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Response to Recommendations in the Final Financial System Inquiry Report
Submission by the Financial Rights Legal Centre

The Financial Rights Legal Centre (*formerly known as the Consumer Credit Legal Centre (NSW)*) is a community legal centre that specialises in helping consumer's understand and enforce their financial rights, especially low income and otherwise marginalised or vulnerable consumers. We provide free and independent financial counselling, legal advice and representation to individuals about a broad range of financial issues. Financial Rights 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. Financial Rights took over 22,000 calls for advice or assistance during the 2013/2014 financial year.

Financial Rights also conducts research and collect data from our extensive contact with consumers and the legal consumer protection framework to lobby for changes to law and industry practice for the benefit of consumers. We also provide extensive web-based resources, other education resources, workshops, presentations and media comment.

This submission is an example of how community legal centres utilise the expertise gained from their client work and help give voice to their clients' experiences to contribute to improving laws and legal processes and prevent some problems from arising altogether. Federal Government changes to Community Legal Services Program funding agreements in mid 2014 restrict policy and law reform that community legal centres can undertake with Federal Government funds. These restrictions have the potential to deprive Government and others from valuable advice and information and reduce efficiency and other improvements in the legal system. For more information please see http://www.communitylawaustralia.org.au/law-reform-and-legal-policy-restrictions/

General Comments

Thank you for the opportunity to comment on the final report of the Financial System Inquiry.

We support the FSI report's broad acknowledgment that consumer protections based on disclosure in financial services are not currently adequate to ensure that the needs of individual Australians are met. We are very encouraged to see the final report's focus on fairness and emphasis that "in itself, mandated disclosure is not sufficient to allow consumers to make informed financial decisions." We know that consumers do not always read mandated disclosure documents, and when they do they are rarely capable of absorbing or understanding all the information presented to them. Products which are poorly designed and overly complex only compound this problem. Additionally, behavioural economists have found that individuals are prone to making systematic errors in decisions that involve assessing risk and uncertainty. Along with other consumer advocates, we support this shift in focus and the rational that the FSI panel has advanced to support it.

We agree with the FSI that consumers should bear responsibility for their financial decisions, but protections can be put in place to assist them in doing this. We endorse the Consumer Action Law Centre's comments that "This is not a shift that absolves consumers of the obligation to protect their own interests; instead it requires that businesses meet consumers half way".

Overall the FSI panel has convincingly concluded that the current system of financial regulation is not one where financial products and services are necessarily performing in the way consumers are led to believe they will. This could be because consumers are sold financial products that are not suited to their needs or because of shortcomings in disclosure or financial advice. The FSI panel has made thoughtful and appropriate recommendations for each of these issues, and we strongly encourage the Government to take the necessary steps to enact them.

We note that the FSI recommendations are very imprecise and require significant fleshing out before they can be effectively implemented. We strongly suggest that the government continue to consult both industry and consumer groups in the course of implementation to achieve the best possible outcomes, without allowing vested interest to derail the process.

Consumer input

The Final Report (at p193) says that:

"The Inquiry also supports continuing industry and Government efforts to increase financial inclusion. Reviews and proposed changes to the financial services framework should involve consumer organisations in policy development, alongside industry, regulators and other stakeholders."

We note that consumer input to this and other relevant inquiries is almost solely provided by organisations who are to a greater or lesser extent dependent on government funding and whose existence and availability is far from assured.

The FSI report also states *"Consumers should have access to competent, good quality, customer –focused advice and guidance." (p197).* While in relation to investment this is often provided by profit driven services such as financial planning businesses, such advice is also provided in relation to personal finances including credit, banking and insurance disputes, by financial counsellors and community lawyers.

In implementing the recommendations of the Financial System Inquiry the government should keep in mind that a robust consumer protection framework must include an adequately funded consumer assistance sector, with the capacity for input into complex debates.

Specific Comments on FSI Recommendations

16 Clearer graduated payments regulation

Strengthen consumer protection by mandating the ePayments Code. Introduce a separate prudential regime with two tiers for purchased payment facilities.

We support this recommendation. We have no comment on the other recommendation in this section.

17 Interchange fees and customer surcharging

Improve interchange fee regulation by clarifying thresholds for when they apply, broadening the range of fees and payments they apply to, and lowering interchange fees; Improve surcharging regulation by expanding its application and ensuring customers using lower-cost payment methods cannot be over-surcharged by allowing more prescriptive limits on surcharging.

This report specifically refers to the many submissions received by the inquiry on the issue of surcharging. Australians are fed up with price gouging on surcharges by a number of retailers. An objective of this inquiry must be that excessive surcharging must stop. The proposed recommendation proposes reforms but does not actually propose a solution that is certain to achieve the protection of consumers from excessive surcharging.

The recommendation proposes a solution that may have the effect of improving price signals although it is uncertain whether the proposed model would achieve the objectives set out. Our view is that this process needs to deliver certainty for consumers. We contend that certainty can only be delivered by setting price caps on surcharges with an enforcement mechanism clearly built into the process. It is important to make it clear that the current system for surcharging and interchange fees has completely failed to protect consumers from excessive surcharges and wide scale uncertainty on whether the consumer will be hit with a surcharge. The industry has had many years to iron out these issues and yet from a consumer protection perspective the issues remain.

The Final Report notes that consideration was given to imposing reasonable cost requirements through regulation but this approach was rejected based on costs and administration concerns. We consider that it is absolutely necessary for regulation. The current system is not working to protect consumers from excessive surcharges. The recommendation in the final FSI report would also fail to provide adequate protection. The Australian public has clearly called for action on this issue through numerous submissions and this should not be ignored.

We contend that there would be very little administrative costs or burden in simply banning surcharging. This would have the effect of protecting consumers from excessive surcharging. This was the system prior to 2004 and it does work. We do concede that further work needs to be considered on the issue of high cost credit cards and it may be necessary for a carve-out surcharges for that type of card only.

In the alternative, the other option is to implement the proposed recommendation with additional regulation which imposes a reasonable cost cap that is enforceable by a regulator (either ACCC or ASIC). The regulator should not be the RBA. The appointed regulator could then review the systems in detail and set appropriate caps for the 3 tiers.

RECOMMENDATION

Surcharges should be banned.

In the alternative, the recommendation should be implemented with clear regulation on reasonable costs of surcharges and the inclusion of a regulator that can set and enforce caps. We contend that all debit card savings transactions should be fee free at a minimum to incentivise use of this low cost payment method.

Direct debit cancellations

Direct debits are used widely in Australia as a form of payment. Direct debits may be deducted from savings accounts or credit cards. Consumers need to have authority over their own funds. A consumer must be able to simply cancel a direct debit if the consumer no longer wishes the payment to be made.

Currently, the process to cancel a direct debit on a savings account requires notifying the bank holding the savings account of the cancellation. The direct debit then should be cancelled expeditiously as the consumer has withdrawn their authority to debit their account. Unfortunately the process for cancelling a direct debit on a credit card is difficult with the consumer required to notify both the financial institution that issued the credit card and the party using the direct debit for payment.

Problems can arise when a merchant does not act on an instruction to cancel a regular payment. These problems can also arise when a consumer closes their credit card account but does not arrange with third party merchants to cancel regular payments. In this case, a consumer is generally responsible for establishing and cancelling authorities directly with the relevant merchant. They will also be responsible for any transactions debited to the credit card account, even after the account has been closed.

The approach taken with credit cards can be contrasted with direct debits on transaction accounts. Under clause 19 of the Banking Code of Practice, banks are required to promptly process a consumer's instruction to cancel a direct debit request. We submit that there should be no difference in treatment between credit card accounts and other accounts under the Code.

In our view, a consumer should be able to instruct their bank to cancel a credit recurring payment authority, as they can with a transaction account direct debit authority. Further, upon cancellation or closure of a credit card account, a bank should take steps to cancel all regular transactions and other standing authorities.

RECOMMENDATION

The distinction between credit cards and savings accounts in relation to direct debits needs to made uniform by self regulation or regulation if self regulation fails.

18 <u>Data access and use</u>

Review the costs and benefits of increasing access to and improving the use of data, taking into account community concerns about appropriate privacy protections.

This recommendation is supported. We also support the Comments of Consumer Action Law Centre in relation to consumer access to their own data in useful formats.

19 <u>Comprehensive credit reporting</u>

Support industry efforts to expand credit data sharing under the new voluntary comprehensive credit reporting regime. If, over time, participation is inadequate, Government should consider legislating mandatory participation.

Financial Rights strongly opposes this recommendation and any consideration of legislating mandatory participation and adding further data. Comprehensive Credit Reporting (CCR) was introduced after significant consultation and an Australian Law Reform Commission report. The recommendations in the ALRC **report were made to strike the appropriate balance between privacy and reforming the credit reporting system.**

The new CCR regime is new and there are still a number of issues outstanding in relation to the implementation of the system and interpretation of the law. The OAIC has not released any regulatory guidance apart from a series of fact sheets. Many credit providers are still completing work on changing systems to adapt to the new CCR regime. In summary, the new CCR regime is still in a "bedding down" phase which will continue for a few years to come. To make recommendations for change in these circumstances is risky and there is a lack of evidence that it will deliver any benefit at all. There is also a risk of detriment to consumers.

We note that the Australian experience with CCR has to be distinguished from other countries as Australia has strong responsible lending laws in place in credit. Credit providers do not need a credit report in Australia to responsibly provide credit because extensive information is already required to be obtained as part of the approval process. A credit report is complementary and allows confirmation of certain information but it is not necessary. Mandating data and access must be challenged in these circumstances, as arguably, it adds little (if anything) to the public benefit of responsible lending. Any mandatory use of the credit reporting system and extra data is arguably adding a cost burden to credit providers without delivering any benefit for consumers. Where there is a business case for using the credit reporting system, credit providers will use it.

We are particularly opposed to extending access to repayment history information to non-credit licensees. The Australian Law Reform Commission report particularly recommended that this not occur as non-credit licensees do not have the licensing and legal obligations of licensed credit providers. The ALRC position was repeated in the Explanatory Memorandum to the *Privacy Amendment (Enhancing Privacy Protection) Bill 2012*, which stated:

> **Repayment history information can only be disclosed to credit providers who are licensees. This is because licensees are subject to responsible lending obligations under the NCCP Act, and the repayment history information is intended to assist those credit providers meet those obligations.**

We also strongly oppose the addition of further data on credit reports on the basis that there is no evidence that this is required. It is simply poor practice to make changes to the current (very new) system until it has been reviewed and evaluated in detail. We welcome the Inquiry's recommendation of a review of the CCR regime in 2017. However, the focus of the review must be around whether the changes are meeting objectives and whether further changes are required to improve consumer outcomes.

RECOMMENDATION

No reforms to credit reporting are considered until the review in 2017.

20 Strengthen product issuer and distributor accountability

Introduce a targeted and principles-based product design and distribution obligation.

Financial Rights supports the introduction of a principles-based design and distribution obligation. This would complement the FOFA reforms, and ensure that product issuers (and possibly some entities involved in distribution but not advice) share some of the responsibility for avoiding widespread consumer detriment from poorly designed and/or poorly targeted financial products. We support the FSI Report conclusion that this new obligation should not only be for 'complex' products (pg202) – many consumers do not even understand simple financial products or services. Further we agree that self-regulation will not be sufficient in this space for the reasons given in the Final Report.

We also emphasise that it is important that this obligation does not become a tick-a-box exercise where the product is stress tested and the suitable market segment identified at the outset, and the process considered complete. There needs to be a requirement for monitoring and feedback, incorporating both complaints (directly or via the EDR schemes) and other pro-active measures, to ensure the original assumptions hold true (for example, periodically reviewing products after sale to investigate which classes of consumers are buying the product and whether this is consistent with initial decisions about the target markets). There should be specific offences for failing to conduct the original assessment, for failing to have in place processes for continual assessment, and for systemic failures - where for instance evidence of problems in either design or distribution have not resulted in corrective action.

We appreciate that the FSI has recommended stopping short of requiring an individual appropriateness test. However, we argue that in the event of a failure to comply with the product design and distribution obligations, consumer compensation should form part of the remedies or orders available.

In relation to scope we note that the recommendation specifically refers to products and not services. However financial products and services are often inextricably intertwined and the use of the term "product" in this context appears needlessly limiting (indeed there is no specific indication in FSI report that related services are to be necessarily excluded). We accept that credit products already carry a suitability requirement, and that it is arguable that FOFA covers financial advice as defined in the Corporations Act; however advice forms a vital part of the distribution chain. We argue that while *advisors* may already be subject to the best interests duty and other relevant obligation, advice still forms part of distribution of financial products and the activities of *advisors* would be relevant to determining whether a product issuer has breached the design and distribution obligations above, at least to the extent that the issuer could reasonably have been aware of, or should have had in place reasonable controls over those activities.

In our Insurance Law Service practice we see particular applications for this obligation. There are a number of insurance products which are emotively marketed to particularly vulnerable consumers in circumstances where they provide extremely dubious benefits (funeral insurance, consumer credit insurance, and other add-on products like extended warranties) for relatively high cost (compared to the resources available to the consumer). In the case of consumer credit insurance for example, sales to consumers who cannot possibly claim (because they are already unemployed or otherwise do not fit the criteria to qualify to make a claim) are widespread.[1]

A particular concern for our services, is a range of services currently being offered that are related to personal finances but do not get caught by either the financial services regulation (including of course FOFA) or the National Consumer Credit Protection Act:

- Advice in relation to credit & debt management (including but not limited to options under the Bankruptcy Act) which does not include signing a consumer up to a specific credit product or suggesting a consumer take out or stay in a particular credit product;
- Credit repair services which purport to be able to improve a consumers credit report or credit rating; and
- Budgeting services - including services which will distribute a consumer's income to their creditors for a fee.

Financial Rights has been involved in a number of disputes with such service providers (which consumer advocates refer to as 'For-Profit Financial Difficulty Businesses') on behalf of individual clients and reported many complaints to ASIC (while recognizing their powers may be limited because of the regulatory loophole). We are also aware that these companies, particularly credit repair businesses, are causing significant problems for industry and the EDR schemes. It would be unfortunate if ASIC were given additional powers as recommended and still not be able to take action in relation to practices already entrenched, clearly related in subject matter to the sector being regulated, and yet outside the definitions currently contained in the relevant law. See **Appendix A** for more information on these types of businesses.

RECOMMENDATION

- The Corporations Act should be amended to include advice about credit, credit reports and other aspects of personal finance (exempting accountants in lawyers acting in the normal course of their professional practices); and
- The product design and distribution powers should include products, services and advice. For example – a budget management services which charges regular fees should not be marketed or distributed to consumers who are Centrelink recipients or are otherwise experiencing to an income/expenditure deficit.

Insurance and suitability

In the case of insurance, we argue that there should be a specific, individualised suitability requirement. Many insurance products are designed to enable consumers (including very unsophisticated consumers) to improve their financial resilience and protect very important personal assets like their homes and vehicles. In this case there needs to be clear obligations on insurers to ensure that these products are fit for purpose and that

[1] *ASIC v The Cash Store Pty Ltd 9in liquidation)* [2014] FCA 926. The Court found that the selling of consumer credit insurance by a pay day lender unconscionable in circumstances where the median terms of the contracts were only 13 days, and a significant proportion of the customers were unemployed and ineligible to claim for the main components of the coverage, disablement and involuntary unemployment. In Financial Rights experience, this may be an extreme example but it is far from an isolated occurrence.

consumers are able to access the information they need to make informed decisions within a range of potentially suitable products.

ASIC Report 415 Review of the Sale of Home Insurance made a number of pertinent observations regarding insurer practices that are insufficient and suggestions for improvement (but we note this is not a comprehensive list):

- That the sales process was designed to meet the insurer's needs rather than promote understanding of the product for the consumer (p6);
- That sales staff were sometimes poorly trained in relation to product features and/or trained to avoid giving any explanations or guidance (no advice model);
- That insurer's telephone scripts could set out better ways for insurers to convey to their customers (p40-41, 44,):
  - Insurance features and exclusions;
  - How cap and limits operate in practice (through the use of hypothetical examples);
  - Include a plain English explanation of what the sum insured means and how it should be estimated with calculator style questions or at least references to available calculators.

While the ASIC report was focused on the disclosure obligations of insurers, we submit that the above also spells out how a suitability obligation could potentially be implemented, with an obligation on the insurer to explore the objectives and requirements of consumers and match products accordingly.

In the absence of a specific suitability requirement, or to complement such a requirement, the government should improve the standard cover provisions of the ICA which currently service no practical purpose.[2] At the very least the ICA may need to be amended to ensure that the general product design and distribution requirement also applies to insurance[3]. We endorse the comments by Consumer Action Law Centre in relation to the potential to significantly improve the standard cover regime and in relation to reintroducing the *Insurance Contracts Amendment (Unfair Terms) Bill 2013.*

RECOMMENDATION

- The government should implement Recommendation 20.
- There should be specific offences and remedies attached, including for failing to monitor and taking corrective action where problems are identified.
- The Corporation Act should be amended to include a range of services related to personal finance that are not currently caught, particularly those we have identified as for profit financial difficulty businesses.
- There should be an individual suitability test for insurance products at point of sale.

[2] The ICA provides for standard cover in certain types of common general insurance but allows insurers to contract out of these provisions so long as they clearly disclose this fact in writing. In practice all insurers contract out of the provisions, rendering them pointless.

[3] Section 15 of the Insurance Contracts Act currently excludes the operation of other laws which, for example, provide for judicial review of a contract on the grounds of harshness or unconscionability or relief from the consequences of misrepresentation.

21 Introduce product intervention power

Introduce a proactive product intervention power that would enhance the regulatory toolkit available where there is risk of significant consumer detriment.

We strongly support giving ASIC product intervention powers and agree with FSI comment that early intervention "would be more effective in reducing harm to consumers than waiting until detriment has occurred." There would need to be considerable thought and consideration put into the design of the relevant legislation to strike the right balance between allowing flexibility and speed to *prevent* significant detriment and ensuring accountability and a degree of certainty for industry and consumers alike.

We submit that product intervention rules could be made consistently the *Legislative Instruments Act 2003*, reviewable by the Federal Court of Australia and subject to disallowance by the parliament; and that intervention orders (in relation to a specific provider or set of named providers) be reviewable by the Administrative Appeals Tribunal. This would provide a high degree of accountability.[4]

We also support a broader approach than implied by "product" intervention. Financial products and services are often bundled or interrelated in complex ways. Further incorporating products, distribution and advice, gives the regulator the greatest potential to target the problem as effectively and efficiently as possible without the potential for technical arguments about validity that are unrelated to the substantive issues of preventing detriment versus contractual certainty. Also, to make the intervention power effective and complete the circle (from design obligations at one end of the spectrum to intervention when things have gone significantly awry at the other) it must cover the entire chain from design to all distribution points including advice.

Financial Rights is concerned that the use of the words "last resort" are inconsistent with the pre-emptive, preventative nature of the proposed powers. While we agree that such powers should be used judiciously and infrequently it is imperative for them to be effective that these powers:

- Are not required to be founded in a breach of an existing law (this would defeat the purpose of facilitating a speedy response to emerging issues and seriously curtail their effectiveness);
- Allow for certain steps to be dispensed with (at least temporarily) when time is of the essence in preventing harm;
- Should respond to *potential* detriment - *actual* detriment to consumers should not need to be established (but would be very persuasive in proving potential detriment to other consumers);
- Also enable smaller problems affecting large numbers of consumers to be tackled where-
    - There is no other effective response available in the regulator's tool kit; and
    - The disruption and/or potential costs to financial products and services providers, and existing customer/investors, are not significant.

In effect we are proposing a sliding scale. Where disruption and losses arising from the intervention are minimal, a less serious amount of consumer harm to a large number of consumers should be sufficient to

[4] A paper prepared for the ASIC Consumer Advisory Panel of which Financial Rights is a current member provides more detail in relation to these proposals.

trigger the power. Where the potential detriment and losses resulting from the intervention are potentially significant, then a more serious degree of potential harm would need to be established to justify intervention. We note that amendments to marketing materials and disclosure materials, warnings, labels and terminology changes and distribution restrictions are all potentially lower level interventions which should be more readily available to the regulator than product banning. Setting a high bar for product banning should not prevent the regulator from being able to take less interventionist action where it is warranted. We also note that distribution should include not only preventing products and services being promoted or sold via certain outlets, but also the method of distribution (including, for example, the use of default options on a website).[5]

We are concerned about the temporary nature of the powers. We appreciate the principle that the regulator should not be assuming the role of the parliament and in many cases it may be appropriate that the rules and orders issued under product intervention powers should be temporary. However, one of three stated goals of the proposed powers is to "*limit or avoid the need for more prescriptive regulation*"[6]. This goal would not be met if every use of the intervention powers resulted in a corresponding legislative amendment at a later date. Financial Rights submits that there should be a process or mechanism for making a particular rule or order permanent in circumstances where certain pre-defined prerequisites are met (subject to the same review processes as making the rule or order in the first place). At the very least the process for extending the duration of any rule or order should not be overly cumbersome.

In response to industry concerns that this power will create uncertainty, constrain innovation, create more costs for consumers, and potentially harm provider reputations unduly we point to the accountability mechanisms above, including the need to consult with those affected in most cases before taking action, and the options for review. Businesses that already have robust product design and distribution practices should not be negatively impacted. Further the reputational capital of the financial services industry is at an all-time low in the wake of recent large scale collapses and scandals, and the potential for intervention by the regulator to prevent harm in appropriate cases will, in our view, do more for public confidence in financial service providers than any potential reputational harm as a result of the intervention.

RECOMMENDATION

- The government should implement recommendation 21.
- The power should be broadly based to maximise effectiveness but with the powers of review and impact on existing rights and liabilities clearly defined.

[5] Several airlines are selling travel insurance as the default option on their websites – you have to actively untick the box. This can result in consumers buying insurance they are not aware they are purchasing, and which may be unsuitable for them. We can envisage other similar circumstances where, for example, consumer credit insurance could be sold in a similar way through a loan application website. We submit that this is the type of practice that should be addressed by both a financial services provider's own obligation to ensure appropriate distribution and a potential target for intervention if necessary.

[6] Financial Services Inquiry – Final Report, p207

22 <u>Facilitate innovative disclosure</u>

Remove regulatory impediments to innovative product disclosure and communication with consumers, and improve the way risk and fees are communicated to consumers.

Improving Disclosure

We strongly support the FSI panel's recommendation to improve disclosure in financial services. Disclosure is a key part of making sure consumers have enough information to choose the right product for their needs, especially in the context of insurance. Financial Rights believes that mandatory disclosure must remain a part of the regulatory regime for providing financial products and services. However, we also strongly believe that disclosure alone has not been sufficient to enable consumers to make informed decisions and consistently purchase financial products and services that meet their needs. Disclosure should be used where it is the best response for enabling consumers to purchase suitable products and services, but other tools (for example product design and distribution obligations) might be a better solution to overcome problems created by products which are unfair, conflicted or overly complex.

Information disclosure is the way that consumers determine suitability of financial products and services. If disclosure works poorly then many consumers may purchase unsuitable products, sign up for inappropriate financial services or end up with unsuitable insurance coverage.

There have been a number of research projects into consumer understanding of disclosure documents, but we submit that much more research is needed in this area. We contend that disclosure needs to be tested for it to be effective. Otherwise, it is more than possible that the disclosure may be ineffective.

We submit that financial service providers cannot continue to claim they meet their obligations as licensees to provide services efficiently, honestly and fairly and to provide disclosure that is clear, concise and effective, while relying entirely on documents which mounting evidence suggests significant percentages of their customers don't read, or don't understand.

Removing regulatory impediments to innovative product disclosure and communication with consumers

We support in principal the removal of impediments to innovative disclosure and communication, but we endorse the submission of Consumer Action Law Centre that

- Any shift to electronic disclosure must be designed to avoid leaving the most vulnerable and disadvantaged consumers (who are less likely to have reliable access to the internet) behind. Improving disclosure should create benefits for everyone.
- New methods of disclosure must be consumer tested before they are rolled out to make sure they are useful for consumers.
- While consumer choice should be retained where possible, a consumer's preference and the method of disclosure most likely to command their attention are not necessarily the same thing (people may prefer to receive documents by e-mail but they may not be more likely to read them). Consumer testing should explore ways of not only communicating effectively in test conditions, but also capturing people's attention against the background demands of every day life.

The Government should give clear guidance that Financial Service Providers must take some responsibility for testing whether their customers receive and comprehend vital disclosure information. New innovative forms of product disclosure and communication with consumers have the potential to save industry significant sums in printing and postage of disclosure documents. We submit that some of the resources freed up in this way must be redirected to improving consumer understanding of the products they are purchasing.

Industry self-regulation of disclosure

As is stated above, Financial Rights believes that mandatory disclosure must remain a part of the regulatory regime for providing financial products and services. We do not believe that industry can adequately self-regulate when it comes to improving the way risk and fees are communicated with consumers.

There are many examples in the marketplace of financial products and services that intentionally obscure the true cost of their products. Such products include consumer leases or consumer rentals; 'Add-on' insurance products; payday loans; discretionary risk products and debt agreement administration.

These types of businesses will not voluntarily improve how they communicate risks and costs to consumers since it is clear that the success of their business models rely on consumers failing to understand the overall price that they might pay or the risks included.

RECOMMENDATION

- Any voluntary industry response to improve disclosure of costs and risks needs to be accompanied by investigation and enforcement work by regulators to target businesses that habitually conceal the risks and cost of their product.
- Testing the effectiveness of disclosure about a product or service should be a baseline requirement along with product design and distribution. Products which cannot be effectively explained should be modified or limited in their distribution. Disclosure should be optimised for best effect.

24 <u>Align the interests of financial firms and consumers</u>

Better align the interests of financial firms with those of consumers by raising industry standards, enhancing the power to ban individuals from management and ensuring remuneration structures in life insurance and stockbroking do not affect the quality of financial advice.

We strongly support this recommendation. We agree with the FSI panel believes that "better aligning the interests of financial firms with consumer interests, combined with stronger and better resourced regulators with access to higher penalties, should lead to better consumer outcomes.".

Remuneration in life insurance

In regards to ensuring remuneration structures in life insurance do not affect the quality of financial advice we strongly agree that the minimum level of reform needed is for a level commission structure to be implemented. The FSI recommends that this be implemented through legislation but the recent Life Insurance Adviser Working Group (LIAWG) report instead recommends that this change be implemented through changed licensing requirements by ASIC. We support either implementation method as long as the change is mandatory across the entire industry and is not reliant on voluntary codes or self-regulatory measures.

We have been disappointed by the life insurance industry's failure to adequately self-regulate its remuneration structures and quality of advice. Even after ASIC released Report 413 (its critique of the quality of advice given by life insurance advisers) all remuneration options considered by the industry were commission based. Consumer advocates do not agree that commissions are necessarily required to sell life insurance advice. The challenge of moving away from commissions is a problem with the culture of advisers, not necessarily a problem with consumers.

We agree that life insurance is an important product and advisers play an important role in helping consumers find the product that strategically suits their personal needs, but we do not agree that life insurance is necessarily 'sold' not 'bought' as the industry continues to assert. Nor do we agree that commissions are necessary to create the incentive for advisers to sell life insurance products. Just because consumers may not be able to pay the cost of strategic advice upfront does not mean they aren't willing to pay for advice in instalments, or as a transparent percentage of their premiums. There are significant costs for advisers in providing strategic advice and arranging suitable insurance products and they should be properly remunerated for their work, but upfront commissions are not the only remuneration solution. Consumers pay for valuable strategic advice in many other sustainable industries that don't rely on hidden upfront commissions (ie legal advice and financial advice).

However, we appreciate that the industry may not be ready to shift from a completely commission based remuneration structure to one based entirely on fee for service. We endorse the LIAWG reports recommendations as a positive first step with the understanding that over time the recommended changes will help create the environment for a fee for service regime.

Enhancing the power to ban individuals from management

We support the introduction of a new power to ban individuals from management. The extension of the current enforcement requirements and actions that apply to financial advisers and to those managing a financial service business, provide an additional mechanism to enhance consumer confidence and trust in the financial advice industry, and the financial services industry more broadly.

RECOMMENDATION

- The Government should accept Recommendation 24;
- The Government should as a minimum enact legislation to require that an upfront commission for life insurance is not greater than the ongoing commissions, or ASIC should enact the LIAWG remuneration limitations as a licensing requirement for life insurers; and
- The Government should amend the law to provide ASIC with an enhanced power to ban individuals, including officers and those involved in managing financial firms from managing a financial firm.

25 Raise the competency of advisers

Raise the competency of financial advice providers and introduce an enhanced register of advisers.

We support raising the competency of financial advice providers. We support the 14 recommendations made by the Parliamentary Joint Committee (PJC) on Corporations and Financial Services Inquiry into proposals to lift the professional, ethical and education standards in the financial services industry.

In line with the recommendations made by the PJC we support the following changes in the industries in Australia which provide financial advice:

- *More robust on-the-job training for financial advisers.*

  The PJC's recommendation about a structured professional year is a great start, but even after this first year, industries which include financial advice should continue to have robust training regimes for junior advisers. Minimum educational standards are necessary, but ingrained ethical standards and strategic advice skills are learned on the job and should be done in an environment with rigorous supervisions and regular assessments.

- *Ongoing quality assurance audits.*

  The industry needs to develop more effective models of quality assurance reviews and advice audits. We believe that best practice would be that all Statements of Advice are reviewed at some stage. Ideally before the cooling-off period for a consumer has lapsed, but if that is not practicable, SOAs should be reviewed within the financial year and adjustments to advice should be made when necessary. If all SOAs cannot be reviewed, then random and robust audits should be done of a statistically significant number of SOAs each financial year.

- *Elimination of conflicted remuneration incentives.*

  Large upfront commissions and sales-based performance bonuses have led to a culture of bad quality financial advice. Remuneration structures have already been radically changed under FOFA, and the life insurance industry (or at least LIAWG) has started suggesting changes to its remuneration as well. We support these changes and cannot emphasise enough the need to eliminate conflicted remuneration incentives from all forms of financial advice. This is particularly important when the best strategic advice for a consumer is to not to purchase a financial product. Consumers should be able to access strategic advice that in their current situation the status quo is the best option for them, even if it means paying a fee for service for that advice.

RECOMMENDATION

The Government should accept the recommendations made by the Parliamentary Joint Committee on Corporations and Financial Services Inquiry into proposals to lift the professional, ethical and education standards in the financial services industry.

26 Improve guidance and disclosure in general insurance

Improve guidance (including tools and calculators) and disclosure for general insurance, especially in relation to home insurance.

As discussed above under Recommendation 23, we broadly support improving disclosure for general insurance products, especially the way that insurers explain the risk relevant to prospective consumers.

As the FSI panel observed in its interim report "the current disclosure regime produces complex and lengthy documents that often do not enhance consumer understanding of financial products and services." For example, the disclosure regime for insurance contracts is particularly poor and inadequate. Details of the inadequacy of the current disclosure regime include:

- No information at all about the insurance policy at the time of purchase when buying insurance over the phone except details of the type and premium;
- Key Facts Sheets (KFS) commenced in November 2014 which are provided after purchasing insurance on the phone or by clicking a link to another page on the internet (ie not front and centre for consumers); and
- Product Disclosure Statements (PDS) (which is usually many pages long) are sent in the post to consumers after purchasing an insurance policy, and these documents have no required structure for setting out key information.

Overall, this has led to a situation where the vast majority of consumers do not read their PDS, including the critical information on coverage and exclusions which can be over 20 pages into the PDS. It is hoped that the KFS may improve this situation but there has been no testing or research on this point. Significantly, there has been no testing or research on the current disclosure process in insurance at all.

Accordingly, we strongly support the FSI panel's stated objectives for Recommendation 26:

(1) Reduce the incidence of inadvertent underinsurance by assisting consumers make an informed decision about the sum insured.

(2) Increase the ability of consumers to make informed decisions when taking out insurance.

(3) Enhance consumer understanding of insurance policies, especially key features caps and limits, and exclusions.

However, as we expressed above under Recommendation 23, we do not believe that industry self-regulation alone will be enough to ensure these objectives are met. Nor do we believe improving disclosure is enough on its own to meet these objectives.

The Government should endorse the FSI panel's recommendation that the general insurance industry guide consumer as to the likely replacement value for home building and contents for the purpose of insurance, but the Government should also take steps to ensure that insurance products are fair and suitable for consumers at the design and distribution stage.

RECOMMENDATION

Improving Disclosure

(1) The current disclosures used under the National Consumer Credit Protection Act 2009 and

the accompanying research on effectiveness should be emulated for insurance disclosure.

(2) Key Fact Sheets should be redesigned to be more targeted and to include disclosure over the phone and internet.

(3) Any proposed disclosure forms must be tested with consumers by an iterative process of redrafting and retesting.

Improving suitability of home building insurance

(4) The Government should endorse Recommendation 21 above.

(5) The Government should encourage insurers to offer total replacement policies for residential home building policies

Comparison Websites

We support the FSI panel's recommendation in *Chapter 3: Innovation* that the Productivity Commission review how data can be used fore effectively to enhance consumer outcomes; better inform decision making and facilitate greater efficiency and innovation in the financial system. The panel believes that price competition can help address underinsurance and that for mass-marketed insurance products governments can play a role in encouraging comparison websites.

Although we support better price competition among insurance products, we are very hesitant to endorse comparison or aggregator websites as a panacea. Current comparison websites for home and contents insurance compare some features, but not others and the comparison is usually focused on price (online discount, monthly premiums, and excess) and not on all features.

The comparison is ultimately cursory and limited to the listed features. It ultimately requires the person to read their PDS themselves to determine the extent of their coverage for things like general exclusions; or whether the insurer matches materials, and to what extent.

We will submit our views and consumer evidence to the Productivity Commission should they be instructed to review the use of data to enhance consumer outcomes. In the mean time we make the below recommendations to Government should they choose to play a role in encouraging comparison websites.

RECOMMENDATION

(1) Aggregator sites must compare points of coverage (and this would need to be legislated and regulated)

(2) All aggregator sites should have accessible links to the full PDS wording; and

(3) The comparison site should prompt a consumer to think about risk and what, for a multitude of claims, are the comparison points.

(4) Whether Aggregators will improve competition needs to be thoroughly researched, through the experiences of other similar markets, before it is heavily invested in.

<u>27 Regulator accountability</u>

Create a new Financial Regulator Assessment Board to advise Government annually on how financial regulators have implemented their mandates.

Financial Rights has no objection per se to increasing regulator accountability. Indeed there are advantages to setting clear, measureable performance indicators and increasing transparency around the execution of the regulator's mandate. However, overburdening regulators with multiple layers of accountability, with overlapping objectives and potential inconsistencies only detracts from the regulator's ability to resource and focus on their core remit.

ASIC for example is already accountable through a variety of mechanisms:

- Its own governing legislation;
- The *Public Governance, Performance and Accountability Act 2013*, which sets out a comprehensive performance framework, including performance reporting obligations;
- Ministerial oversight, the Senate Estimates process and audits by the Auditor-General;
- Annual Reports (tabled in Parliament);
- Statements of expectations and intent;
- The *Legislative Instruments Act 2003* which allows the Parliament to disallow an ASIC instrument ;
- Appearances at Parliamentary committees and inquiries: Including the PJC on Corporations and Financial Services and the Senate Standing Committee on Economics, and ad hoc committees and inquiries;
- Administrative and judicial review of its exercise of discretionary powers;
- Commonwealth Ombudsman oversight;
- Regular Financial Sector Assessment Program (FSAP) reviews conducted by the International Monetary Fund;
- Best Practice Regulation Requirements (for proposed new regulation);
- *Legal Services Directions 2005* (including the requirement to act as a model litigant); and
- Media releases and regular enforcement reports .

While there is some logic to the Final Report's arguments in relation to providing a balanced overall assessment of the regulators use of its powers we have some concerns about adding yet another accountability mechanism without any rationalisation of the existing requirements.

In the event that this recommendation is implemented we would also make the following points:

- Annual reporting is too frequent – many regulatory strategies play out over a longer period than 12 months. There is also a danger that overly frequent reviews will absorb resources and influence strategy in undesirable ways. We suggest every 3 years would be a more appropriate time frame.

- There should be consumer expertise on the Financial Regulator Assessment Board ("the Board") itself, in addition to industry and government, not just consultation. While industry members have some interest in ensuring "bad apples" are eliminated, there are many circumstances where the consumer interest is at odds with the vested industry interests and that view must have equal representation on the Board. Further, industry experts may not be abreast of relevant issues such as the impact of some business models/products on consumers (or particular groups of consumers), and the latest trends in consumer research which may provide important insights into what the regulator is (and is not) doing.

- The Board should have clearly pre-defined criteria by which to evaluate the regulators performance. It is important that the impact of the Board is not to make ASIC timid in taking action (even if ultimately unsuccessful in some cases) or to create distortions in strategic decision making (for example, hitting lots of easy targets rather than taking difficult but decisive action against a larger player or more complex problem).
- The board should be independent and have sufficient expertise to judge full ambit of regulator's work.

28 Execution of mandate

Provide regulators with more stable funding by adopting a three-year funding model based on periodic funding reviews, increase their capacity to pay competitive remuneration, boost flexibility in respect of staffing and funding, and require them to undertake periodic capability reviews.

We strongly support this recommendation. Regulator funding should be relatively stable and predictable; sufficient for purpose and promote regulator independence, strategic planning and accountability. As far as possible this process should be divorced from the political cycle.

29 Strengthening the Australian Securities and Investments Commission's funding and powers

Introduce an industry funding model for the Australian Securities and Investments Commission (ASIC) and provide ASIC with stronger regulatory tools.

We support stronger regulatory tools for ASIC. The licensing system should not be undermined by loopholes, such as changes of ownership and control, or the inability to consider misconduct which occurred in previous roles in other businesses. We also support the ability to impose license conditions provided this does not undermine other forms of enforcement in appropriate circumstances.

We support industry funding to the extent that this will improve stability and capacity (including pro-active surveillance), provided this can be done in a way that does not create inappropriate accountability to industry or to larger contributors in particular.

We also note that independent advice in the style of financial counselling in Australia is funded by an industry levy in the United Kingdom. Financial counselling and credit related legal services are a vital link in the consumer protection framework. Many clients are able to financially rehabilitate with the right advice and assistance. In recognition of this, a large number of referrals to the Credit and Debt Hotline at Financial Rights Legal Centre (the NSW answer point for national financial counselling access line 1800 007 007) are from banks and other major creditors. In addition, consumer protections enshrined in law are only as good as the extent to which they are accessed and/or enforced and both financial counsellors and credit legal services play a crucial role in assisting consumers to assert their rights and alerting regulators to unlawful conduct. The government should investigate the option of funding financial counselling & and credit legal services through a levy on credit licensees.

<u>40 Provision of financial advice and mortgage broking</u>

Rename 'general advice' and require advisers and mortgage brokers to disclose ownership structures.

We support the recommendation that advice should be relabelled in a way the better helps consumers to understand what kind of advice or information they are receiving. We do not believe the consumers understand the difference between 'personal advice' and 'general advice'. However, we note that no amount of relabelling can make up for poor advice and the sale of unsuitable products, and we consider other recommendations in the final report a higher priority.

We also strongly support better disclosure of ownership structures; although we do not believe it is sufficient to disclose this in Statements of Advice. Ownership disclosure must be abundantly clear to consumers and should be prominent on all consumer-facing documents including business cards, letterheads and in marketing material.

Mortgage brokers are required to disclose certain aspects of their role, remuneration structures and relationships with lenders in a document called a Credit Guide:

Section 113 (1), National Consumer Credit Protection Act: "A licensee must, as soon as practicable after it becomes apparent to the licensee that it is likely to provide credit assistance to a consumer in relation to a credit contract, give the consumer the licensee's credit guide in accordance with subsection (2)."

In our experience these documents are often being provided once a consumer has agreed to apply for pre-approval for a particular loan (that is once they have already committed to using the broker) rather than as early as possible in the consumer's engagement with the broker. This means that they are not serving their essential purpose about informing the consumer about the broker's role and informing the consumer's decision about whether to use a particular broking service. The information is not being explained verbally either, leaving consumers to have to sift through written material, something that is even less likely to happen once they are considering a particular loan, no doubt have a pile of related paperwork, and are focused on that decision rather than the credentials of the broker. It is our view that the National Consumer Credit Protection Act provisions should be reviewing in this regard, with a view to improving their effectiveness.

Regulation of sales and advice should apply generally

We strongly endorse the following comments made by the Consumer Action Law Centre:

> Any consumer protection related to financial advice needs to apply to all sales and advice provided to consumers, not only particular classes of products.
>
> Our submission does not focus on regulated financial advice and the discussion in the interim report about how to improve the quality of financial advice. We are concerned, however, about advice and 'assistance' that falls outside the scope of regulated credit assistance and financial advice. In our initial submission, we referred to for-profit financial difficulty businesses which included credit repair, budgeting services and bankruptcy services. As these businesses are not promoting a regulated 'credit product', nor are they engaging in 'credit assistance', they fall outside the regulatory regime.
>
> A similar problem occurs in relation to property investment advice and spruiking, which appears to be growing in the wake of improved regulation for financial advice. There have been many inquiries which have recommended that property investment advice be regulated in the same way as financial advice, and we support this. We encourage the Panel to consider, in recommendations about advice

frameworks, that regulation focus on the nature of the advice and assistance given, the consumer risks involved, and not limit its scope to advice in relation to particular types of products.

> **RECOMMENDATION**
>
> Regulation of sales and advice should apply broadly to financial products and services, rather than being limited to particular classes of products. In particular, financial systems regulation should not allow for-profit financial difficulty businesses, budgeting services, debt agreement providers and property spruikers to fall through gaps in regulation.

Beyond the comments on specific recommendations above, we also strongly endorse the comments made by the Consumer Action Law Centre in regards to the following recommendations:

- The payday lending review scheduled to occur after 1 July 2015 be independent and evidence-based, and involve a consultation process. Further enhancing regulation in this sector should also be considered by the Review, with the objective of improving consumer outcomes.
- That a last resort compensation scheme be a key component of financial services regulation.
- The Government ensure consumers get equivalent access and outcomes from the two EDR schemes in the financial services sector, if necessary by merging the two schemes.
- Government should ensure consumer organisations are adequately resourced and permitted to take part in policy development.

Concluding Remarks

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 Financial Rights Legal Centre on (02) 9212 4216.

Kind Regards,

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APPENDIX A

Submission to FSI Regarding For-Profit Financial Difficulty Businesses

For-Profit Financial Difficulty Businesses are those businesses that charge consumers sums of money to assist with a range of financial difficulty problems. There are a number of different types of businesses:

- That manage a consumers budget for a fee;
- That negotiate with creditors for reduced lump sum settlements for a fee;
- That consolidate debts (although this often leads to a part IX debt agreement); and
- That repair credit reports which in theory will enable a consumer to get a loan.

None of the above businesses are subject to regulation. They are all part of a regulatory loophole or series of loopholes. As a consequence, the businesses are not licensed, not required to be in EDR, can charge large fees, cause significant consumer detriment and consumers have limited access to redress.

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 can be severe, including:

- Adding a significant debt owed to the financial difficulty predator business when the consumer is already in financial hardship;
- Consumers becoming subject to legal proceedings because they have paid a 3rd party instead of their creditors and/or they have been advised to stop paying their original creditor for the purposes of creating greater leverage in negotiations;
- Consumers having their credit report impaired after following advice to stop paying their debts;
- Consumers being placed in Part XI Debt Agreements when it's not in their best interests;
- Consumers being made bankrupt in circumstances where this was unnecessary and highly detrimental; and
- Consumers being prevented from going bankrupt when this is their most appropriate option.

The Financial Rights Legal Centre 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.

Recommendations:

1. Obligation to be licensed under NCCP
2. Obligation to be a member of an External Dispute Resolution scheme
3. Specific consumer protection legislation in the NCCP to cover the problems with these businesses