Consumer Credit
Legal Centre NSW

April 2014

Submission in relation to the Financial System Inquiry by the Consumer Credit Legal Centre (NSW)

Consumer Credit Legal Centre (NSW) Inc ("CCLC") is a community-based consumer advice, advocacy and education service specialising in personal credit, debt, banking and insurance law and practice. CCLC operates the Credit & Debt Hotline, which is the first port of call for NSW consumers experiencing financial difficulties. We also operate the Insurance Law Service which provides advice nationally to consumers about insurance claims and debts to insurance companies. We provide legal advice and representation, financial counselling, information and strategies, referral to face-to-face financial counselling services, and limited direct financial counselling. CCLC took over 20,000 calls for advice or assistance during the 2012/2013 financial year.

A significant part of CCLC's work is in advocating for improvements to advance the interests of consumers, by influencing developments in law, industry practice, dispute resolution processes, government enforcement action, and access to advice and assistance. CCLC also provides extensive web-based resources, other education resources, workshops, presentations and media comment.

The Consumer Credit Legal Centre (NSW) (CCLC) welcomes the opportunity to contribute to the Financial Systems Inquiry. The submission below responds to the Inquiry's terms of reference released on 20 December 2013. The financial system has the potential to create significant benefits for (or cause significant harm to) the community as a whole, or particular groups within it. As a service advising and assisting thousands of consumers every year, the CCLC is well placed to comment on both aspects of the system – where it is working well and where it is failing end users.

This submission strongly endorses the comments submitted by the Consumer Action Law Centre on 31 March 2014. Some of the sections below provide additional evidence in relation to problems identified by Consumer Action Law Centre, and some are additional challenges or observations. While we have not covered all the topics covered in the Consumer Action submission we endorse the entire submission and all its recommendations.

This submission is set out as follows

1. **Part 1, positive developments since the 1997 Wallis inquiry, including:**
    a. Industry based external dispute resolution
    b. Responsible lending and the commencement of the national credit law
2. **Part 2, problem areas where the system is not delivering desirable outcomes for end-users, including:**
    a. Insurance
    b. Fringe lending
    c. Financial difficulty predator businesses
    d. Avoidance
    e. Access to advice and assistance

PART 1: Positive developments since the 1997 Wallis inquiry

We strongly endorse all of the comments made by Consumer Action Law Centre and submit the following additional comments and evidence.

There have been many significant developments in the Financial System since the Wallis Inquiry – both in the way the industry operates and in the way it is regulated.

The CCLC operates two information and advice telephone lines for consumers:

1. The Credit & Debt Hotline, which is staffed by financial counsellors and solicitors and gives advice to consumers in NSW who are in financial difficulty and/or wanting advice about credit, debt or banking; and

2. The Insurance Law Service advice line, which is staffed by solicitors and available across Australia.

Through these advice lines we take between 15,000 and 20,000 calls per year from consumers either in financial difficulty and/or having a dispute with a credit provider, deposit-taking institution, insurer or other related broker or service provider. We speak to financial counsellors and other community lawyers who are assisting consumers and require expert advice. We also open between 400 and 500 casework files, including representing consumers in EDR schemes and in courts (the latter in a small percentage of cases). As such we have good understanding of the issues facing consumers, and which aspects of the system are working well for end users and which are not.

(a) Industry External Dispute Resolution

We strongly endorse all of the comments made by Consumer Action Law Centre and submit the following additional comments and evidence.

Access to redress where things go wrong was a key theme coming out of the Wallis Inquiry. In our view the availability of free, accessible, expert dispute resolution in the form of the current External Dispute Resolution services (EDRs) which are funded by industry, independently governed, and overseen by ASIC has been the single biggest advance for consumers in Australia in decades. EDR schemes ensure the financial services industry is accountable for its conduct in a meaningful way and that consumers affected by industry failures and transgressions are able to access appropriate resolution and, where appropriate, redress. We also strongly support the availability of EDR schemes after the commencement of legal proceedings.

i. Appropriate resolutions for consumers

There is no doubt that consumers have very poor access to justice through the courts. Free or affordable legal representation is inadequate to meet the need. The vast majority of debt collection claims are default judgments. When the national credit laws were introduced, *External Dispute Resolution* was intended by the government to replace the credit jurisdiction of tribunals formerly available in a number of states.

Our staff solicitors and financial counsellor have made over 3,000 referrals to either the Financial Ombudsman Service (FOS) or the Credit Ombudsman Service Ltd (COSL) per year for the past three calendar years (in fact peaking in 2012 when 3,921 referrals were made). In urgent cases, where consumers are facing imminent enforcement action in the courts, we assist them to lodge their dispute with the EDR scheme while they are on the phone. We also represent disadvantaged consumers in EDR. We have assisted 500 consumers to lodge in EDR since January 2010. Our assistance may include lodgement only, drafting key submissions for the client, or full blown representation including all correspondence, preparation of evidence, informal negotiations, and representation at conciliation conferences where appropriate.

EDR Casework Statistics

External Dispute Resolution Service	2010	2011	2012	2013	2104	Total
Credit Ombudsman Service	32	32	51	23	6	144
Financial Ombudsman Service	76	104	106	61	12	359
Total	108	136	157	84	18	503

EDR Case Studies

Travel Insurance

Our clients were self –funded retirees in their sixties. They were planning an overseas trip and purchased travel insurance. The male member of the couple informed the insurer about his wife's pre-existing medical condition, including that she was under the care of a specialist and had had previous surgery. They paid an extra premium to cover the pre-existing condition.

Prior to the date of travel the wife found out that she had to undergo further surgery and would be undergoing treatment for a further 6 months which would prevent them from undertaking their planned holiday. They claimed for the cancellation of the holiday under their insurance policy and were rejected on the basis that the pre-existing condition was excluded as a result of a clause covering situations where the insured is "awaiting a specialist opinion" at the time of purchase of the policy.

The couple felt extremely aggrieved. They had informed the insurer in full of the wife's condition and paid an extra premium to ensure that her condition would not prevent their being successful should they need to make a claim.

CCLC assisted the clients to lodge in the Financial Ombudsman Service and to present their evidence and arguments. The insurer denied having been informed of the wife's circumstances but could not explain what the additional "pre-existing cover" that had been paid and noted on the policy for was actually for (if not the wife's condition as allegedly disclosed).

The Financial Ombudsman service recommended in favour of our clients on the basis that: the policy was convoluted and difficult to understand in relation to the hierarchy of pre-existing conditions that could and could not be covered and in what circumstances; and, having accepted a premium for a pre-existing condition, the insurer was estopped from then relying on the policy wording to say that the condition was not actually covered. The insurer accepted the recommendation and paid our clients the cost of their loss ($6,000), interest on that amount, plus $1,000 non-financial loss.

Had these clients not been paid they would have been unlikely to be able to afford another holiday in the future, and would have been permanently disillusioned with travel insurance as a useful risk management option.

Natural disaster

In May 2013, Caxton Legal Centre received the final decision from the Financial Ombudsman Service (FOS) for the last of the 116 flood insurance cases run by the service. All 116 clients were individuals and families affected by the January 2011 floods and who had their initial insurance claims refused.

The 116 Caxton clients were part of a cohort of more than 700 clients who engaged either a Legal Aid or a Community Legal Centre to dispute flood insurance refusals. The other three organisations were Legal Aid Queensland, Legal Aid New South Wales and the Insurance Law Service (a project of the Consumer Credit Legal Centre (NSW)). The collaborative work of the four organisations is (as far as we are aware) the largest casework collaboration between the Legal Aid commissions and Community Legal sector. The project also involved volunteer solicitors and students, and the support of pro bono firms in the early days.

Caxton's assistance resulted in reversals of refusals in nearly 50% of cases and more than 5 million dollars in money returned to the community. In a rare opportunity to quantify the value of CLC work, the $5 million returned to the community was managed with a total funding to Caxton of just $350 000 over two years. The collective efforts of the four organisations returned more than $20 million dollars to flood-affected families.

Joint consumer submission to the 2013 independent review of FOS.

Fraudulent Mortgage

Our client was elderly woman from a non-English speaking background. Her adult daughter, who suffered from mental illness, obtained a series of drawdowns against her mother's mortgage and sent the funds offshore to Nigerian scammers. Her mother had never been involved in any of the transactions and had not benefitted from the funds withdrawn and faced the prospect of losing her home. The bank denied any wrongdoing and relied on the signed loan documents and mortgage. The client was on a pension, and due to the value of the property was not eligible for Legal Aid. She had the option of commencing legal proceedings in the Supreme Court against the bank which would be expensive and stressful or lodging in EDR. The client chose to pursue EDR, and a dispute was lodge on her behalf arguing that the signatures were forgeries and the bank failed to take steps to verify her identity.

After lodging in EDR and the complainant filing her evidence and submissions, before the bank was required to provide its evidence and for the EDR scheme to arrange a forensic hand writing expert, the bank agreed to clear the balance owing and withdraw the mortgage. The dispute was resolved at low cost to both the complainant and the bank (compared to taking the matter to court).

ii. Keeping traders accountable and ensuring quality products and services

Access to external disputes resolution is not only synonymous with access to justice for consumers; it is also a key accountability mechanism against poor market practice. The regulator cannot be everywhere. Where dodgy providers and practices are not held to account, quality financial services and product providers suffer because they are outcompeted. Accessible, high quality dispute resolution improves the efficiency of markets generally. Where consumers cannot easily complain about poor treatment and seek redress, dishonest traders hold an unfair competitive advantage over more responsible traders.

Sham to avoid the credit law

Our client (Mrs K) was given a series of small loans which were arguably in breach of the national credit laws in relation to responsible lending. Mrs K was struggling financially and had already paid back significantly more than she had borrowed. CCLC assisted Mrs K to lodge in the Credit Ombudsman Service. Mrs K continued to receive texts inviting her to borrow more even after the dispute was well underway.

The businesses involved in the transactions maintained that they were not covered by the credit law. They had devised a series of services and transactions which they claimed kept them outside the letter of the law and meant they did not have to comply. The Credit Ombudsman Service found for Mrs K and required that everything she had paid over and above the amounts actually borrowed needed to be refunded.

More importantly, the Credit Ombudsman found that the businesses involved were covered by, and needed to be compliant with, the national credit laws. This is very important for both consumers and other lenders in the same market who cannot easily compete with non-compliant entities who charge higher amounts and have lower compliance costs.

iii. Access to EDR after legal proceedings have commenced is vital

CCLC is also very supportive of the post-statement of claim jurisdiction of the EDR schemes. Since the commencement of the post-statement of claim jurisdiction at FOS in January 2010 (it commenced at COSL prior to this), CCLC has taken 1340 calls from 644 separate individuals who were in financial difficulty and had already received a statement of claim in relation to their home mortgage. That is 644 individuals and their families facing the loss of their home that would have had no recourse but to file a defence in court had the EDR scheme not been available.

In our experience, using EDR post-statement of claim allows consumers to come to arrangements with their lenders that are ***mutually beneficial*** and allow the matter to be settled without the cost and indignity of court based enforcement.

Mortgage hardship in rural NSW

Mrs B received a statement of claim for possession of her property in rural NSW. Mrs B had fallen behind on the couple's mortgage as her husband, who was nearing retirement age, had several medical conditions that required lots of travel and treatment and he had run out of sick pay. Her mortgage was relatively small, but on reduced wages and Centrelink they were finding it difficult. Mr B was soon to reach retirement age, and his superannuation would repay the mortgage. With the assistance of a financial counsellor, Mrs B was able to re-arrange her payments and make the regular mortgage repayments. The CCLC solicitor lodged in the Financial Ombudsman Service on her behalf, and was able to negotiate for the statement of claim to be discontinued and Mr and Mrs B to make the regular payments until he retired. Mr B retired and discharged his mortgage in full from his superannuation. Without the additional cost of rent to look forward to this greatly enhanced their standard of living in retirement.

Mortgage hardship and time to sell

Mr C lives in rural NSW, about 600 kilometres west of Sydney. He and his wife had borrowed money to start a small business secured over his home. The business failed and Mr and Mrs C placed their property on the market for sale. Mr and Mrs C received a statement of claim. By the time they found CCLC they had received notification that their lender was going to proceed to default judgment the following day. CCLC assisted them to file in the Financial Ombudsman Service online to request an additional 3 months to sell the property. Mr and Mrs C were hoping to exchange contracts the following week with a potential buyer. A default judgment listing on their credit file would have adverse impact on them finding rental accommodation, in a small town where rental was difficult.

While there have been a number of criticisms levelled at EDR in recent years, the schemes have to undergo regular independent reviews to retain their ASIC approval. These reviews are usually rigorous and submissions are made by a wide variety of stakeholders. Improvements are invariably made as a result of each review process. We submit that this is the appropriate mechanism for dealing with any operational issues.

Recommendation: The availability of free, independent, ASIC approved EDR should remain a key component of the financial services landscape. Any issues with the process should be addressed through the regular independent reviews required to retain such approval.

(b) Responsible lending

We strongly endorse all of the comments made by Consumer Action Law Centre and submit the following additional comments and evidence.

Prior to the introduction of the *National Consumer Credit Protection Act 2009* problems in the lending industry were rife. Many consumers were granted loans they could not afford to repay. In credit card lending, unsolicited offers of credit, reliance on behavioural scoring and minimum repayment records, led to dramatic mismatches between credit limits and ability to pay. In the home lending industry decreasing loan-to-valuation ratios, and more generous repayment to income allowances, pushed the limits of affordability. At the same time the growth of no-doc and low doc lending created opportunities for outrageously unaffordable loans to be given in the home loan market also. While some lenders specifically targeted and priced their products for marginal borrowers, the trend soon spread into the mainstream, with most mainstream lenders including the major banks offering low doc products.

This trend was exacerbated by the growth in the use of mortgage brokers. Brokers carried none of the default risk worn by lenders and had a strong financial incentive (in the form of commissions) to get as many and as big a loans as possible accepted by the financial institutions and other lenders. The presence of the 3rd party in the transaction also allowed the lender (keen to grab or retain market share) to distance themselves from the transaction and to either genuinely miss, or effectively *turn a blind eye,* to irregularities in loan applications.

These problems have been well documented for instance *Report 19: A report to ASIC on the finance and mortgage broking industry*; ASIC's *Report 119: Protecting wealth in the family home: An examination of refinancing in response to mortgage stress;* and the *National Finance Broking Regulation Regulatory Impact Statement Discussion Paper.* CCLC assisted many consumers with irresponsible and predatory loans:

Pre-NCCP CCLC Case Studies

Credit cards
An elderly pensioner, Mrs. F, accumulated over $70,000 in credit card debt. The debts were accumulated via a series of credit card limit increase with no assessment of the client's ability to pay. Mrs. F in fact had two cards with each of two major banks and had been surviving by using one card to pay off another in addition to whatever payments she could make.

Personal Loan

CCLC represented Mr and Mrs S Stanton in a hearing in the General Division of the CTTT to recover finance broker fees paid. Mr and Mrs S approached a broker to arrange a personal loan. They ended up with a business/investment loan with a 2nd mortgage over their home to a fringe lender with high costs. The costs of arranging the loan were so significant that of the $30,000 they borrowed, they only received $17,000. The broker's costs alone were over $7,000. Our clients were successful in getting an order in the CTTT for a refund of most of the broker's fees. The lender and solicitor involved had also profited considerably from high fees and a high interest rate but it was not possible to mount a successful case against them. In this case our clients were able to refinance back to the mainstream. In other cases clients have approached us having already lost their homes as a result of similar transactions.

Line of equity

Mr & Mrs D are illiterate. Mr. D earns an average wage as a labourer. Mr & Mrs D had a home loan with a major bank. A door-to-door salesperson called at their home without notice stating that he could save them thousands of dollars and take several years off the term of their home loan. Mr & Mrs D did not understand how this would work but very much wanted to repay their home loan as soon as possible. Mr & Mrs D were asked to sign a contract but the contract was not explained. It turned out Mr & Mrs. D had agreed to refinance to a more expensive interest only line of credit loan which was totally inappropriate in their circumstances. The salesperson charged them $5000 for the plan to save thousands of dollars. Mr & Mrs. D ended up owing a lot more money on their loan and owing Over $10,000 on a credit card linked to the loan. Mr & Mrs. D could not afford the repayments on the loan or the credit card and faced losing their home.

Predatory home lending

A couple had been in serious default on their home loan and they had approached a mortgage broker in an attempt to save their house. They had a large and growing family and, at the time of consulting the broker, their sole source of income was Centrelink benefits.

The couple had informed the broker of their level of income from the outset and that they were unemployed. In fact, the broker told the couple that he knew they would not be able to afford the loan, so he would structure the loan to include six months "prepaid interest". That way they would not have to make any payments for the first six months. He assured them that after the six months, he would change the loan over to a "normal (cheaper) loan" for no extra charge. He also assured borrowers that they would receive $26,000 at settlement to pay various other debts. At settlement the clients received significantly less than $26,000, there was no "repayment holiday" and their repayments were twice those they had been unable to pay on their previous loan. It would have been obvious to the broker that the clients would quickly default again and inevitably lose their home. The costs of setting up the loan were close to $30,000, including $15,000 in brokerage fees.

The broker was a member of the Credit Ombudsman Scheme Limited and the borrowers lodged a complaint. The Ombudsman found in favour of the borrowers on numerous points of law, but the broker failed to comply with the Ombudsman's Determination. At the time, membership was not compulsory and there was no real consequence of being rejected from the scheme. The lender commenced proceedings in the Supreme Court for judgement and possession of the couple's home. CCLC lodged a defence and negotiated for the clients to sell their home and repay significantly less than the sum sought. The broker was rejected for eligibility for a license or authorisation as a credit representative under the new law shortly after its enactment for failure to belong to an EDR scheme.

The landmark case of *Permanent Mortgages Pty Ltd v Michael Robert Cook and Karen Cook [2006] NSWSC 1104 (24 October 2006)*[1] the NSW Supreme Court found that a loan entered by the Cooks was unjust under the then applicable *Uniform Consumer Credit Code 1996:*

> "Given the means of the Defendants and their credit history, the Plaintiff, in my view, was aware, or would have been aware, had it made the most perfunctory of enquiries, that the Defendants were not capable of servicing the loan even at the lower rate of interest and could only satisfy their obligations by selling the mortgage property for a sum sufficient to cover the principal and interest. It was likely that they would thus become obligated to pay interest on the amount of the credit, not at 8.8% p.a., but at the much higher rate of 13.8%."[2]

However, the offending loan was one loan at the end of a whole series of refinances undertaken in response to financial difficulty which took an $110,000 bank loan to over $245,000 in the space of 5 years. Throughout this series most of the increased loan amount was made up of interest and fees that were paid to numerous parties, both lenders and brokers. The finding of unjustness in relation to the last loan did not save the home of the borrowers, who could not afford to pay the principal and reasonable interest on the final loan in the series. Clearly in the case of predatory, or even just irresponsible, lending prevention is far better than cure. CCLC saw many cases of this nature in this period, where clients had refinanced repeatedly to save an impossible situation, completely depleting their equity without ever gaining any benefit.

In 2009 the *NCCP Act* was enacted, coming into effect in stages over the subsequent couple of years (starting from 1 July 2010). This legislation includes several measures which go directly to the heart of the problems described above in relation to responsible lending and are completely new (and in some aspects unique in the world):

- Licensing of lenders AND importantly, brokers and intermediaries (including general conduct obligations and the ability to remove or place conditions on a license);
- Specific responsible lending obligations; and
- Compulsory EDR membership.

[1] See also *Cook v Permanent Mortgages Pty Ltd [2007] NSWCA 219 (9 August 2007)*

[2] Patten AJ at 88

Since that time ASIC has released Regulatory Guidance, including importantly *RG 209 Credit licensing: Responsible lending conduct*. In an area of new and largely untested law this form of guidance is crucial. ASIC has also released surveillance reports[3], banned a number of market participants[4], and commenced enforcement action in the courts in a handful of cases[5].

This regime is particularly effective because it allows for preventative action by the regulator in the form of regulatory guidance, surveillance and other interventions, it allows for offending industry players to be banned to prevent repeat behaviour, and it provides EDR to ensure that consumers are able to access redress where applicable and to provide a forum in which some of detail of how the law works in practice can be ironed out in a practical context. Court cases to test laws are expensive and rare and if relied on as the only form of enforcement and redress are of extremely limited use. Court cases will eventually happen, and all the cogs in the regime will adjust their practice accordingly, but in the meantime the law is already effective.

Importantly, CCLC has ceased to see the types of cases described above. While there are still problems in relation to pay day lending and consumer leases and more complicated disputes where the responsibilities of lenders and borrowers under the new laws are still being ironed out, <u>the blatant problems that we frequently encountered prior to the enactment of the new regime are simply not presenting.</u>

In our view it is the three arms of the regime (licensing, EDR and responsible lending) working in concert to achieve this result.

The *NCCP Act* is a large and somewhat daunting piece of legislation but:

- The work required to be done by the consumer lending industry to comply with that law has already been undertaken
- The problems that the law was introduced to address were serious, with detriment suffered by not only individual borrowers but the broader economy
- The regime appears to be working!

Recommendation: The *NCCP (Act) 2009* architecture should remain largely unchanged.

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[3] *Report 262 Review of credit assistance providers' responsible lending conduct, focusing on 'low doc' home loans* (November 2011); *Report 264 Review of micro lenders' responsible lending conduct and disclosure obligations* (November 2011); *Report 330 Review of licensed credit assistance providers' monitoring and supervision of credit representatives* (March 2013); *Report 358 Review of credit assistance providers' responsible lending conduct relating to debt consolidation* (July 2013)

[4] These are regularly reported in media releases available at http://www.asic.gov.au/asic/ASIC.NSF/byHeadline/Media%20centre Recent examples include 13-265MR South Australian mortgage broker charged with providing false or misleading information, *Friday 27 September 2013;* 13-200MR Former mortgage broker pleads guilty to submitting false documents to lenders, *Friday 2 August 2013;* 13-179MR ASIC permanently bans mortgage broker, *Wednesday 17 July 2013;* 13-170MR ASIC bans Perth finance broker for falsifying documents, *Thursday 11 July 2013;* 13-113MR ASIC permanently bans motor vehicle finance and insurance broker, *Wednesday 22 May 2013;* 13-080MR ASIC bans Sydney mortgage broker and cancels his Australian credit licence, *Tuesday 16 April 2013*

[5] 13-205MR ASIC commences legal action against Fast Access Finance, *Wednesday 7 August 2013;* 13-257MR ASIC takes civil action against The Cash Store, *Wednesday 11 September 2013*

PART 2: problem areas where the system is not delivering desirable outcomes for end-users

(a) Insurance

We strongly endorse all of the comments made by Consumer Action Law Centre and submit the following additional comments and evidence.

i. Flood cover still a major problem

In the aftermath of the catastrophic Queensland storm and flood events of late 2010 and early 2011, and the Victorian floods of early 2011, several inquiries were commissioned. These events brought home that many Australian homes were simply not covered for flood events, a fact that was a shock to many, and had expensive consequences for not only the individuals affected, but their families, communities, charities and governments who were called upon to fill this void.

The National Disaster Insurance Review, commissioned by the then Assistant Treasurer, the Honourable Bill Shorten, was tasked with making recommendations to address the issues that had arisen. Key objectives of the review were facilitating rebuilding and recovery by people and communities as quickly as possible; allowing people to choose the location of their homes in the knowledge of the attendant risk; improving access to adequate insurance cover where possible; and promoting risk mitigation works by individuals and governments. Guiding principles were that government should only interfere in the private insurance market to the extent that there was clear failure by those markets to offer appropriate cover at affordable premiums.[6]

The above review made four "pivotal recommendations":

1. That an agency be established with the two key functions of managing the national coordination of flood risk management and operating a system of premium discounts and a flood risk reinsurance facility;
2. That all home insurance, home contents and home unit insurance policies include flood cover;
3. That a system of premium discounts be introduced to ensure affordable cover to high risk properties without the need for cross-subsidisation by other policy holders in low risk areas; and
4. That any funding shortfall occurring in the reinsurance facility through claims exceeding the funds held in the facility would be met by governments.[7]

[6] NDIR Report, Terms of Reference, I & ii.
[7] NDIR Report, pp3-4

Flood cover is now included in many home and contents insurance policies, with a common definition, but consumers have the choice to "opt out". In our experience many consumers are doing so, or simply finding it impossible to find cover at an affordable price:

CCLC gets regular calls from consumers who are unhappy with the premium being asked in relation to their flood cover. Complaints include:

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

Some callers are being refused insurance completely:

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

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

We are concerned that events similar to 2011 are likely to occur again, with significant numbers of properties uninsured for flood as a result of customers being unable to afford appropriate cover in the private market, being refused cover, or opting out of cover without appreciating the full extent of their risk. The market solution is not currently working. All indicators currently point to a likely increase in natural disaster events. These events are inevitably going to cost the government significant amounts of money. The NDIR recommendations offered a solution which invested that money in strategic way, ensuring flood mitigation and improved planning was a key part of the equation. Either the recommendations of the NDIR should be fully implemented or the government and insurance industry need to come up with an alternative model which provides real solutions.

ii. Budget options and fine print – all insurance policies are not created equal

Consumers are constantly inundated with offers to switch and save on insurance. As a service that assists consumers not at the point of sale, but at the point of claiming, we are all too aware that not all insurance policies are created equal. Consumers are accepting savings upfront without fully appreciating what they are losing in terms of appropriate cover. Further, we are well aware that consumers do not read their Product Disclosure Statements (PDS) or do not fully appreciate the differences between the various policies on offer until they have the need to claim.

Ms B insured her investment home and residential home and contents with the same insurer. Ms B's properties were located just below Wivenhoe Dam in Queensland. Advertisements on TV which for the insurer said the insurer would provide automatic flood cover.

Following the significant weather events which struck Queensland in January 2011, Ms B's investment and residential properties were completely inundated by water and ultimately left uninhabitable. Ms B was devastated at the loss but was happy that she had made sure she had adequate insurance. Based on hydrology reports, the insurer determined that the insured properties were both *flooded* and accepted the claim for flood. Little did Ms B know that the insurer would only pay her $15,000 for each of her home buildings and contents claims. Ms B was not clearly informed of the significant limit within her policy which limited the benefit payable for flood claims.

The Insurance Law Service raised a dispute in the Financial Ombudsman Service (FOS) against the insurance company and argued that it could not prove that Ms B's properties were flooded. Where the properties were inundated by *stormwater*, the payment under the policy would not be capped at $15,000 and Ms B would be entitled to receive the full cost of rebuilding her properties and replacing her contents items. The Insurance Law Service also argued that the insurer could not rely on the term within the policy limiting flood cover as the insurer failed to clearly and unambiguously disclose its significant monetary cap on flood claims within the policy document.

Ultimately, Ms B had victory against the insurer when it conceded that Ms B's properties could have been inundated by stormwater before any flooding. Some ten months after the significant weather event, her claims were paid in full, but only on the basis of technical arguments over the definition of storm and flood and factual arguments about the sources of the water entering the property first. Many other policies were affected by the same limitations on cover for flood. While some would argue those that had limited flood cover were better off than those who did not realise they had no flood cover at all. Nonetheless, home building cover limited to $15,000 is of extremely limited use!

We are concerned that more and more insurers are moving to address customer concerns about affordability by limiting cover in creative ways. This will only add to consumer confusion, disappointment and disillusionment with insurance. It will also mean that risks intended to be borne by the private insurance industry will fall back on individuals, communities and government.

iii. Insurance associated with superannuation policies

Many Australians obtain their life insurance and income protection insurance as part of their superannuation policy. This type of insurance is obtained as a group insurance policy where the insured is the superannuation fund with the members being third party beneficiaries. CCLC is strongly in favour of superannuation carrying life insurance and total and permanent disability cover as a default option. For many of our clients these policies are the only insurance of this nature they will ever have (in some cases the <u>only</u> insurance product they will ever have).

Total and Permanent Disability Insurance

Our client approached us with seemingly insurmountable financial problems. He was a 50 year old illiterate man, with no family, who had suffered three heart attacks in late 2008 and was unable to continue in his occupation as a cleaner. He was in receipt of the Disability Support Pension (DSP).

He was in a depressed state when referred to CCLC in September 2009 after a major bank refused to extend his hardship arrangement to repay his $7,600 credit card debt. The client initially said he had no assets and wanted us to seek to have the debt waived or go bankrupt because he had no funds other than his pension.

A CCLC financial counsellor reviewed his personal and financial situation. The financial counsellor searched the ATO lost -super site, which revealed that he had 8 superannuation policies. The client was surprised to learn that three of these included cover for Total and Permanent Disability (TPD).

The financial counsellor worked with the client him to complete the TPD application forms and obtain the medical and other reports requested by the super funds. The financial counsellor established with Centrelink that if the client retained most of his TPD proceeds in his super funds his TPD pension would not be reduced. The client decided to take out some funds to refurnish his Housing Department unit, pay off his debt to the bank and go on the (modest) overseas holiday he had always dreamed about but could never afford.

Struggling with the Mortgage

Rose was an Aboriginal woman struggling to pay her mortgage on a Carer's Pension. She could not afford the repayments and was in a terrible state upon first seeking assistance. After lodging a hardship application CCLC discovered that the client had a potential claim on for Total and Permanent Disability related to her superannuation that she was not aware of. After making a claim she was able to reduce the balance of her mortgage to an amount that could be refinanced to an Aboriginal specific lending organisation, affording her lower interest and affordable repayments.

Obtaining insurance through a superannuation fund involves little more than ticking a box and paying the premiums out of contributions received. There are many positives for some, who are receiving a benefit they would otherwise not have. However, the extent of the coverage and benefits can be difficult to ascertain.

Members of the superannuation fund are generally not cognisant about what the insurance covers except in a very general sense. Policies generally have complicated wording which is difficult for consumers to navigate. Often, the PDS is issued only once at the commencement of the fund or where a member seeks to increase their cover. Beneficiaries often either never read these documents or forget about the benefits they may have because they are not currently relevant. Policy booklets are often discarded or lost.

The Insurance Law Service receives a lot of calls from consumers seeking to claim under their superannuation insurance policy. The first problem to be dealt with is that the consumer does not have a copy of the insurance policy, as superannuation funds often switch insurers and it can become complicated to determine what policy covers them for a particular time. A lot of our work is getting the consumer to the right policy. Consequently, the consumer often does not see a copy of the policy until their claim is rejected.

Confusion Between Insurers

Our client sought to claim on her Total and Permanent Disability policy attached to her superannuation. This claim proved extremely difficult to establish because the superannuation fund had changed insurers during the period in which our client's condition had been deteriorating and there was a dispute over which policy, if any, applied. CCLC's Insurance Law Service assisted the client to lodge a complaint in the Superannuation Complaints Tribunal. Both policies had different definitions and ultimately we argued that the client met both definitions and that she must therefore be covered by one of them. Eventually (after 12 months or so) one insurer agreed to pay and the complaint was withdrawn.

The Insurance Law Service operates an email enquiry function, we have set out examples of typical inquiries received (dates, and other identifying information have been changed):

> I have been off sick since September 2010. I have been receiving income protection since February 2011. Since then, I have been trying to get a copy of my insurance policy but, because the employer was paying for it, they said that they didn't have to disclose it to me. Now I finally received a copy which has an effective date of November 2011 and issue date of January 2012. In this copy it says that my TPD claim amount will be based on 6 months after the date I became ill but what if the earlier policy says something different, can they change the policy wording what would be the wording relevant to my claim?

> Hi there, became ill [date] 2012, left work [date] 2012, and claimed STANDALONE INSURANCE that I had been paying into. STANDALONE INSURANCE claim went from June 2012 to January 2014.
>
> I found out I had income protection thru SUPER INSURANCE, I applied January 2014, I received paperwork from the same insurer as my STANDALONE INSURANCE, and I filled it in thinking they would merge my old claim with new one ....no after constantly contacting STANDALONE INSURANCE for an answer, I was told that my claim was back with SUPERTRUSTEES awaiting review, I contacted SUPERTRUSTEES to be told that claim was still with STANDALONE INSURANCE. I contacted STANDALONE INSURANCE, and was advised my claim was waiting for STANDALONE INSURANCE manager review. This week I contacted STANDALONE INSURANCE for an answer, to be told that claim was again back with SUPER TRUSTEES awaiting review. I contacted SUPER TRUSTEES to be told that my claim has been cancelled as I never completed and returned paperwork to I had to SUPER INSURANCE and to contact SUPER INSURANCE to discuss, they have no record of any claim pertaining to my name?
>
> I'm very depressed at this treatment I've endured!! I have completed and emailed claim paperwork to SUPER INSURANCE today, knowing they have no details about me, but SUPER TRUSTEES and STANDALONE INSURANCE insist that my important completed paperwork has been forwarded onto SUPER INSURANCE. I am at a loss as to what or who or if anyone can help me get what I believe I am entitled to and until someone says no you're not entitled, I will keep trying but alas I keep getting fobbed off.

Finally, any dispute for a superannuation related group policy would usually need to be heard by the Superannuation Complaints Tribunal which is a slower and less dispute resolution focused process then going to the Financial Ombudsman Service.

iv. Life insurance

The first two issues below apply equally to group policies associated with superannuation.

Access to documents

The *Insurance Contracts Act 1984* (ICA) does not give an insured a *per se* right to the re-issuing of a PDS or a certificate of insurance, irrespective of whether an insured is direct or through a super fund. The insurer only needs to issue it once (see s74 ICA). In our view, access to the certificate and PDS is essential and in the current digital age is not an onerous proposition on an insurer. The *Life Insurance Act 1995* allows an insured to request replacement policy document in substitution for a lost document and the company may issue a replacement policy document to the policy owner if it is satisfied that there is sufficient evidence of the loss or destruction of the original policy document. If the company does not issue a replacement policy document within 6 months after it receives a request from a policy owner, the policy owner may apply to a court of summary jurisdiction of a State or Territory for an order. This is obviously of very little assistance.

Claims handling and transparency

The claims process in income protection is often beset by delay with life insurers taking months to process claims, sometimes asking for the same information multiple times. This can cause further stress to a person seeking to claim a benefit. The process often appears non-transparent, slow and bureaucratic.

For general insurance there is the General Insurance Code of Practice which provides industry guidelines on complaints handling, and claims handling including taking into account relevant information and claims time frames and notification of claims processing where it will take further time. Breaches of the GICOP can be argued to be a potential breach of the insurer's duty of utmost good faith to the insured. The time frames and the right to documents provide consumers some guidance and certainty about claims handling and industry standards. However, life insurance products are not covered by the GICOP, and there is no industry Code, or best practice guidelines for claims handling of income protection or life insurance claims.

Life insurance is for life!

Financial literacy and consumer awareness usually promotes a mantra of compare, switch and save. This advice is all the more compelling with products like life insurance where premiums increase with age and insured customers are often feeling the pinch of increasing premiums but don't want to *waste* all those years of premium payment[8] by dropping cover as they are becoming more likely to benefit from it. Unfortunately for life insurance customers switching can be highly prejudicial to the chances of any beneficiary making a successful claim. Policies do not cover people for pre-existing medical conditions. As people age, they inevitably accumulate pre-existing conditions. Every time they change insurer's they reset the clock on what counts as a pre-existing condition to a later date, narrowing the situations in which they will be covered each time.

While we are aware ASIC has been doing some work in this area in so far as it relates to life insurance churning by financial advisers (which is particularly reprehensible but may at least result in an actionable complaint), there is also a problem for consumers who change of their own volition, possibly in response to television advertising by particular insurers or as a result of consumer awareness campaigns in relation to switching and saving.

v. Insurance products of dubious value

Many low income consumers have no car insurance, despite the considerable financial risk to themselves and others as a result, but will have poor value products like consumer credit insurance or funeral insurance. At best, the financial system should provide for suitable products and services which build capacity and confidence among low income and marginal consumers– at the very least, products which exploit low income consumers and cause them to pay more than the majority of the population for inferior products and services should be minimised.

Funeral insurance is very heavily advertised at very low starting prices for premiums. Many clients on a low income, especially those from Aboriginal or non-English speaking backgrounds, are attracted by what looks like an opportunity to provide well for their family members in the event of their death. What is not clear, however, is the extent to which premiums increase over time. One of our clients who spoke very poor English paid $16,000 before the premiums became completely unaffordable and he was forced to stop paying the premiums, losing all hope of any benefit under the policy. In another case our client was an elderly lady who was left with $10 per week to live on after she paid her aged care living expenses and funeral insurance[9]. She was no longer able to pay for her medicine. Many clients we talk to will never benefit from this product because it will inevitably become unaffordable. In the meantime they will have paid enough money in premiums to pay for a pretty decent funeral if they simply put the same amount in a savings account – in some cases paid a few times over.

Many of our clients are also marketed consumer credit insurance which is of absolutely no benefit to them. Clients who are already unemployed or on the disability support pension

[8] The Insurance Law Service at CCLC almost never sees life insurance policies with an investment component that can be cashed out.
[9] These cases were both ultimately settled with the insurers in question on confidential terms.

cannot make a successful claim on a consumer credit insurance policy. Even those customers who were employed at the time of inception often find the benefits of such limited use because of the restrictions on when you can claim and for how long that they would have been better off paying the premium amounts deducted directly off the loan and saving on interest.

Consumer Credit Insurance

Julia had consumer credit insurance over her credit card. She was diagnosed with Huntington's Chorea and made a claim. After many months, the insurer paid the balance of her credit card. Julia was soon able to return to part time work. She continued to pay premiums on the policy. 18 months later, she was diagnosed with cancer. She was working on average 10 hours per week when she needed to cease work completely to seek treatment and she sought to claim on her CCI. The insurer declined her claim, accepting that it was an unrelated disorder, but relying on a clause excluding people from eligibility if they were working less than 15 hours per week prior to the event giving rise to the claim.

Recommendations

The NDIR recommendation regarding flood insurance cover should be implemented in full or an alternative pursued involving a strategic industry/government partnership with equivalent goals.

Unfair contract terms legislation should be extended to cover insurance.

Life insurance and TPD cover should be included as the default position in superannuation accounts (with opt out available for those who already have cover).

There should be greater regulation of life insurance (including TPD claims attached to superannuation) including:

- Compulsory obligation to provide PDS on request
- Implementation of an ASIC approved code, guidelines or enforceable standards in relation to claims handling
- Access to FOS for group policies attached to superannuation

There should be further consideration given to:

- The problems related to life insurance switching, including associated education campaigns and effective regulation;
- Improved availability of statistics to evaluate the intrinsic value to consumers of various insurance products (claims to premium ratios)
- Better tools for consumers to compare policies
- Improved regulatory tools for preventing the systemic sale of poor value insurance products to vulnerable consumers
- Recognition that an insurance policy can simply be unfit for purpose (where for example the amount covered will inevitably be completely insufficient to indemnify the loss, or where the circumstances in which a successful claim could be made are so narrow as to render the product pointless).

We fully endorse the comments of Consumer Action Law Centre and NSW Legal Aid in relation to the prevalence of underinsurance.

(b) Fringe lending

We strongly endorse all of the comments made by Consumer Action Law Centre and submit the following additional comments and evidence.

High cost commercial lending does not help consumers in financial difficulty. When a person does not have enough money to meet their day to day expenses, they will not have enough money for their day-to-day expenses plus paying back a loan – any loan. Where this is a high cost loan, the problem intensified.

> **Can't Pay the Rent**
>
> A financial counsellor contacted CCLC on behalf of a client in April 2012. The client was escaping domestic violence and was homeless until about 6 weeks previously. She received Centrelink income. She was paying off a small but expensive loan. The client did not know how much she still owed. She had taken out the first loan with this lender about 12 months ago. She had obtained another loan from them within the last 4 weeks because she could not afford to buy food. This was a very short term solution. The repayments were $178.00 per fortnight. The lender directly debited her account leaving her short for paying the rent on her recently acquired premises. The community centre was assisting her with food and negotiating on her behalf to get rent up to date and avoid eviction.

Some low income earners can afford small loans, at affordable rates, for one-off expenses. Very few low income earners (if any) can afford a high cost loan, repaid over a short period. The smaller amount lending industry, however, relies on repeat borrowing and high costs. Their entire business model depends on it.

> **Trouble Making Ends Meet**
>
> Our client was referred for assistance by a financial counsellor in November 2011 because he had four contemporaneous loans, some of which appeared very irregular (the client given less cash than appeared on the contract). The client had 4 loans for $300, $400, $600 and $2020 respectively from four different lenders. The client was an aged pensioner in his seventies. He said he borrows the money because he can't keep up with living expenses on the pension any more. He said he gets a loan half paid off and then another bill comes in so he gets another loan – partly to refinance the old loan and partly to pay the latest expense. He said it was easy to get the money. He also said he has a friend who has similar loans to five different lenders and only has $60 per fortnight left to live on.

And clients with drug addictions or gambling habits use these loans to postpone the consequences of their behaviours.

> **Client had to stop paying to go into rehabilitation for substance abuse:**
>
> "I used to get cash advances from [lender] pretty much every fortnight. They started out at about $70 or $80 and went up to $100 or so (I think) once I proved I would pay. I was doing this for months, possibly a year. I also had person loans- They would let me get it down to about $180 each time before they would lend me another $600, so I would get about $420 in the hand by the time they paid out the previous loan. [Another lender] would not let me get a new loan until I had paid off the old one. I would go in with my bank statements as soon as I had paid one off and they would give me another one right away. I am not sure [how long this was going on for], certainly months, maybe years...I think one year at least. It was always the same lenders and always pretty much back to back loans."

> A caller to the Credit & Debt Hotline in April 2012 admits to being a gambler. He has debts of approximately $12,000 including a credit card debt of $3,000 plus concurrent loans to eight different pay day lenders.

These lenders are now subject to a range of provisions designed to minimise the harm of this type of lending:

- Small and medium amount lenders must comply with the responsible lending laws applicable to all other consumer lending;
- There is a rebuttable presumption that the third loan in any 3 month period is not suitable;
- There is now a national cap of 48% on consumer lending but there are exceptions for medium and small amount loans – medium amount loan contracts can include an additional $400 establishment fee, and small amount lenders can charge a flat rate of 20% establishment fee and 4% per month interest (calculated on the total amount borrowed);
- Small amount lenders must obtain 3 bank statements as part of their assessment of suitability (affordability);
- Small amount lenders must make specific disclosures about the high cost of their loans and give a number for access to free independent financial counselling;
- Borrowers who receive more than 50% of their income in welfare payments cannot be committed for more than 20% of their income in repayments;
- Lenders cannot recover more than 200% of the loan amount from the debtor (in other words default charges are capped).

These are all worthy measures, and we certainly support them in the absence of other more effective action. They have also removed the highest cost loans from the market and importantly, limited the total amount that can be recovered in default charges when a person cannot pay on time. We particularly support the capacity to provide such tailored responses to a particular problem when generic consumer protection laws have failed to provide adequate protection.

The small amount lending regime is nonetheless extremely complicated and time consuming to apply. CCLC is running a number of cases in the EDR schemes alleging breaches of the legislation (mainly responsible lending breaches) and while we are having some success, gathering and presenting the evidence and submissions required for each individual loan is considerable and the loans are many. The amounts at stake may only be hundreds of dollars, or a couple of thousand across several loans, but the casework files are many inches thick.

From our perspective breaches of the responsible lending laws are endemic in this part of the industry. We have some confidence that ASIC will be able to make some changes at the systemic level using the tools now available to them but it is difficult to imagine that the harm caused by these loans will ever be well contained when the business model is so dependent on multiple borrowing. There is an in-built motivation to lend people more than they can realistically afford (not enough to inevitably default – just more than they can comfortably pay) both to keep up a profitable approval rates and keep people entrenched in the borrowing cycle.

The Caught Short report found that 56 of 105 borrower respondents to their survey (53%) had taken out had taken out more than 10 loans in the previous 2 years. Of those 42 (75%) had taken out more than 20 loans in that period.[10]

> *Four themes provide a more complex understanding of a participant's borrowing practices: one-off, cycling, spiralling or parallel loans. Forty two per cent of borrowers reported taking out one or more one-off loans separated by periods of time. Forty four per cent of people discussed a practice of cycling – how they had immediately taken out a new loan once the previous loan had been paid out. Twenty three per cent became involved in the spiralling process of refinancing the balance of a partially paid-out loan to start a new loan, and a quarter of respondents described how they took out two or more parallel loans from the same or different lenders simultaneously.*[11]

Some of the lenders interviewed by these researchers also gave very high estimates of repeat borrowing (80%[12] in one case and 98%[13] in another) even while suggesting that they

[10] Banks, Marston, Karger & Russell, Caught Short, Exploring the role of short term loans in the lives of Australians, Final Report, August 2012, Social Policy Unit, The University of Queensland, Brisbane page 37
[11] Caught Short, Interim report, page 17
[12] Caught Short, pages 62 & 64
[13] Caught Short, page 66

tried to take measures to look after borrowers' welfare by attempting to wean them off loan reliance or referring them to community organisations.

The Joint Parliamentary Joint Committee also concluded "on the basis of this information it would appear that either industry significantly underestimates the number of consumers accessing short-term loans per year or there is extensive and substantial repeat borrowing by consumers."[14]

It would appear that while the most harmful aspect of this form of borrowing is its tendency to trap people into income-siphoning cycles of debt, it is this very behaviour that is keeping the industry thriving.

CCLC is of the view that applying the 48% cap universally and focussing attention on dealing with the avoidance problems which plagued NSW[15] would have been a far more effective way of achieving the consumer protection goals. These measures (as opposed to a 48% cap) were introduced in order to "balance consumer protection and *industry viability*." It was argued that in the absence of alternative sources of finance (such as community based schemes like No-Interest Loans Schemes (NILS) which are a fraction of the size of the commercial small amount lending industry), the industry was necessary to ensure access to finance for low-income, financial excluded people. The problem with this reasoning is that a large percentage of pay day lending borrowers would never get a loan from a responsible source (community or commercial) because borrowing is intended to be repaid from excess income – people who are borrowing to fund daily expenditure have no excess from which to make repayments. The overlap between the commercial small amount lending industry and genuine community based free or subsidised lending programs is in fact very small.

Trying to protect consumers from harm that is inherent in a business model at the same time as treating that business model as a species to be protected is an exercise doomed to failure.

There is a need for greater investment in no-interest loans and other subsidised or community backed affordable loans. This is vital for creating opportunities for productivity and participation among financial excluded members of the community. There are also many people on income support and lower incomes who can afford very small loans, but this needs to be a very personal assessment based on actual expenditure because factors like housing potentially represent a very high proportion of a low income person's income and

[14] Report of the Parliamentary Joint Committee on Corporations and Financial Services Inquiry into *Consumer Credit & Corporations Legislation Amendment (Enhancements) Bill 2011*, December 2011, Report, Page 61

[15] The ACT and eventually Queensland also introduced comprehensive caps on credit but NSW had the longest history.

vary significantly according to circumstance. However, as noted above, there is very little overlap between this need and the demand being met by pay day lending.

It is not the role of the financial system to compensate for inadequate income support. Equally it is not the role of the financial system to kick people while they are down and this is the effect of high cost, irresponsible lending.

Recommendations

The pay day lending provisions should be retained unless they are replaced with even more stringent requirements aimed at reducing repeat borrowing.

Extending the 48% cap to all loans and introducing general anti-avoidance provisions would be a more effective solution.

There should be greater availability of safer, affordable small loan products (recognising that many current pay day lending customers would not qualify for such loans).

(c) For profit financial difficulty businesses

We strongly endorse all of the comments made by Consumer Action Law Centre and submit the following additional comments and evidence.

Consumer detriment from these businesses is primarily financial, but can also be non-financial. In financial terms, these businesses invariably charge significant fees when free options to assist struggling debtors may be available (i.e. financial counselling). Non-financial detriment can arise if services do not meet consumer needs (increased financial stress alone can lead to health problems, mental illness and relationship breakdown). In some cases the financial detriment is severe:

- consumers are subject to legal proceedings because they have paid a 3rd party instead of their creditors and/or they have been advised to stop paying for the purposes of creating greater leverage in negotiations;
- consumers have their credit report impaired as a result of advice to stop paying;
- consumers are placed in Debt Agreements under the Bankruptcy Act when this is not in their interests;
- consumers are made bankrupt in circumstances where this was unnecessary and highly detrimental; and
- consumers are prevented from going bankrupt when this is their most appropriate option.[16]

[16] Some consumers have reported being told they cannot go bankrupt until they have made payments over a set period to the service provider

CCLC Case Studies

Mrs Z wanted to apply for finance but was rejected because of a default listing on her credit report by a Telco. She rang a credit repair service after seeing an advertisement on the internet while trying to contact the credit reporting agency who held her credit file. After talking to Credit Repair nothing seemed to happen for some time so she tried calling the Telco directly and was able to negotiate the removal of the default listing on the spot. Credit Repair then contacted her saying that they had successfully removed the listing and requesting $1,800 ($900 retainer plus $900 per listing removed). When Mrs Z said that she had negotiated the removal of the listing herself, they said she was in breach of her contract with them for contacting the Telco. Ms Z had never been sent a copy of any contract. Credit Repair also said they would add dishonour fees to the bill for non-payment.

Mr B had several debts, incurred after he ceased full time employment and began caring for his chronically ill partner and 4 children. He had 2 defaults, each for a loan of less than $1,500. Mr B signed up over the phone with a credit repair service and they commenced direct debiting his account.

Mr B stopped the debits to the credit repair service because they were continually causing his bank account to be overdrawn, and they were adding to his inability to pay his two debts. He did not return the privacy agreement Credit Repair had given him. He was continually telephoned and pressured to re-activate the direct debit. When CCLC became involved he had already paid in almost $2,000 and allegedly owed another $2,000 as a result of accumulated default fees. His financial position had seriously deteriorated, with additional defaults and threatened enforcement activity.

Mr E signed up to a personal budgeting service (Budget Service). He is 65 years old and is on a Disability Support Pension when he is unable to work due to a chronic knee condition. He contacted Budget Service who prepared a "savings plan" and arranged for all of his earned income and Centrelink to be diverted to Budget Service who would then pay his bills and provide him a "living wage". When his income reduced when he was off work, he received only $25/week living expenses. He went to a Financial Counsellor who gave him food vouchers to get through the week. He wanted to cancel the contract, because he continued to receive letters and phone calls saying he was overdue, which distressed him as he otherwise had a good payment history with his creditors, and could not live on $25. Mr E had already paid over $700 for their services while some of his bills were going unpaid.

Our client was diagnosed with schizophrenia approximately 5 years ago. She has one child, and is pregnant with her second. She is in receipt of a Disability Support Pension from Centrelink as her sole source of income. She completed high school and undertook a business administration course but been unable maintain employment due to her condition. Her partner is a 21 years old Aboriginal man and in receipt of a Newstart allowance.

They live together in the Central Coast in a flat. After our client confirmed her second pregnancy they were keen to move to a larger flat without stairs or a house. They were keen to save for a bond.

Our clients made an appointment with a commercially operated budgeting service. I am instructed our clients discussed their desire to move larger premises and their need for financial assistance and assistance in budgeting to afford the move. They disclosed the following debts:

a. ATO liability of $200;
b. Energy debt $269;
c. Vodafone debt of $280;
d. Cash converters personal loan $600.

The quoted establishment fee was $1,645 and there is an ongoing administration fee of $42.82 per week being $2,226.64 per annum. They have a gross combined income of $26,000 per annum and would have been charged $3871.64 for the budgeting service (15% of their income). The establishment fee alone was sufficient to pay out their debts. They were not referred to appropriate services such as free financial counselling or the NSW Government's Rent Smart service (for help in raising a rental bond).

Our clients signed up but then tried to exercise cooling off rights under the contract. They were told that they could not do this and it took a CCLC solicitor intervening to assert their rights.

Mrs T had $70,000 debt in unsecured loans, including multiple credit cards and a personal loan. Mrs T was suddenly unable to work when she contracted cancer. Her creditors began to harass her for late payments and became quite stressed. She decided to sign up with a debt negotiation company (Avoid Bankruptcy), who promised to negotiate with her creditors to get her reduced payments, save her from bankruptcy and, stop her creditors from contacting her. Avoid Bankruptcy said that they have a 100% success rate for the clients. Avoid Bankruptcy charged 16% ($11,200) of her debts to negotiate on her behalf. They said she could pay this off through fortnightly payments, she only had to pay $2,000 upfront and the company would begin negotiating for her. 18 months later and Mrs T is being harassed by her creditors again. She contacted Avoid Bankruptcy to find out why this is happening and she was told they have not achieved any settlements yet. Mrs T is furious, but Avoid Bankruptcy point out the contract she signed states that there is no guarantee of Avoid Bankruptcy achieving anything for her. Mrs T wants to cancel her contract but Avoid Bankruptcy say she is contractually obligated to continue paying for another 18 months. So now Mrs T is further in debt as her creditors have continued to charge in interest, her creditors are threatening to take her to court, and she has spent $7,600 on a service which has not done anything for her and still has to pay them another $5,600. Mrs T tried to seek help from the government agencies but she has been told there is nothing they can do and that such companies don't even need a licence.

The CCLC submits that ASIC's ability to take action in relation to these entities is very limited. Some of these businesses have an Australian Credit Licence, but the services offered may not necessarily be regulated by consumer credit or financial services legislation (i.e. debt agreement brokers, credit repair services). Although the fees that these businesses charge may be very high and disproportionate to the service provided, this may not itself be unlawful, even though consumers suffer great detriment.

Even if ASIC takes action to remove an entity's credit license, it does not have the authority to prevent the entity from engaging in its core activities. CCLC recently acted in two matters where the other party's credit license has been removed since December 2012 and its principal banned for 3 years. Despite this, there does not appear to be any recourse as the activity undertaken does not appear to satisfy the definition of credit activity under the NCCP Act. Some of these entities are in EDR because they undertake other activities that are caught by the credit law (or the financial services regulation). However, there has been a move recently for businesses to split their functions across two legal entities to avoid unnecessary EDR membership.

In many cases these activities are also causing losses to industry. Credit repair agencies place considerable pressure on lenders to remove credit listings in circumstances which are inappropriate and would potentially impair the credibility and usefulness of the credit reporting system. In the case of budgeting services and debt negotiation services, another creditor is added into a situation where often the fundamental problem of the consumer is that they don't have enough money to pay their existing creditors – this simply siphons off money that might otherwise have been applied to their original debts. ASIC has been examining the limits of its powers in this area. ASIC recently convened a Roundtable of consumer and credit industry representatives to promote discussion of the problems being experienced from both perspectives and to encourage solution focussed thinking, and a significant research project is being undertaken by ASIC[17] as a result.

An additional challenge raised by the credit repair industry in particular is that ASIC is not the regulator in relation to credit reporting – this is covered by the Privacy Act and falls into the jurisdiction of the Privacy Commissioner at the Office of the Australian Information Commissioner (OAIC). The OAIC has a very broad remit, no expertise in relation to the

[17] A large part of this project is being undertaken by external analysts with funding from ASIC's Consumer Advisory Panel budget.

dynamics of credit markets or credit regulation, and a poor history in relation to taking effective enforcement and intervention. ASIC has the expertise in this area and a better enforcement track record.

We support ASIC in its activities in this area and argue that is has a valuable role to play in fostering innovative solutions where possible and also informing the government of the limits of its powers and the problems it cannot resolve as a result of those limitations. In particular, this is another example where ASIC's regulatory powers are limited and urgent considerations needs to be given to ensure that ASIC has adequate regulatory powers to protect consumers using these services.

In our view, these entities should all be licensed under the credit law (including the obligation to be in EDR). While more work needs to be done to refine the most appropriate regulatory response, it is likely that specific provisions are also needed to address issues such as disclosure of costs and conditions, specific protections for money handling, and a duties to the client/customer.

It is completely foreseeable that where a particular industry becomes subject to tighter regulation, and particularly licensing, that players unable to get over the barrier to entry will look for new unregulated activities. In our view the credit regulation should always have included a wider range of activities, such as advice about regulated credit contracts, and assistance with negotiations in relation to the repayment of credit contracts. Ideally the regulator in these circumstances needs some flexibility to be able to address emerging issues quickly and effectively without needing law reform on every occasion. It is particularly a problem that making a case for law reform takes so long that a whole new industry with vested interests can develop to oppose meaningful regulation in the interim. We strongly support *comments made by Consumer Action Law Centre* in relation to investigating the viability of an unfair trading prohibition.

Recommendations

ASIC's role in identifying and making recommendations to government in relation to gaps in the law should be explicitly recognised and retained.

There should be consideration given to introducing a general unfair trading provision.

All commercial entities involved in regulated credit advice, negotiations, credit reporting and personal budgeting/repayment services should be subject to licensing, EDR and specific tailored provisions to improve outcomes for consumers (and prevent the identified harm).

Responsibility for the enforcement of credit reporting regulation should be transferred to ASIC.

(d) Avoidance

The regulation of pay day lending and other high cost, short term credit products in NSW has a history of move and counter move by regulators seeking to limit availability of certain products considered usurious and the industry's deft manoeuvres to escape regulation.

A 48% cap on interest rates in NSW came into effect in 1996. A lack of regulation of loans for less than 62 days led to an explosion of very short term, high cost loans that were inevitably rolled over. A move to limit the cost of short-term loans, then led to loans for greater than 62 days with the costs expressed as fees instead of interest to avoid the cap. Amendment to the cap to capture fees in addition to interest led to proliferation of avoidance techniques including:

- splitting entities into separate broker and lender outfits and then charging brokerage;
- disguising consumer loans as *promissory notes* or *bills of exchange*,
- and inducing consumers to sign false *business purpose declarations*.

When these loopholes were closed over the years by piecemeal legislation, new techniques emerged including: the forced selling of expensive DVDs (for example $400 and ironically about money management) as part of a loan transaction; charging consumers for cheque cashing or for an electronic access card that could then be loaded with cash from the loan; deferred establishment fees; the introduction of a mystery co-borrower from a State that did not impose an interest rate cap to the loan transaction; and perhaps most creative of all, lending disguised as diamond trading.

Regulators were constantly playing catch-up and the industry was always at least one step ahead of the game. The new national caps have been written with this history in mind but already recent amendments were consulted on to shore up the regulations in the light of emerging practices.[18] This history should not be used as evidence that regulation of the cost of credit, for example, is impossible and should be abandoned – tax avoidance is not always easy to detect and enforce but governments do not abandon their efforts; it is however a clear indicator that our law makers and regulators need a more effective toolbox to ensure that the policy settings agreed on by government can be translated into effective regulation and enforcement.

Recommendation
There should be a general anti-avoidance power in credit and financial services regulation.

[18] Draft Consumer Credit Regulations released 7 February by Commonwealth Treasury available at http://www.treasury.gov.au/ConsultationsandReviews/Consultations/2014/Consumer-credit-regulations

(e) Access to advice and assistance

Free, independent financial counsellors and community based credit lawyers play a vital role in the financial system.

CCLC operates one of the answer points for a national helpline for consumers seeking financial counselling (1800 007 007). This service provides free access to financial counsellors for initial information and advice, backed up by referrals to face-to-face financial counselling services in other agencies for those who need more in depth assistance. At CCLC, as with two other answer points around the country, consumer lawyers are also available to assist client in need of legal advice.

This timely access to advice and assistance often assists both consumers and traders to come to a speedier resolution. When consumers are in financial difficulty they are tempted to take a number of options which exacerbate their problems in the longer term including:

- Paying nothing at all because they cannot afford the amount claimed or demanded;
- Stoping responding to letters and phone calls; or
- Turning to high cost lenders to meet their short term needs, leading to much bigger problems in the longer term.

Given appropriate advice from an independent source these people can be encouraged to take more constructive steps towards resolving their problems. In recognition of this banks and other credit providers have become a significant source of referrals to our service.[19]

Where real and meritorious disputes exist, early access to advice often means that the issues are aired as quickly and efficiently as possible and consumers get help to compile their evidence. This can mean an early resolution of an otherwise drawn out dispute. The fact that financial counsellors and consumer lawyers can participate in government policy review processes (such as this one) is also vital to the effectiveness and authenticity of those processes. Recent cost benefit analysis surveys have also endorsed the effectiveness of both community legal centres and financial counselling[20].

Financial counsellors and community based credit lawyers struggle constantly to maintain funding levels sufficient to meet demand. A number of large financial institutions invest in

[19] In the six months to December 2014 the two biggest sources of referrerals to the service at 12% each were the EDRs and creditors. All other clients come from a variety of sources or are self-referred after an internet search. Financial Counselling Australia also conducted a recent analysis of referrals to the 1800 007 007 number which can be found at: http://www.financialcounsellingaustralia.org.au/Corporate/News/Website-Audit-Demonstrates-Importance-of-Financial

[20] FCA media release: Economic Evidence About the Benefits of Financial Counselling - $5 return for each $1 invested – report available at http://www.financialcounsellingaustralia.org.au/Corporate/News/Economic-Evidence-About-the-Benefits-of-Financial. A sample of CLCs were assessed as having cost benefit ratio of 1:18 http://www.lawcouncil.asn.au/lawcouncil/images/LCA-PDF/a-z-docs/fmsdownload0463.pdf

social development and financial inclusion programs but our services cannot compromise our independence by accepting direct funding from these sources. Independence is vital to engender community trust and is absolutely essential for professional advocacy (legal or otherwise). There is also reluctance on the part of financial institutions to invest in this area if the result will be a withdrawal of government support and hence no net gain in service provision. This is an area where a government/industry/community partnership could be enormously beneficial by providing a mechanism by which relative contributions by government and industry could be agreed and the funds could be distributed via an independently operated trust to ensure that advice and advocacy services retained their independence.

Recommendation

Consideration should be given to fostering industry investment in financial counselling services and credit legal services (for disadvantaged consumers) in partnership with appropriate government funding programs.

Conclusion

Thank you again for the opportunity to comment on the Financial System Inquiry. If you have any questions or concerns regarding this submission please do not hesitate to contact the Consumer Credit Legal Centre on (02) 9212 4216.

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