis, six eminent economists from diverse standpoints wrote an open letter putting forward issues to consider during an inquiry into the financial system.²⁰ This letter included an open question that summarises the benefits of re-establishing a People's Bank well.

Should citizens who feel unsure and unqualified to shop wisely in our financial markets be able to access basic savings, payments, and wealth management products that have been vouchsafed by governments as being safe and professionally managed (for example, why can't Australians invest with the Future Fund)? Is there a role for a publicly-owned entity to offer essential services in Australia's finance sector that leverage off unique government infrastructure, such as Australia Post, the tax system, and the government bond market?²¹

1.25 The Greens submit that a People's Bank, with the imprimatur of the government, using the existing outlets of government agencies, and offering products on a cost recovery basis, would be able to challenge the existing banking model

¹⁶ Financial Services Royal Commission, *Interim Report*, Volume 1, September 2018, p. 302.

¹⁷ Tim Battin, *Abandoning Keynes: Australia's Capital Mistake*, Palgrave Macmillan, 2014, p. 36, citing Ben Chifley, 1937.

¹⁸ World Bank, Policy Research Working Paper 8297, *Bank Ownership: Trends and Implications*, January 2018.

¹⁹ *Ibid.*

²⁰ Joshua Gans, Nicholas Gruen, Christopher Joye, Stephen King, John Quiggin and Sam Wylie, 'Rules underpin prosperity', *Sydney Morning Herald*, 8 July 2018.

²¹ *Ibid.*

through price competition in a way that no other new or existing entrant is able to. A People's Bank would not necessarily need to obtain a major share of the market to have an impact. The mere existence of a credible, accessible and widely respected participant in the market providing a baseline is likely to be enough to force changes in the market.

1.26 The Greens have proposed a detailed plan²² that would see the People's Bank provide:

- Savings accounts pegged to the RBA cash rate, with debit cards linked to these accounts also available.
- Term deposits pegged to the Commonwealth bond rate.
- Mortgage tracker accounts pegged to the RBA cash rate.

1.27 The design adopted by the Greens is largely based on that proposed by Nicholas Gruen.²³ A particular feature of this design is that it would involve people holding accounts directly with the Reserve Bank of Australia (RBA). In the digital age, there is little impediment to individuals being granted the same privileges as banks in being able to access the RBA directly. This would not mean that the RBA would need to establish a 'shopfront'. Rather, people would hold accounts with the RBA, but the transactions with these accounts would be handled by an intermediary. The Greens have proposed, as have many others, that Australia Post be the primary government outlet for a People's Bank. However, depending on the design, existing retail banks could also be afforded the opportunity to intermediate the accounts of individuals with the RBA.

1.28 Irrespective, the Commission might also consider the provision of services for commercial banks by Australia Post. Australia Post currently processes transactions for commercial banks and is increasingly used by customers of commercial banks as the outlet for physical transactions. However, the discretionary nature of this service has recently come to light following ANZ's unilateral refusal to agree to the revised terms of the service agreement proposed by Australia Post.²⁴ The Commission might consider whether a condition of being granted a license is that banks are required to allow Australia Post to process basic transactions. The cost of Australia Post providing this service could then be levied on banks. This model would ensure universal access to physical banking outlets for all Australians.

A more level playing field

1.29 The Greens submit that competition in the banking industry would also be improved if the structural and regulatory advantages afforded to the major banks were addressed. While the Commission is not required to examine macro-prudential policy

²² The Greens, 'A People's Bank', <https://greens.org.au/sites/greens.org.au/files/People%27s%20Bank%202018%20Announcement%20FINALv2.pdf> (accessed 15 November 2018).

²³ Lateral Economics, *Submission 39*, Productivity Commission Inquiry into Competition in the Australian Financial System, 2017.

²⁴ ANZ Media Release, 'Update on Australia Post discussions', 15 October 2015.

and regulation, we submit that where a clear link can be made between macro-prudential settings, weak competition and misconduct, then the Commissioner should examine these relationships and consider associated policies.

Wholesale funding advantage

1.30 The Productivity Commission has summarised how the major banks' market power begets market power through their wholesale funding advantage, including as a result of them being perceived to be too-big-to-fail:

With their better credit ratings and a perception of being 'too big to fail', the major banks are able to source funds from investors and depositors at lower interest rates than are smaller institutions. The smaller entities (especially non-ADIs that are unable to accept deposits) both compete against the larger institutions and at the same time rely on them to access some of the funds that allow them to continue competing. A substantial gap also remains between the average operating costs of Australia's major banks and its smaller institutions.²⁵

In the wake of the global financial crisis, the IMF prepared a report for the G-20 considering how the public might be compensated for the value of implicit guarantees provided to systemically important banks.²⁶ The IMF recommended a levy to pay for 'the fiscal cost of any future government support to the sector'.²⁷

1.31 The Major Bank Levy introduced in 2017 has gone some way towards addressing these issues. The Explanatory Memorandum to the Major Bank Levy Bill 2017 also stated that:

The major bank levy will also contribute to a more level playing field for smaller, often regional, banks and non-bank competitors. As the House of Representatives Standing Committee on Economics report on the four largest banks found, the major banks' size and market dominance affords them significant funding cost advantages and pricing power at the expense of their customers.²⁸

1.32 However, the annual levy rate of six basis points on covered liabilities is short of the value of the wholesale funding advantage extended to the major banks. The RBA estimated the value of this advantage at between 20 and 40 basis point in a 2016 paper.²⁹ As a result of a number of subsequent changes to the major bank's capital requirements, the Productivity Commission suggested that 'the funding cost advantage of the major banks may have reduced from that modelled by the RBA'.³⁰ Nevertheless, the Productivity Commission found that ratings agencies still provide an uplift to the major banks' on the basis of their too-big-to-fail status, which implies that

²⁵ Productivity Commission, *Competition in the Australian Financial System – Final Report*, June 2018.

²⁶ IMF, *A Fair And Substantial Contribution By The Financial Sector – Final Report For The G-20*, June 2010.

²⁷ Ibid.

²⁸ Productivity Commission, *Competition in the Australian Financial System – Final Report*, June 2018.

²⁹ RBA, *RBAFOI-151609 Documents Released*.

³⁰ Productivity Commission, *Competition in the Australian Financial System: Productivity Commission Inquiry Report*, no. 89, 29 June 2018, p. 192.

the Major Bank Levy has not covered the full value of the wholesale funding advantages.

1.33 The Greens submit that the Council of Financial Regulators should commission an annual estimate of the funding advantage of the implicit government guarantee to the major banks, and that the Major Bank Levy should be adjusted annually to reflect this value.

Mortgage risk weights

1.34 The Productivity Commission has also summarised how regulatory settings assist the major banks in maintaining their market power, including the exceptional arrangements regarding mortgage risk weights.

On one hand, the major banks (as well as Macquarie and ING) use internally developed risk models, approved by Australian Prudential Regulation Authority (APRA), that in effect lower their funding costs compared with all other ADIs, which use APRA's standard risk weighting. On the other hand, it is only the major banks that are required by APRA to hold additional capital because of their size and complexity. This requirement can be costly for the major banks, but it can also support them to the extent that it is viewed by international credit rating agencies as an indirect recognition of their 'too big to fail' status. The net result of these regulatory measures is a funding advantage for the major banks over smaller Australian banks that rises in times of heightened instability.³¹

1.35 The Productivity Commission estimated that the major banks' exceptional use of internal risk based (IRB) models equates to a 0.14 per cent reduction in the cost of funding across an otherwise identical loan portfolio.

1.36 APRA explained that achieving IRB approval 'requires an ADI to have a strong and sophisticated risk management framework and capacity'.³² In 2016, in the wake reports of systemic issues with the major banks lending standards, APRA requested that the major banks undertake an audit of their data policies, procedures and controls relating to mortgage lending. In February 2017, APRA explained why it had singled out the major banks.

The work was requested of the banks that are authorised to use their internal models for risk rating purposes—that is common knowledge. That is the four major banks and Macquarie. The reason we focused on those banks is that if they do not have their data right then the risk weights are not as accurate as they might otherwise be.³³

1.37 APRA had previously refused to make these targeted reviews public.³⁴ However, the Commission has published them. The targeted reviews show that the major banks' approach to data collection, analysis and management is neither the

³¹ Productivity Commission, *Competition in the Australian Financial System – Final Report*, June 2018.

³² See Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry, *Background Paper No. 9: The Regulatory Capital Framework for Authorised Deposit-Taking Institutions (ADIs)*, April 2018, p. 5.

³³ Mr Wayne Byres, Chairman, Australian Prudential Regulation Authority, Senate Economic Legislation Committee, *Senate Hansard*, Budget Estimates, 30 May 2017, p. 147.

³⁴ *Ibid.*

strong nor sophisticated approach required by APRA to receive IRB accreditation. UBS went so far as to downgrade its investment advice for Westpac on the back of the Commission's release of these reports.

1.38 The targeted reviews show that there is no justification for the major banks to continue to receive differential and favourable treatment by APRA with respect to mortgage risk weights. The Greens submit that this is relevant to the considerations of the Commission because of the competitive advantage that IRB accreditation provides the major banks. The Greens have suggested that all banks should be required to use standardised mortgage risk weights. Failing that, the Commission should consider endorsing the recommendation of the Productivity Commission that standardised risk weights be used for small business lending, and the conclusion that:

More nuance in the design of APRA's prudential measures — both in risk weightings and in directions to authorised deposit-taking institutions — is essential to lessen market power and address an imbalance that has emerged in lending between businesses and housing.³⁵

Remuneration caps

1.39 Culture starts at the top. When the CEOs of banks are rewarding themselves for returns above everything else, then it is not surprising that a culture that prioritises sales and profit above the interests of customers has become a defining feature of banks.

1.40 The Commission is to be commended for having emphasised the role of remuneration in the misconduct that has been uncovered, including the role of incentive based remuneration. This is an obvious problem that has been recognised for many years, as is noted by the Commission. Yet it remains unaddressed because the current approach relies on self-regulation.

1.41 Put simply, the banking fraternity decides how much they will pay themselves, and they've been quite happy to pay themselves handsomely. Some senior bank executives earn over 100 times the average wage. This practice clearly falls below community standards and expectations.³⁶ Yet banks have been able to get away with it because they are comfortably insulated from the threat of any serious retribution. A reliance on self-regulation without there being any incentive to self-regulate is next to useless.

1.42 In the past, to the extent that they felt compelled to provide a justification, banks would often say that sky-high salaries were required to ensure that best-of-the-best are in charge of these important national institutions. The Commission has debunked this myth: if obscene salaries attract more competent managers, then how is the level of misconduct uncovered by the Commission to be explained?

1.43 On the contrary, excessive executive salaries appear to be part of the problem. Beyond a certain point, increased pay does not provide an incentive for executives to

³⁵ Productivity Commission, *Competition in the Australian Financial System – Final Report*, June 2018.

³⁶ Sorapop Kiatpongsan and Michael I. Norton, 'How much (more) should CEOs make? A universal desire for more equal pay', *Perspectives on Psychological Science*, vol. 9, no. 6, November 2014, pp. 587–593.

perform better or to act in the long term interests of a company or the public.³⁷ And exorbitant executive pay may also be leading to adverse selection where executives more motivated by personal reward are more likely to apply for a job. In turn, these executives then tend to employ like-minded individuals, thus creating an 'executive club' that re-enforces the culture and behaviours that justify exorbitant executive pay.

1.44 But, besides all else, there is simply no justification for bank executives, who run a business that has a privileged position within society, is effectively an essential service, and that has a clear social responsibility, to be paying themselves the ridiculous salaries that they have been.

1.45 The Greens submit absolute limits should be established on the remuneration payable to bank executives, and have nominated that a cap be set at ten-times the average wage for base remuneration and a further five-times the average wage for variable remuneration. Further, the Greens submit that the Bank Executive Accountability Regime (BEAR) should be extended to cover all institutions that provide simple and essential financial products and services, or other retail grade products (see further exploration of these concepts below).

1.46 Australia would not be a pioneer in establishing executive pay caps. In 2016, Israel agreed to establish a cap on executive pay in the banking and insurance sector at 35 times the wage of the lowest paid worker in the company.³⁸ The Knesset's Finance Committee Chairman, MK Moshe Gafni, explained the merits of the legislation.

Financial corporations are different from other entities. They are part of a monopoly and they were given a license to handle the public's funds, and they give themselves salaries that are excessive and disproportional to the returns they bring.³⁹

Business models

1.47 At the core of the problems with the modern banking and finance is the rise of universal banking, where everything from saving accounts to derivatives trading is under the one roof. As outlined by the Commission, this has been characterised in Australia by development of the big-four banks into vertically integrated institutions during the late 1990s and early 2000's.⁴⁰

1.48 This privatised and deregulated model has failed in banking for the same reason it has failed in so many essential services: it is built on the fallacy of the efficient-market hypothesis. The efficient-market hypothesis has been the economic orthodoxy in most of the western world for most of the last thirty-odd years. The efficient-market hypothesis justifies a *laissez-faire* approach to financial market regulation. Subscription to the efficient-market hypothesis is reflected in the

³⁷ Michael J. Cooper, Huseyin Gulen and P. Raghavendra Rau, 'Performance for pay? The relation between CEO incentive compensation and future stock', *Social Sciences Research Network*, 2014; Ric Marshall and Linda-Eling Lee, 'Are CEOs paid for performance? Evaluating the effectiveness of equity incentives', IRRC Institute, 7 December 2016.

³⁸ The Knesset, 'Finance Committee approves bill limiting the pay of executives in financial corporations', *Media release*, 17 March 2016.

³⁹ *Ibid.*

⁴⁰ Financial Services Royal Commission, *Interim Report*, Volume 1, September 2018, p. 79.

architecture of Australia's financial system that is, by and large, the product of Keating-era deregulation; and that was bedded down through the 1997 Wallis Financial System Inquiry and the legislative response to it.

1.49 The efficient-market hypothesis puts store in the idea that well-informed individuals will act rationally and seek out the best deal for themselves; and, in doing so, these individuals will bring discipline to the market and ensure that asset prices reflect their underlying value. In other words, the system will be self-regulating.

1.50 This is nonsense. To start with, most Australians either don't have the time, wealth or inclination to warrant spending their evenings poring over financial reports. Most people only ever want or need basic banking services at a fair price. And even if people are up for playing the market, then it is going to take some effort get in a position to compete with these financial behemoths, all the more so given the ever increasing complexity of modern finance. In the words of the Commission, 'there is always a striking asymmetry of power and information between bank and customer that favours the bank'.⁴¹

1.51 Instead, universal banking has allowed banks to pray upon customer's trust and loyalty to them. The vast bulk of instances of misconduct revealed by the Commission have been within vertically integrated institutions. Whether people wanted to play in the market or not, banks have made a habit of talking customers into buying products they do not understand or do not need.⁴²

Basic banking: Simple and essential products and services

1.52 The Greens submit consideration of the structure of banking businesses—and concurrent consideration of the regulatory architecture—would be well informed by a distinction being made between the *simple and essential* products and services that the vast majority of Australians use (retail banking, superannuation and insurance), and the more *complex and selective* activity that is the domain of big business, the wealthy, and the adventurous.

1.53 This distinction would create the concept of 'banking between the flags' that comes with a high level of consumer protection: *caveat vendor* to a greater extent, and *caveat emptor* to a lesser extent. As the providers of an essential service, banks, superannuation funds and insurance institutions should be obliged to make all reasonable efforts to ascertain a customer's circumstances and the suitability of the products offered to them. People should be able to deal with banks, superannuation funds or insurance firms with confidence that their best interests are being attended to.

1.54 This is not to say that individuals and small business should be blithe to the risks they are taking on. But there should be limitations on what individuals and small business are expected to understand when consuming basic banking products.

1.55 To make an analogy with buying a car, consumers need to be conscious with how much they are spending and what basic features they want, but they are not

⁴¹ Financial Services Royal Commission, *Interim Report*, Volume 1, September 2018, p. 269.

⁴² See George A. Akerlof and Robert J. Shiller, *Phishing for Phools: The Economics of Manipulation and Deception*, Princeton and Oxford, Princeton University Press, 2015.

expected to understand the mechanics of the vehicle in any detail. As is the case with most retail consumption, in the words of the ACCC, the products should 'do all the things someone would normally expect them to do'.⁴³

1.56 The Greens submit that the starting position for the regulation of simple and essential products and services should be based on this principal. Accordingly, carve-outs given to particular products and services that are simple and essential (e.g. insurance from unfair contract terms; life insurance and investment property from financial advice standards) should be abolished.

Structural separation

1.57 The Commission has well detailed the inherent conflicts of interest within vertically integrated institutions. It has long been evident to observers of the financial sector that vertical integration is at the heart of a large number of instances of misconduct with the financial sector. This was evident during the Senate's landmark inquiry in the conduct of ASIC that uncovered problems within the CBA's financial planning arm.⁴⁴ It was also evident within misconduct revealed prior to the Royal Commission within the financial planning arms of other institutions, including those involved in forestry managed investment schemes.⁴⁵

1.58 The Greens submit that these conflicts and the incentives to cross-sell and subsidise within vertically integrated institutions cannot be sufficiently regulated so as to prevent the myriad ways in which consumers can be unfairly or unknowingly disadvantaged. It is simply too difficult for legislators and regulators to identify, and act to prevent, all of the opportunities that arise within integrated institutions to do something other than act in the best interests of consumers, be it by subtly but consistently directing existing customers towards in-house products, or by exploiting the loyalty and inertia of customers with excessive fees and charges. The profit motive is simply too strong and structural separation is necessary to curb its worst excesses.⁴⁶

1.59 The Greens submit that financial institutions should be constrained through ownership to being one of the following:

- an authorised deposit-taking institution (bank);
- an APRA regulated superannuation fund;
- an insurance provider, including life insurance and general product insurance; or
- a provider of other financial services, including wholesale and retail wealth management, investment banking, shadow banking, hedge funds, self-managed super funds, financial markets, and auditors and liquidators.

⁴³ Australian Competition and Consumer Commission, *Consumer guarantees*, <https://www.accc.gov.au/consumers/consumer-rights-guarantees/consumer-guarantees> (accessed 15 November 2018).

⁴⁴ Senate Economics Reference Committee, *Performance of the Australian Securities and Investments Commission*, 2014.

⁴⁵ Senate Economics Reference Committee, *Bitter Harvest: Agribusiness managed investment schemes*, 2016.

⁴⁶ George A. Akerlof and Robert J. Shiller, *Phishing for Phools: The Economics of Manipulation and Deception*, Princeton and Oxford, Princeton University Press, 2015.

1.60 The cross-selling of bank owned superannuation and insurance has been a feature of the misconduct uncovered through this inquiry. The model proposed by the Greens would remove the inherent conflicts for the cross-selling of these products within vertically integrated institutions.

1.61 This would not prevent these institutions from selling other products altogether, only to stop them from manufacturing and selling in-house products. For example:

- Banks could still sell investment into (retail-grade) unit trusts (managed investment schemes).
- Banks could still offer mortgage insurance.
- Superannuation funds could and should still include group (life) insurance within default funds.

1.62 The Greens submit that the distinction between banks, superannuation and insurance is appropriate for the following reasons:

- Banks are unique as the recipients of deposits, and the issuers of loans against these deposits. These savings and loans facilities provide for the everyday management of cash by individuals and small business. Consumers have a high level of engagement with their banks and the products they are provided.
- Superannuation funds have a very specific role as the managers of (mostly) compulsory savings for retirement. As illustrated in the Round 5 hearings of the Commission, consumer engagement with superannuation funds is very low. This reflects that many people have a set and forget approach to superannuation.
- Insurance is altogether different to banking and superannuation in that it provides relatively affordable protection against financial loss in the case of adverse events by pooling risk.

Financial system stability

1.63 Consideration of the structure of financial sector institutions cannot and should not be constrained to a consideration of misconduct alone. The Greens submit that the Commission should give close consideration to the impact on financial system stability and the economy more generally that arises from universal banking.

1.64 The Murray Financial System Inquiry identified four sources of systemic risk to Australia.⁴⁷ The first two—our reliance on foreign capital and our susceptibility to shocks in foreign markets—are largely inescapable and beyond the scope of this inquiry. The government can help mitigate the impact of these risks, but it can do little to stop them manifesting. The second pair—the concentration in the market and the exposure of banks to housing—are domestic in origin and intimately linked to the existing business model of banks.

⁴⁷ *Financial Systems Inquiry – Final Report*, November 2014.

Too-big-to-fail

1.65 Despite the promise of the efficient-market hypothesis, universal banking has failed to provide much in the way of market discipline or protection against the build-up of systemic risk. Instead, universal banking encouraged market concentration, resulting in individual banks having even more power, and becoming 'too-big-to-fail' and riddled with moral hazard. With the government compelled to act as a lender of last resort, too-big-to-fail banks have been more willing to take risks. That was the global financial crisis.

1.66 The issues associated with too-big-to-fail received significant attention in the wake of the global financial crisis, including the imposition of levies on systemically important banks. The OECD Secretariat also considered the risks associated with 'horizontal integration', and recommended the structural separation of retail banking from investment banking.⁴⁸ This addresses the proliferation of counterparty risk through derivatives contracts within systemically important banks that are the beneficiaries of implicit and explicit government guarantees. It says to banks: if you want to play in the securities market, then you're on your own.

Too-big-to-manage

1.67 Consideration of the business models of banks also requires consideration of whether universal banks are simply too-big-to-manage: in the ever more complicated world of modern finance, can executives and directors ever be expected to get their heads around all of the workings of vertically and horizontally integrated institutions?

1.68 This issue also emerged in the wake of the global financial crisis as an accompaniment to too-big-to-fail. However, it has not been given the same level of attention as too-big-to-fail, particularly in the Australian context. A recent paper by Deloitte explores the issue of managing universal banks given that 'post-crisis it is more difficult than ever before'.⁴⁹ A recent study undertaken by officials at the US Federal Reserve of Richmond concluded:

that larger banking organizations are more exposed to operational risk. Specifically, larger banks have higher operational losses per dollar of total assets, a result largely driven by their failure to meet professional obligations to clients, or from the design of their products.⁵⁰

1.69 In considering whether banking behemoths are too-big-to-manage, the Greens also submit that the issue of worker and customer representation within the governance structures of banks might be considered. Worker and customer representation is a common feature in corporate management in many parts of Europe. It is a natural question to ask: if banks had a greater range of voices sitting around the

⁴⁸ See Adrian Blundell-Wignall, Paul Atkinson and Caroline Roulet, 'Bank business models and the separation issue', *OECD Journal: Financial Market Trends*, Volume 2013/2, 2014.

⁴⁹ Deloitte, Centre for Regulatory Strategy, *Global Bank Governance in a Structurally Reformed World: Too Complex to Manage?* September 2017, p. 2.

⁵⁰ See F. Curti and Atanas Mihov, 'Diseconomies of scale in banking: Evidence from operational risk', *Social Sciences Research Network*, 15 April 2018; John A. Kay, *Other People's Money: Masters of the Universe or Servants of the People?*, London, Profile Books, 2015.

board room table would the Commission be uncovering such systemic and widespread misconduct?

Exposed to housing

1.70 The build-up of housing debt within Australia economy represents a massive failure of banking regulators over the last twenty years. Instead of using the global financial crisis as a catalyst to re-order the financial system, governments allowed banks to continue to pump money into asset bubbles. A crisis founded on loose lending standards and a build-up of private debt has been responded to with loose lending standards and a build-up of private debt.

1.71 Property bubbles are now a world-wide. But Australia is a world leader in overpriced housing and household indebtedness. Since 2008, housing debt to household income has increased from around 110 per cent to around 140 per cent.⁵¹ The market for land is being turbo-charged by generous tax incentives and record low interest rates. But the banks have played their part too and have built business models 'heavily exposed to developments in the housing market'.⁵²

1.72 The banking-property complex has created a number of economic problems, the enormity of which is difficult to understate. Firstly, the decline in homeownership rates is contributing to an increase in wealth inequality.⁵³ This is not just a moral issue: inequality is widely recognised to be a drag on growth.⁵⁴

1.73 Secondly, the banking-property complex is drain on productivity, restricting private capacity to spend in other areas of the economy, and redirecting capital away from businesses and infrastructure. The Reserve Bank has insured around \$250 billion worth of bank assets through the Committed Liquidity Facility⁵⁵ to address the mismatch in the ratio of government debt to bank debt within the Australian market.⁵⁶

1.74 Finally, as identified above, banks are not diversifying their risk. This is not surprising. Banks have been creaming it off home loans. Since the global financial crisis, the average margin between the RBA cash rate and standard mortgages interest rates—the spread—has doubled from just below 2 per cent to now just below 4 per cent.⁵⁷

1.75 The Greens submit that the banking-property complex is relevant to the Commission's considerations not only because of the weight of the associated economic issues, but also because it cannot be disentangled from the business structures of the major banks. Within vertically and horizontally integrated major banks, mortgage brokers are owned by the very banks whose loans they are

⁵¹ Greg Jericho, 'We can't take on any more debt – so what else will drive the economy?' *The Guardian*, 20 February 2018.

⁵² *Financial Systems Inquiry – Final Report*, November 2014.

⁵³ Productivity Commission, *Rising inequality? A stocktake of the evidence*, August 2018.

⁵⁴ See International Monetary Fund, *IMF's work on income inequality*, <https://www.imf.org/external/np/fad/inequality/> (accessed 15 November 2018).

⁵⁵ APRA, *Aggregate Results on the Committed Liquidity Facility*, September 2018.

⁵⁶ Guy Debelle, 'The Committed Liquidity Facility', Speech to the APRA Basel III Implementation Workshop 2011, Sydney, 23 November 2011.

⁵⁷ Productivity Commission, *Competition in the Australian Financial System – Final Report*, June 2018.

recommending, and these banks then securitise these mortgages and on-sell them through in-house brokers. Not surprisingly, they have been happy to write home loans to anyone with a pulse. This the natural response of institutions who are the beneficiaries of implicit and explicit government guarantees that underwrite this model, as well as tax settings that create incentives to invest in housing, and regulatory settings that create incentives to lend for housing.

1.76 The Commission has already had an impact on this front. The first round of hearings—including the release of APRA's targeted reviews—has exposed a fallacious approach to mortgage lending, especially by the major banks. A regulator unambiguously tasked with consumer protection (see below) would and should ensure that lenders undertake proper verification of a borrower's expenses. It follows that the widespread use of the Household Expenditure Measure cannot be justified for mortgage lending.

1.77 Further, a regulator tasked with considering the financial position of households would know that measuring lending standards by the rate of default is a false indicator in today's economic climate. The cash rate in Australia has been at the record low rate of 1.5 per cent for more than two years. If default rates were anything other than low during this period then that would be cause for enormous concern. And the persistence of ultra-low interest rates is itself a result of the level of household debt in the economy.

Intermediaries and retail investors

1.78 The Commission has well identified the inherent conflict where product issuers are also the intermediaries of these products. The Greens submit that, again, the policy response to this issue would be well informed by distinguishing between simple and essential (retail) products and services, and those which are more complex and selective (wholesale).

1.79 In the case of investment products, such a distinction already exists between retail and sophisticated (wholesale) investors. However, there is no framework to ensure its consistent application. In fact, the Commission details how, through the establishment of ASIC and the subsequent Corporate Law Economic Reform Program, the Wallis-era reforms provided for a more uniform treatment of intermediation, and placed no restriction on the ownership of intermediaries or the offering of wholesale grade products to retail investors. Instead, this approach placed faith in the efficient-market hypothesis, and in mandatory product disclosure being adequate to protect retail investors.⁵⁸

1.80 The scandal that was forestry managed investment schemes (MIS) is a tragic example of what can happen when wholesale grade products are sold to retail investors. Forestry MIS was a Ponzi scheme built up on the back of a tax break. When it collapsed tens of thousands of ordinary Australians lost their money, a network of fast-and-loose financial practices were exposed, and farming communities around the

⁵⁸ Financial Services Royal Commission, *Interim Report*, Volume 1, September 2018, p. 77.

country were left reeling by the rapid acquisition and then abandonment of agricultural land.⁵⁹

1.81 The widespread sale of hybrid debt/equity securities is a live example of retail consumers being sold a complicated product without due understanding of the risk that they are taking on. Former ASIC Chairman, Greg Medcraft, explained:

They are banned in the United Kingdom for sale to retail. I am very concerned that people don't understand, when you get paid 400 basis points over the benchmark, that is extremely high risk, and I think that, because they are issued by banks, people feel that they are as safe as banks. Well, you are not paid 400 basis points for not taking risks, and I do think this is, frankly, a ticking time bomb.⁶⁰

1.82 The Greens submit that the intermediaries of retail grade products, including mortgage brokers and financial advisors, should be separately owned from the institutions who originate the products they sell, save for the provision of financial advice by superannuation funds regarding the asset allocation of a member's contributions within that fund. The Greens also submit that retail grade intermediaries should be individually licensed so as make them individually accountable, and should be required to hold professional indemnity insurance.

1.83 It follows that value based commission structures are not appropriate when dealing with retail grade products, and that intermediaries should be subject to the best interest duty in the same way that product producers are. The Commission should recommend a clean slate for commissions on all past, present and future sales of banking, superannuation, insurance or any other retail grade products. Value based commissions for all retail grade products should be prohibited, including ending the current carve-outs for certain products, and ending the grandfathering of subsequently banned commissions.

The regulators

1.84 One of the most striking findings of the Commission is that the misconduct uncovered was 'contrary to existing laws'.⁶¹ The inescapable conclusion is that the regulators have failed. The Commission has well detailed the shortcomings of ASIC and APRA, and their failure to 'mark and enforce'⁶² the bounds of permissible behaviour.

1.85 This is not to say that changes to existing laws or powers are not required, or that budget cuts have not impacted upon the regulators' ability to do their job. But at the heart of the problem is that both ASIC and APRA have conflicted mandates, and that this has exacerbated a soft-touch approach and has further exposed them to

⁵⁹ See Greens Dissenting Report, Senate Economics Reference Committee, *Bitter Harvest: Agribusiness managed investment schemes*, 2016.

⁶⁰ Mr Greg Medcraft, Chairman, Australian Securities and Investments Commission, Senate Economic Legislation Committee, Supplementary Budget Estimates, *Senate Hansard*, 26 October 2017, p. 30.

⁶¹ Financial Services Royal Commission, *Interim Report*, Volume 1, September 2018, p. 269.

⁶² Financial Services Royal Commission, *Interim Report*, Volume 1, September 2018, p. 270.

regulatory capture. The Greens submit that is the result of a regulatory system that is broken, and that an overhaul of the regulatory architecture is required.

Conflicted mandate

1.86 The ASIC Act does not give the regulator a primary objective other than to enforce the laws it is empowered to enforce. However, the Act asks ASIC to, *inter alia*, strive to:

maintain, facilitate and improve the performance of the financial system and the entities within that system in the interests of commercial certainty, reducing business costs, and the efficiency and development of the economy; and

promote the confident and informed participation of investors and consumers in the financial system.⁶³

1.87 Very recently, this was further expanded to include consideration by ASIC of 'effects that the performance of its functions and the exercise of its powers will have on competition in the financial system'.⁶⁴

1.88 APRA is given a clearer primary responsibility, namely prudential regulation. Nevertheless, in doing so:

APRA is to balance the objectives of financial safety and efficiency, competition, contestability and competitive neutrality and, in balancing these objectives, is to promote financial system stability in Australia.⁶⁵

1.89 ASIC's conflicted mandate came about at its inception, when the Howard Government implemented the recommendation of the Wallis Financial System Inquiry and took consumer protection powers for the financial sector away from the ACCC. The thinking was that a specialist financial regulator would be better able to understand financial products and services. The wisdom of this decision has been questioned ever since. One of the key members of the Wallis Inquiry, Professor Ian Harper, recently admitted that it was likely to have been a mistake to disempower the ACCC, saying:

We placed too much faith in the efficient market hypothesis and in light touch regulation...

With the benefit of hindsight and what's been coming out at the royal commission, the weaknesses of the specialist approach we took to regulation are also evident.⁶⁶

1.90 Prof. Harper's comments highlight that the 'all things to all people' approach to regulators is an extension of the logic that says banks too can be 'all things to all people'. It is steeped in a belief in the efficient-market hypothesis, and that, through the rational application of the law, a financial regulator will treat consumers and banks alike.

⁶³ *Australian Securities and Investments Commission Act 2001*, s 1(2).

⁶⁴ *Treasury Laws Amendment (Enhancing ASIC's Capabilities) Bill 2018*.

⁶⁵ *Australian Prudential Regulation Authority Act 1998*, s 8(2).

⁶⁶ *Ibid.*

1.91 The problem with this approach is that there is an inherent conflict between conduct regulation and system regulation. In respect of APRA, this was adroitly identified by Counsel Assisting in his Opening Address to the Round 5 hearings:

...first, it is not obvious that it is possible to separate public enforcement action from a regulator properly undertaking conduct regulation. Secondly, there may be an inherent tension between, on the one hand, maintaining stability and, on the other hand, the destabilising effect for one or more entities of public enforcement action.⁶⁷

1.92 In other words, what is good for markets is not necessarily what is good for customers.

Regulatory capture

1.93 A soft-touch approach to regulation is also a complement to the efficient-market hypothesis. As noted above, a belief that markets will be self-regulating is inherent to the efficient-market hypothesis. It follows that a regulator need not be heavy-handed, all the more so when they are required to 'balance' the outcomes for consumers and banks.⁶⁸

1.94 And it is natural for regulators with a conflicted mandate taking a soft-touch approach to work closely with the very institutions they are regulating so as to understand the impacts of any possible enforcement on the institutions and to 'accommodate the expressed wishes of the entity'.⁶⁹ The unedifying spectacle of ASIC consulting on the wording of media releases with the very banks they were supposedly reprimanding is a textbook example of regulatory capture.

1.95 The problems with this are obvious and run deep. Primarily, as documented by the Commission, there is a lack of deterrence. It is not surprising that the banks have behaved as if they are untouchable. In respect of ASIC, Allan Fels, the inaugural Chair of the ACCC, put it bluntly: they 'are not feared'.⁷⁰ Another former Chair of the ACCC, Graeme Samuel, said similarly:

The regulators have got to be totally feared, for their independence, their rigor, their commitment and their intolerance to bad behaviour, and they have not been feared for that – neither ASIC nor APRA.⁷¹

A new architecture

1.96 As forecast above, the Greens submit that a reorder of the regulatory architecture should be informed by a distinction between simple and essential products and services, and more complex and selective activity. In the case of simple and essential products and services, distinction should be made between conduct regulation and system regulation, and that these two distinct responsibilities be given

⁶⁷ Financial Services Royal Commission, final transcript for day 40, Mr Michael Hodge, Monday 6 August 2018, p. 4161, ln 39–43.

⁶⁸ Senate Economics Legislation Committee, Budget Estimates, May 2018.

⁶⁹ Financial Services Royal Commission, *Interim Report*, Volume 1, September 2018, Volume 1, p 280.

⁷⁰ Professor Allan Fels, ABC AM, Thursday 9 Aug 2018

⁷¹ Jessica Irvine, "'Stop being bastards': How the royal commission could reform banks", *Sydney Morning Herald*, 22 September 2018.

to separate regulators. This would make it clear that, where is it *caveat vendor* to a greater extent, and *caveat emptor* to a lesser extent, that there is a regulator with an unambiguous mandate to protect consumers, including through the fostering of competition.

1.97 This is the distinction made in the so-called Twin Peaks model where one regulator is 'responsible for regulating to prevent financial crises (the prudential regulation peak), the other to ensure good market conduct and consumer protection (the good conduct peak)'.⁷²

1.98 The Greens propose that:

- The ACCC be the conduct regulator for retail banking, superannuation, insurance, retail grade intermediators (financial advisers and mortgage brokers), and the sale of other retail grade products and services.
- APRA would continue to be the system (prudential) regulator, but no longer be required to balance this with competition or consumer objectives.
- ASIC would be the conduct and system (market integrity) regulator over the remainder of the financial system.

1.99 This is not a conclusion that the Greens came to in haste. Throughout the Senate inquiry into the conduct of ASIC, the Greens were critical of the performance of ASIC, but largely supportive of the institution. Faith in public institutions is important to the operation of the financial system. However, the Commission's hearings have shown that the current structure is no longer defensible.

1.100 The ACCC is already the conduct regulator over almost every other market place. The objects of the Competition and Consumer Act that directs the ACCC are unambiguous: 'The object of this Act is to enhance the welfare of Australians through the promotion of competition and fair trading and provision for consumer protection'.⁷³

1.101 Whether conduct regulation over simple and essential products and services is entirely provided for by the Competition and Consumer Act would require further consideration. Irrespective, the ACCC should be also given the power to enforce the provisions of the Banking Code of Practice and other financial services industry codes of conduct under Part IVB of the *Competition and Consumer Act 2010*.

1.102 There is a large body of support for reinstating the ACCC as the primary conduct regulator, particularly in the wake of the findings of the Commission.⁷⁴ As noted above, support for this model is being hinted at by Prof. Harper, and is clearly advocated for by the inaugural Chair of the ACCC, Allan Fels. Another clear supporter is former chief economist at ASIC, Alan Erskine, who has examined the regulatory architecture in detail, and says that, 'The ACCC should receive the

⁷² Andrew Schmulow, 'South Africa joins the club that regulates financial markets through "Twin Peaks"', *The Conversation*, 29 April 2018

⁷³ *Competition and Consumer Act, 2010*, s 2.

⁷⁴ Patrick Durkin, 'Pressure builds to unleash ACCC on the banks', *Australian Financial Review*, 14 October 2018.

competition mandates currently held (and generally ignored) by APRA and other regulators'.⁷⁵

1.103 The government has tacitly acknowledged the ACCC's suitability for the role of conduct regulator when it tasked them to inquire into any impact the Major Bank Levy had on mortgage rates.⁷⁶ The Commission itself has highlighted the distinct difference in approach between the ACCC and ASIC in respect of the implementation of the new laws regarding unfair contract terms.⁷⁷ The Productivity Commission recommended the ACCC be appointed as competition champion over financial services, though did not recommend any further changes to regulatory responsibilities.⁷⁸

1.104 In taking on responsibility for competition and consumer regulation, the ACCC should also be tasked with considering the impact that banking and finance is having on the wellbeing of households. As has been discussed above, the financialisation of everyday life has been considered intrinsically good by adherents to the efficient-market hypothesis. But the reality is that the last thirty-odd years have resulted in an increase in debt and risk exposure carried by households, and this is reshaping the very nature of society.⁷⁹ Yet, at the moment, this is largely outside the consideration of financial system regulators. As former Productivity Commission chair, Peter Harris, recently noted, 'there is no entity charged to think about cost to consumers'.⁸⁰

1.105 The Greens consider that, in the case of complex and selective products and services, ASIC could continue to be both a conduct and system (market integrity) regulator given that participants in these markets are expected to be more informed and more active, and the products concerned are more likely to require specialist understanding. That is not to say that no consumer protections exist, just that it is more clearly a case of 'buyer beware'.

Cooperation and oversight

1.106 The Greens submit that two further changes to the regulatory architecture should be made to ensure better cooperation between regulators, and better public oversight of regulators.

1.107 The Council of Financial Regulators should be elevated.⁸¹ An independent Chair should be appointed and minutes of the meetings should be published in a similar vein to those of the Reserve Bank of Australia. Further, the ACCC should be given a permanent position on the Council. This is largely in accord with the recommendation of the Productivity Commission who noted that the Council has the

⁷⁵ Alex Erskine, *Funding Australia's Future: Regulating the Australian Financial System*, July 2014, p. 7.

⁷⁶ ACCC, *Residential Mortgage Price Inquiry – Interim Report*, March 2018.

⁷⁷ Financial Services Royal Commission, *Interim Report*, Volume 1, September 2018, p 281.

⁷⁸ Productivity Commission, *Competition in the Australian Financial System – Final Report*, June 2018.

⁷⁹ See Dick Bryan and Mike Rafferty, *Risking Together: How Finance is Dominating Everyday Life in Australia*, Sydney University Press, 2018.

⁸⁰ Patrick Durkin, 'Pressure builds to unleash ACCC on the banks', *Australian Financial Review*, 14 October 2018.

⁸¹ See Alex Erskine, *Funding Australia's Future: Regulating the Australian Financial System*, July 2014.

capacity to 'generate timely and trusted debate' among regulators.⁸² Such debate would all the more important if and when a clear distinction was made between conduct and system regulation.

1.108 The Greens also submit that a Financial Regulator Assessment Board be established to advise Government annually on how financial regulators have implemented their mandates, as recommended by the Murray Financial System Inquiry.⁸³

Justice and redress

1.109 The Commission would be well aware that the existence of this inquiry is in no small part a result of advocacy by aggrieved customers seeking justice for the harm inflicted upon them by banks and other financial services providers. Many of these customers, understandably, see this Commission as a means to provide them with satisfactory resolution. For many, simply having their case heard before the Commission and having the banks admit to their misconduct would be a consolation.

1.110 The Greens appreciate the difficulty that the Commission faces in this respect, having received in the order of 9,000 submissions outlining instances of misconduct, and being tasked with considering the causes and remedies of this misconduct within a twelve month period. However, there is no point in the Commission undertaking this inquiry if the government and parliament does not respond. Unfortunately, the nature of modern politics is that the impetus for reform can quickly wane. The Greens support the Commission reporting by February 2019, to the extent that it is confident in doing so, so that the government and parliament can consider and implement the Commission's recommendations as quickly as is practicable.

1.111 Nonetheless, the Greens support an extension to the Commission's inquiry to allow for the examination of a greater number of individual cases, as well as further examination of particular issues, including the role of receivers and administrators, the collapse of forestry managed investment schemes, and the conduct of Commonwealth financial service providers.

1.112 The Greens also submit that the Commission should make recommendations in relation to external dispute resolution (EDR) mechanisms and a compensation scheme of last resort, advocacy on behalf of customers through these processes, as well as what can reasonably be done to redress outstanding instances of past misconduct.

External dispute resolution

1.113 The first step for customers seeking remediation should be a well-functioning EDR body. The establishment of the Australian Financial Complaints Authority (AFCA) as single and compulsory EDR body promises to improve this process for customers. The previous system of multiple EDR bodies was plagued with problems, including, in the case of the Financial Ombudsman Service, a broad discretion to

⁸² Productivity Commission, *Competition in the Australian Financial System – Final Report*, June 2018.

⁸³ *Financial Systems Inquiry – Final Report*, Recommendation 27 — Regulator accountability, 2014.

exclude disputes⁸⁴ and inadequate funding.⁸⁵ Many of these problems extended from the regulator having little capacity to direct the functioning of privately-established EDR bodies beyond a binary decision to approve or not approve an EDR scheme. Accordingly, AFCA's success will depend heavily on the relevant regulator using the directions powers provided to it to ensure the proper function of the organisation in the interests of consumers, including powers to make directions on the limits of eligible claims and the funding of the organisation.⁸⁶

Last resort compensation scheme

1.114 While a well-functioning EDR scheme will provide adequate resolution in many cases, history has shown that it will not provide for all cases, most notably where institutions become insolvent. The Greens support the establishment of a last resort compensation scheme to provide remedy in these circumstances based on the design features recommended in the supplementary final report of the Ramsay review into external dispute resolution and complaints framework.⁸⁷ This last resort compensation scheme must be well targeted so as to avoid moral hazard, and should accompany other measures identified in the Ramsay review, in particular the requirement for intermediaries to have professional indemnity insurance.

1.115 However, this would not provide redress for many past victims of misconduct. The Commission would well understand the legal and constitutional difficulties in revisiting cases that have previously been resolved, regardless of how unjust the outcome was. Nonetheless, the Greens submit that the Commission should consider how past disputes might be remedied; and how currently solvent and operating institutions might be expected, if not compelled, to reopen cases where the commission has reasonable grounds for a finding against these institutions, and where customers have not been adequately compensated. For example, in the case of forestry MIS, the Commission should consider how the banks who lent money to these schemes, and who profited from these schemes, might be asked to act upon their moral responsibility to provide redress to the victims of these schemes.

1.116 The Ramsay review identifies options to provide redress for past disputes for individuals and small business. Within these options, the Greens suggest that the Commission considers whether the ACCC could be tasked as the body to scope and re-examine past disputes, and to make recommendations for remedy.

Funding for advocates

1.117 Through this inquiry, the Commission would have come to appreciate the work undertaken by financial counselling and advocacy centres. These centres do an

⁸⁴ Sam Kingston, Maddocks, *Excluding a dispute – What can the Financial Ombudsman Service consider?* <https://www.maddocks.com.au/excluding-dispute-can-financial-ombudsman-service-consider/> (accessed 15 November 2018).

⁸⁵ Mr Peter Kell, Deputy Chairman, Australian Securities and Investment Commission, Senate Economics Legislation Committee, Additional Estimates, *Senate Hansard*, 11 February 2016, p. 19.

⁸⁶ See *Treasury Laws Amendment (Putting Consumers First – Establishment of the Australian Financial Complaints Authority) Act 2018*.

⁸⁷ The Treasury, *Review of the financial system external dispute resolution and complaints framework – Supplementary Final Report*, September 2017.

admirable job providing legal assistance to the victims of the banks. However, they are not able to provide assistance for all of the viable cases that they are presented with. The Ramsay review identified the inability to access legal assistance as an impediment to some individuals and small business receiving adequate redress.

1.118 Funding for financial counselling and advocacy centres should be increased to enable greater access to legal assistance; and this increase in funding should be provided for by the banking and financial services industry. APRA, ASIC and AFCA are all funded through arms-length industry levies. A similar approach to the funding for financial counselling and advocacy centres should be considered appropriate given their essential role in providing redress.

Senator Peter Whish-Wilson
Senator for Tasmania

Appendix 1

Submissions, tabled documents, additional information and answers to questions on notice

Submissions

- 1 Legal Aid Queensland
- 2 Commercial Asset Finance Brokers Association of Australia Limited (CAFBA)
- 3 Financial Planning Association (FPA)
- 4 Australian National Audit Office
- 5 Caxton Legal Centre
- 6 National Insurance Brokers Association of Australia (NIBA)
- 7 ANZ Bank
- 8 Insurance Council of Australia
- 9 Australian Institute of Superannuation Trustees (AIST)
- 10 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)
- 11 Australian Small Business and Family Enterprise Ombudsman
- 12 Financial Services Council (FSC)
- 13 Business Council of Co-operatives and Mutuals (BCCM)
- 14 Association of Financial Advisers (AFA)
- 15 Australian Bankers' Association (ABA)
- 16 Customer Owned Banking Association (COBA)
- 17 Mr Stephen Johnson
- 18 LF Economics
- 19 CHOICE
- 20 beyondblue
- 21 Care Inc. Financial Counselling Service
- 22 Australian Lawyers Alliance
- 22.1 Response to submission 22 from ANZ
- 23 SMSF Owners' Alliance

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- 24 Australian Remittance and Currency Providers Association Limited (ARCPA)
 - 25 Public Interest Advocacy Centre Ltd
 - 26 Mr Glenn Pullin
 - 26.1 Supplementary to submission 26
 - 26.2 Response to submission 26 from the Financial Ombudsman Service Australia
 - 27 Acorns Grow Australia Limited
 - 27.1 Response to submission 27 from Commonwealth Bank
 - 28 Dr Serge Diklitch
 - 28.1 Response to submission 28 from MLC Life Insurance
 - 29 Mr Greg Cadwallader
 - 30 Mr Tom Azzi
 - 31 Mr Mohsen Alirezai
 - 31.1 Response to submission 31 from ANZ
 - 32 Mr Paul Westbury
 - 32.1 Response to submission 32 from Macquarie Group Ltd
 - 33 Mr Alexander Walton
 - 34 Name Withheld
 - 35 Dr George Tsambourakis
 - 36 Australian Securities and Investments Commission (ASIC)
 - 37 Ms Diane & Mr Max Lock
 - 38 Ms Alida Deligeorges
 - 39 Integrity New Homes
 - 40 Mr Michael Czajka
 - 41 Name Withheld
 - 41.1 Supplementary to submission 41
 - 41.2 Response to submission 41 from the Financial Ombudsman Service Australia
 - 41.3 Response to supplementary submission 41.1 from the Financial Ombudsman Service Australia
 - 42 Mr Mark Newberry
 - 43 Westpac
 - 44 Keep Me Posted
 - 45 Mr Donald Campbell

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- 46 Consumer Action Law Centre
 - 47 Mr Terry Watson
 - 48 Mr Kenneth Miles
 - 49 Mr Patrick Hayes
 - 50 Mr Stuart Fraser
 - 51 Financial Ombudsman Service Australia
 - 52 Financial Rights Legal Centre
 - 53 IAG
 - 54 Broome Circle Financial Management Program
 - 55 The Australia Institute
 - 56 Finance Sector Union of Australia
 - 57 Australian Timeshare Holiday Ownership Council (ATHOC)
 - 58 Consumer Credit Legal Service (WA) Inc
 - 59 Individuals who provided comments through CHOICE online tool
 - 59.1 Response to submission 59 from ANZ
 - 60 Mr Colin Powers
 - 61 Mr David Bibo
 - 62 Mr Louis Lalos
 - 63 Name Withheld
 - 64 Name Withheld
 - 65 Name Withheld
 - 66 Name Withheld
 - 66.1 Response to submission 66 from the Law Society of NSW
 - 66.2 Response to submission 66 from National Australia Bank (NAB)
 - 67 Credit and Investments Ombudsman Limited
 - 68 Dixon Advisory & Superannuation Services Limited
 - 69 Ms Suzi Burge
 - 69.1 Response to submission 69 from the Financial Ombudsman Service Australia
 - 70 Mr Ralph Binks
 - 71 Mrs Sue Dawes
 - 72 Mr Leo & Mrs Helen Southwell
 - 73 Dr Ragnar Purje

- 73.1 Response to submission 73 from NAB
- 74 Ms Leanne Harris
- 74.1 Response to submission 74 from the Financial Ombudsman Service Australia
- 74.2 Response to submission 74 from ANZ
- 75 Ms Michelle Matheson
- 75.1 Response to submission 75 from the Financial Ombudsman Service Australia
- 76 Mr Tim & Mrs Marlene Slattery
- 76.1 Response to submission 76 from the Financial Ombudsman Service Australia
- 77 Mr Paul Herman
- 77.1 Response to submission 77 from the Financial Ombudsman Service Australia
- 77.2 Response to submission 77 from ANZ
- 78 Ms Carolyn Thomson
- 78.1 Response to submission 78 from the Financial Ombudsman Service Australia
- 78.2 Reponse to submission 78 from ANZ
- 79 Ms Sandy Neilen
- 79.1 Response to submission 79 from the Financial Ombudsman Service Australia
- 79.2 Response to sunbmission 79 from ANZ
- 80 Mr Jim Martinek
- 81 Name Withheld
- 82 Mr Ian Williamson
- 82.1 Response to submission 82 from ANZ
- 83 Mr John Wilmott
- 84 Mr Graham Marks
- 85 Bank Reform Now
- 86 Ms Sandra Phillips
- 87 Dr Evan Jones
- 88 Ms Ruth Leahy
- 88.1 Response to submission 88 from ANZ
- 89 Name Withheld
- 90 Dr Simon Winder
- 91 Financial Counselling Australia (FCA)
- 92 Name Withheld

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- 93 Mr Philip and Mrs Kate Pyke
- 94 Banking and Finance Consumers Support Association (Inc)
- 94.1 Response to submission 94 from Bendigo and Adelaide Bank
- 94.2 Response to submission 94 from ANZ
- 95 Mr Jon Cook
- 96 Confidential
- 97 Confidential
- 98 Confidential
- 99 Confidential
- 100 Confidential
- 101 Confidential
- 102 Confidential
- 103 Confidential
- 104 Confidential
- 105 Mr Peter Johnston
- 106 Hon Michael Yabsley
- 106.1 Response to submission 106 from ANZ
- 107 Tasmanian Small Business Council (TSBC)
- 107.1 Response to submission 107 from Code Compliance Monitoring Committee
- 108 JMA Parties and Staff of Jenolan Village
- 108.1 Response to submission 108 from the Code Compliance Monitoring Committee
- 109 Bank Victims
- 109.1 Response to submission 109 from the Code Compliance Monitoring Committee
- 110 Ms Alison Hale & Mr Greg Saunders
- 110.1 Response to submission 110 from RHG Mortgages
- 111 Confidential
- 112 Name Withheld
- 112.1 Response to submission 112 from Commonwealth Bank of Australia
- 113 Name Withheld
- 114 Name Withheld
- 115 Mr Mario Menso

- 116 Mr Dario Pappalardo
- 117 Mr Trevor Fothergill
- 118 Name Withheld
- 119 Mr George Kelepecz
- 120 Name Withheld
- 121 Confidential
- 122 Confidential
- 123 Ms Naomi Halpern
 - 123.1 Response to submission 123 from Peter Holt
 - 123.2 Response to submission 123 from Korda Mentha
 - 123.3 Response to submission 123 from ANZ
- 124 Holt Norman Ashman Baker Action Group (HNAB-AG)
 - 124.1 Response to submission 124 from Korda Mentha
 - 124.2 Response to submission 124 from ANZ
 - 124.3 Response to submission 124 from Mr Peter Holt
 - 124.4 Response to submission 124 from Mr John Berrill
- 125 Mr Guy Goldrick
- 126 Mr Tim Boman
- 127 Mr Christopher and Ms Claire Priestley
- 128 Mr Lynton Freeman
- 129 Mr Graham Heslop, Ms Patricia Harper and Mr Martin Harper
- 130 Mr Verano Radin
- 131 Mr Tony Rigg
- 132 Name Withheld
- 133 Mr Peter O'Connor
- 134 Confidential
- 135 Former employees of Carlton and United Breweries
- 136 Confidential
- 137 Confidential
- 138 Ms Beth Irvin
 - 138.1 Response to submission 138 from ANZ
- 139 Mr Nicholas Wright

140	Ms Karinalee Honeyman
140.1	Response to submission 140 from NRMA
141	Confidential
142	Confidential
143	Confidential
144	Confidential
145	Confidential
146	Confidential
147	Confidential

Tabled documents

- 1 Document tabled by the Australian Securities & Investments Commission at a public hearing held in Sydney on 26 April 2017.
- 2 Document tabled by the Finance Brokers Association of Australia at a public hearing held in Sydney on 26 April 2017.
- 3 Document tabled by the Finance Sector Union of Australia at a public hearing held in Sydney on 28 June 2017.
- 4 Document tabled by Dr Simon Winder at a public hearing held in Sydney on 28 June 2017.

Additional information

- 1 Document provided by the Finance Brokers Association of Australia following a public hearing held in Sydney on 26 April 2017.
- 2 Document provided by Consumer Action Law Centre following a public hearing held in Sydney on 26 April 2017.

Answers to questions on notice

- 1 Answers to questions on notice from a public hearing held in Sydney on 26 April 2017, received from Financial Ombudsman Service Australia on 9 May 2017.
- 2 Answers to questions on notice from a public hearing held in Sydney on 26 April 2017, received from Financial Rights Legal Centre on 15 May 2017.
- 3 Answers to questions on notice from a public hearing held in Sydney on 26 April 2017, received from Consumer Action Law Centre on 11 May 2017.
- 4 Answers to questions on notice from a public hearing held in Sydney on 28 June 2017, received from Mr Phil Khoury, Independent Reviewer, Banking Code on 25 July 2017.

Appendix 2

Public hearings and witnesses

Wednesday 26 April 2017 - Sydney

Senators in attendance: Senators Hume, Ketter, Xenophon.

Witnesses:

BIRD, Ms Joanna, Senior Executive Leader, Australian Securities and Investments Commission

BRIGGS, Mr Blake, Senior Policy Manager, Financial Services Council

CARSON, Mr David, Corporate Regulatory Adviser, Finance Brokers Association of Australia

DAY, Mr Warren, Senior Executive Leader, Australian Securities and Investments Commission

FIELD, Mr Philip, Lead Ombudsman, Banking and Finance, Financial Ombudsman Service Australia

GREEN, Mr Chris, Group Senior Manager, Australian Securities and Investments Commission

HANSELL, Mr Allan, Director of Policy & Global Markets, Financial Services Council

KELL, Mr Peter, Deputy Chairman, Australian Securities and Investments Commission

KIRKLAND, Mr Alan, Chief Executive Officer, Choice

KRNCEVIC, Mr Jesse, Policy Manager, Financial Services Council

LANE, Ms Katherine, Co-Principal Solicitor, Financial Rights Legal Centre

MacRAE, Mr Drew, Policy and Advocacy Officer, Financial Rights Legal Centre

QUINN, Ms Susan, Senior Policy Officer, Consumer Action Law Centre

RICHARDSON, Mrs Bianca, Senior Policy Manager, Financial Services Council

SMITH, Dr June, Lead Ombudsman, Investments and Advice, Financial Ombudsman Service Australia

TEMPLE, Ms Katherine, Senior Policy Officer, Consumer Action Law Centre

TREGILLIS, Mr Shane, Chief Ombudsman, Financial Ombudsman Service Australia

TURNER, Ms Erin, Acting Director - Content, Campaigns and Communications, Choice

WHITE, Mr Peter James, Executive Director, Finance Brokers Association of Australia

Wednesday 28 June 2017 - Sydney

Senators in attendance: Senators Gallagher, Hume, Ketter, Xenophon.

Witnesses:

ANGRISANO, Mrs Julia, National Secretary, Finance Sector Union

BENNELL, Ms Susie, Managing Director, SR Group

CLANCY, Ms Alicia, National Industrial Officer, Finance Sector Union

COLIN, Mr Kilian, Finance Sector Union

KHOURY, Mr Philip, Private capacity

RUSSELL, Ms Debra, Private capacity

SEDGWICK, Mr Stephen, AO, FIPAA, Private capacity

WINDER, Dr Simon, Private capacity

Wednesday 28 June 2017 - Melbourne

Senators in attendance: Senators Hume, Ketter, Whish-Wilson.

Witnesses:

HALPERN, Ms Naomi, Private capacity.

HENRY, Ms Susan, Chair, Holt Norman Ashman Baker Action Group

JAMES, Mr Brendan, Shareholder, Cleveland Mining

JOHNSTON, Mr Robert, Head, Wealth Advisory, Banking and Financial Services, Macquarie Group Ltd

KORDA, Mr Mark, Managing Partner, Registered Liquidator, KordaMentha

McLENNAN, Mr Matthew, Executive Director, Group Legal, Macquarie Group Ltd

MENDELAWITZ, Mr David, Managing Director, Cleveland Mining Group

SIMPSON, Mr Glenn, Director, Cleveland Mining Group

WARD, Mr Greg, Deputy Managing Director, and Head, Banking and Financial Services, Macquarie Group Ltd

WEBSTER, Mr Bryan, Partner, Registered Liquidator, KordaMentha

Response to certain evidence given during public hearings

- 1 Correspondence from Mr Michael Rosenbaum - response to certain evidence given during a public hearing on 22 February 2018.