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Inquiry into Financial Products and Services in Australia

The Finance Sector Union of Australia (FSU) welcomes the opportunity to submit to the Inquiry into Financial Products and Services in Australia and thanks the Committee for the extension of time to provide our submission.

The FSU represents 50,000 members employed in the finance sector across Australia. Our members deal with the day to day operation of financial services and have an active interest in promoting a professional, efficient, sustainable and fair marketplace for financial products.

The Committee's Inquiry has obviously generated a great deal of interest and debate, particularly given the devastating consequences of recent high profile collapses. We do not propose to dissect the complex details of how these debacles developed – numerous submissions have obviously analysed these issues. The FSU simply wishes to highlight a number of factors that created an environment where such devastating collapses could occur and argue that the behaviours which caused them were encouraged and rewarded.

Responsible lending, sales targets and commissions

The FSU believes that a large amount of activity in the finance sector marketplace is primarily based on short term competition for growth or market share rather than sustainable and responsible practices. This type of activity is often expressed as sales targets for finance sector staff and applies to a wide range of financial services, particularly the sale of credit. In some institutions, meeting sales targets is the only way to achieve a pay increase.

If sales targets are achieved then bonuses or pay increases are granted. If they are not met then staff will suffer a financial loss but may also suffer heightened job insecurity. This has created a culture that is, by definition, designed to maximise sales which ultimately leads to a higher risk of inappropriate sales occurring. When staff are constantly under pressure to achieve sales it will inevitably lead to some consumers being sold products that they may not be capable of repaying or may not even need.

The FSU has long argued for measures to mandate responsible lending, disclosure of sales targets and commissions and (ideally) remove the use of bonuses and commissions in relation to the sale of financial products and advice.[1] If the measures

[1] FSU submission to *Inquiry into competition in the banking and non-banking sectors,* House of Representatives Standing Committee on Economics, 2008; FSU submission to the *Green Paper on Financial Services and Credit Reform*, 2008; *Inquiry into Home Loan Lending Practices and*

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advocated by the FSU had been adopted sooner, then many consumers would not be in their current dire circumstances.

The FSU strongly believes that sales targets for finance industry staff should only be linked to remuneration if a living wage and across the board, guaranteed minimum salary increases are already in place. If basic wage increases are tied to sales targets then staff are effectively compelled to try and make sales at every opportunity. If basic wage increases are secure for finance sector staff then the potential detrimental effect of sales targets through inappropriate sales will be less.

Retail financial products should be sold on the basis of suitability and sustainability – in the case of Storm and the margin loans provided by the Commonwealth Bank of Australia (CBA) this was obviously not the case. There is already robust debate regarding the degree of responsibility that should be accepted by the various companies and regulators – regardless of how responsibility is ultimately apportioned between institutions the FSU submits that the culture of sales targets across the financial services industry was a major contributing factor.

For example in North Queensland, where a large amount of Storm customers were based, the Commonwealth Bank increased sales targets by $170 million in 2008-09. The target of $750 million in lending was comparable to Brisbane city, which had more than twice as many lenders.

Evidence given by the CBA appears to be portraying its role in the Storm collapse as the work of a rogue branch; however the FSU understands that a CBA audit of 600 files in relation to loans provided to Storm clients uncovered no breaches. The loans were given in accordance with the bank's policies and procedures – what has been exposed is the shortcomings and flaws inherent within them. The CBA provided hundreds of margin loan facilities to Storm clients that were obviously inappropriate – even if this was due to inadequate or misleading information provided by third parties we believe the CBA had an obligation to lend responsibly by verifying the information and where appropriate modifying or rejecting applications; obviously this did not occur.

The sales targets for North Queensland that helped create the Storm debacle would have been imposed by the State Manager in full knowledge of the business Storm was providing. The State Manager in turn would have been implementing directives from head office regarding growth targets.

The behaviours of Storm and CBA employees were driven by a culture that encourages sales ahead of good customer service which has become widespread in the financial services industry. The Storm collapse is an extreme example but the remuneration and incentive schemes involved are not uncommon.

The use of up-front commissions, trailing commissions, soft-dollar incentives, volume bonuses, rewards for achieving sales targets and fees based on a percentage of funds under advice are all symptomatic of the culture that allowed and encouraged unsuitable and unsustainable products to be marketed en-masse. We note that these types of remuneration are exactly the ones that ASIC are suggesting should be banned.[2]

Processes, House of Representatives Standing Committee on Economics, Finance and Public Administration, 2007.

[2] ASIC submission – page 35, Inquiry into Financial Products and Services in Australia, Parliamentary Joint Committee on Corporations and Financial Services

Purchasing any financial product is a serious matter, especially large credit products where the family home is used as security. Commissions, bonuses and fees based on the size of a product carry the implicit message that ever increasing sales are good and desirable – the FSU does not share this view and believe it is detrimental to consumers, finance sector staff and the provision of good customer service.

We accept that a major aim of any business is to make profits; however the sale of major credit products has ethical dimensions as well as wider implications for society, especially where inappropriate lending practices become widespread as was the case with many of the margin loans. Institutions such as the CBA that engage in riskier lending practices may lose a percentage of profits when things go wrong. In contrast, the potential impact on consumers is devastating and may have wide ranging effects such as increased demand for welfare services, lower work productivity due to stress and absenteeism, and greater reliance on support networks to survive. The majority of the negative impacts when things go wrong are primarily absorbed by the consumer and society – not the institution engaging in the practice.

CBA and Storm executives rewarded volume ahead of quality. It is not the fault of a few individuals working inside this culture, but the fault of organisations that deliberately create structures and incentives that reward sales without proper consideration of circumstances.

Unfortunately the culture of sales targets is often coupled with systemic psychological bullying of staff by management to meet these targets. In these situations staff who do not meet their targets will not simply experience a financial loss but may also suffer heightened job insecurity. These factors encourage and even coerce staff to sell products to meet their own job and financial security needs rather than those of the consumer.

A survey of FSU members, predominantly in the established banking sector, found that:

- 59 per cent felt pressured to make inappropriate sales to meet sales targets.
- 52 per cent of workers felt obliged to try and sell debt products even when a customer didn’t need them; and
- 63 per cent felt that inappropriate sales targets are having a negative impact on their ability to provide responsible customer service.

Any genuine responsible lending regime will ultimately require finance sector staff to <u>not</u> make sales in certain circumstances. The FSU believes this is entirely consistent with the provision of professional customer service and sincerely hopes that companies will begin to recognise this in their remuneration arrangements. The culture of sales targets simply reward sales – the FSU advocates reward structures that reflect professional service and responsible behaviour.

Financial products should be sold on the basis of suitability and sustainability for all those involved in the transaction – this can only be achieved through transparency and incentives that meet consumer requirements and recognize employee needs.

The GFC was created by widespread inappropriate and unsustainable selling of financial products. There is no question that Australia avoided the worst consequences of the crisis; however the FSU believes we are at serious risk of ignoring the lessons that can and should be learned. The stock market crash demonstrated that the Storm business model was unsustainable and required many homes and assets to be put at risk, but the banks still funded it and profited from it. Consumers were acting on the advice of licensed advisers and buying products from a major Australian bank – the massive and tragic risks involved were tolerated and even encouraged by the institutions involved. On 1 October 2008 the "Australian Bankers' Association (ABA) said the responsible and conservative lending stance which has been adopted by the Australian banks means the sector is strong and withstanding the global turmoil."[3] The banks themselves may have subsequently withstood the global turmoil but many of their consumers did not.

We acknowledge and welcome the various developments that are occurring in relation to the regulation of financial services[4] and the move away from commission based remuneration in some sections of the industry. These measures may prevent another high profile collapse; however they will not help those people affected by the recent collapses and the FSU is concerned that the need for cultural change is still not being treated with the importance or urgency it deserves.

There are initial and welcome signs that the economy is recovering however there are also worrying signs that this will mean going back to "business as usual" for some parts of the finance industry.[5] We submit that "business as usual" is exactly what caused the recent collapses and urge the Committee to take whatever steps it can to prevent this.

If you have any questions in relation to this submission please contact our National Communication and Policy Manager, Rod Masson, on (03) 9261 5330 or James Bennett, Senior Policy & Research Officer on (03) 9261 5405.

Yours sincerely

Leon Carter
National Secretary
8 September 2009

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[3] *Australian banks' sound lending practices have protected customers from a US-style sub-prime crisis,* Australian Bankers' Association, Sydney, 1 October, 2008:

[4] In particular the regulation of margin lending and the introduction of responsible lending requirements.

[5] FSU members within CBA are reporting that sales targets for 2009/10 have actually increased despite Ralph Norris stating that 2009/10 will be a time of low growth for the bank.