15 September 2017

Lodged online: http://www.pc.gov.au/inquiries/current/financial-system

Inquiry into Competition in Australia's Financial System
Productivity Commission
GPO Box 1428
Canberra City ACT 2601

Dear Sir/Madam,

Inquiry into Competition in the Australian Financial System

The Consumer Action Law Centre (**Consumer Action**), Financial Counselling Australia (**FCA**) and the Financial Rights Legal Centre (**Financial Rights**) are pleased to provide a submission to the Consultation Paper for the Inquiry into Competition in the Australian Financial System (**the Inquiry**).

Our response to the Consultation Paper is detailed more fully below.

About the contributors

Consumer Action Law Centre

Consumer Action is an independent, not-for profit consumer organisation based in Melbourne. We work to advance fairness in consumer markets, particularly for disadvantaged and vulnerable consumers, through financial counselling, legal advice and representation, and policy work and campaigns. Delivering assistance services to Victorian consumers, we have a national reach through our deep expertise in consumer law and policy and direct knowledge of the consumer experience of modern markets.

Financial Rights Legal Centre

Financial Rights is a community legal centre that specialises in helping consumers 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 National Debt Helpline, which helps 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 Counselling Australia

FCA is the peak body for financial counsellors. Financial counsellors provide information, support and advocacy for people in financial difficulty. They work in not-for-profit community organisations and their services are free, independent and confidential. FCA is the national voice for the financial counselling profession, providing resources and support for financial counsellors and advocating for people who are financially vulnerable.

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1. Executive Summary

We welcome the Productivity Commission's review of competition in Australia's financial system, and agree with the Inquiry Terms of Reference request that the review should be undertaken with a view to improving consumer outcomes. Competition in the financial system should be considered a means to deliver benefits to consumers, but not an end itself.

For competition in the financial system to improve consumer outcomes, policy must be based on an understanding of how consumers actually make decisions. Too often competition policy has focused on how we think consumer should make decisions: the traditional economic view of 'rational consumers' making decisions based on available information. This approach ignores the behavioural biases which can inhibit rational decision-making. While the extent to which individual consumers exhibit these various behavioural biases varies, all of us exhibit such cognitive limitations at some point.

In order for consumers to benefit from competitive markets, they must be empowered to select products that fit their needs. Consumers depend on the availability of safe products and fair sales practices to guide their decision-making. Effective regulation that empowers consumers to select appropriate products supports healthy competition, and ensures a level playing field amongst competitors.

Consumer outcomes in Australia's financial system have much room for improvement. Horizontal and vertical integration, predatory products and sales practices, conflicted remuneration and harmful 'innovation' have denied many Australians the promised benefits of a competitive financial system. Looking ahead, we anticipate that the increasing use of consumer data will only increase the amount of 'profiling for profit' undertaken by financial firms. We are concerned this will ultimately lead to the poor paying more for financial products and services, while Australia's wealthiest pay even less.

It is critical that our regulators are provided with appropriate monitoring and enforcement powers to ensure competition in the financial system results in improved consumer outcomes. We therefore strongly support recent proposals to introduce design and distribution obligations for financial services providers, and product intervention powers for the Australian Securities and Investments Commission (**ASIC**). We also support the use of market studies to improve competition in the financial system.

In our submission we have provided examples of markets within the financial system where we believe competition has failed. This has led to poor consumer outcomes, particularly for vulnerable and disadvantaged Australians. Problematic sectors we have identified include insurance, credit cards, payday loans, consumer leases, mortgage broking, debt management advice and comprehensive credit reporting. We have argued that strong consumer protections and regulatory powers are necessary to ensure that consumers can benefit from increased competition in these markets.

2. General principles

We broadly support the remarks in the Consultation Paper that a competitive financial system for consumers should deliver products that fit individual needs, and are accessible and flexible. The first indicator of an effective competition policy is that it focuses on making markets work in the long term interests of consumers. We encourage competitive markets not because they are good in themselves but because they can provide the best outcomes for consumers.

Considering what represents positive outcomes for consumers in the financial system, and how an effective and competitive financial services market can deliver these outcomes, should be key guiding principles for the Inquiry.

The Inquiry should also avoid the simple assumption that regulation necessarily limits competition. As set out below, effective regulation can actually promote healthy competition. We also urge the Inquiry to consider behavioural economic principles in making its recommendations. We have provided further details below.

Does regulation limit competition?

We agree with remarks in the Consultation Paper that regulators are accountable to the community to ensure regulatory approaches remain fit for purpose, and that regulation is essential to maintain community trust and confidence in the financial system, protect consumers' rights and offer avenues to address grievances. However, we rebut the implied assumption that regulation necessarily limits competition.

For consumers to benefit from effective competition in the financial system, they must be empowered to select products that fit their individual needs and assess the features of those products. Empowered consumers depend on the availability of safe products and fair sales practices. In this way, effective consumer protection supports healthy competition. This was recognised by the Financial System Inquiry, which recommended new product design and distribution obligations on financial service providers. We strongly support those reforms.[1]

Framing regulation as 'limiting' competition, rather than supporting it, suggests that regulation is a burden. Business lobby groups and policy makers can be quick to 'count' the compliance costs of regulation—the staff hours and input costs required to comply. However, assessing the benefits of regulation is equally essential and policy makers should apply equal rigour on the benefit side of the ledger. There can be a significant information asymmetry in the financial system, and consumer protections are essential to support consumers make sensible decisions and be recompensed should the product or service they buy prove to be unsuitable.

"Single bullet" remedies are unlikely to be effective. Instead, complementary packages of supply and demand-side remedies are needed to promote effective competition. Demand-side remedies in particular can help people to improve their consumer decision-making, such that they are more

[1] See Section 4 of this submission (page 13) for further information.

likely to purchase more suitable products or services for their needs. Regulation of this sort is designed to provide a framework within which competition can thrive.[2]

We encourage the Inquiry to consider ways in which regulation can be developed that aligns with the interests of financial services firms. Rather than conceiving regulation as impeding competition, regulation can be developed to provide incentives to firms to educate rather than obfuscate, develop simple and intuitive product designs that align with rather than defy consumer expectations, and channel consumers to products that are suitable for their circumstances. Such regulation would be pro-competitive. Professor Lauren Willis of Loyola Law School writes of such 'performance-based' regulation, which involves setting performance standards and conducting 'confusion audits' to ensure regulations are resulting in desired consumer outcomes.[3]

How do consumers make decisions?

Competition policy and consumer protection regulation which empowers and encourages consumers to exert influence in the financial system must be based on a real understanding of how consumers make decisions. Too often, a traditional economic view of consumer choice and competition is adopted—one that focuses on rational consumers making informed decisions. While these are important factors, equally important concerns are the behavioural biases affecting choice that can inhibit decision-making. So too is recognition by policy makers that acting in line with these behavioural biases is not a sign of laziness for which the consumer is to blame. As noted by Professor Amelia Fletcher:

> *Consumers will vary in the extent to which they exhibit these various biases, and the impact of these biases will also vary according to the context. However, it is important to remember that such biases do not imply stupidity or laziness, or even a special level of consumer vulnerability; all of us exhibit such cognitive limitations and biases, in one circumstance or another.*

According to Professor Fletcher, some of the most relevant and commonly discussed consumer biases likely to affect competition are:

- *Status quo bias and loss aversion* - giving disproportionate weight to maintaining the status quo;
- *Present bias, myopia, and hyperbolic discounting* - giving disproportionate weight to the present, and insufficient weight to the future;
- *Default bias, saliency bias, and other forms of framing bias* - applying rules to simplify decision-making which involve adopting the default option, focusing on the most salient or prominent aspects of the product;
- *Over-confidence* - feeling more confident than is justified about future behaviour;
- *Limited memory* – failing to 'learn from mistakes'; and

[2] Professor Amelia Fletcher, Centre for Competition Policy, *The Role of Demand-Side Remedies in Driving Effective Competition: A Review for Which?,* 7 November 2016, p. 4.
[3] For example, see Professor Lauren Willis, *Performance-Based Consumer Law,* The University of Chicago Law Review, Vol. 82, No. 3, Summer 2015.

- *Influence of other people* - consumers will often be strongly influenced by what others tell them, especially if these others appear knowledgeable or trustworthy.

Professor Fletcher concludes that consumer decision-making may be worsened if consumers perceive that the decision will be an 'especially hard or time-consuming one to make'. This in turn means that people may be more likely to make mistakes if they are given 'too much information (information overload), too much choice (choice overload) or too little time to make a decision'.[4] These conclusions are particularly relevant when considering why initiatives in the financial system intended to facilitate greater choice of financial products have failed to deliver benefits to consumers, as highlighted in the Consultation Paper. It is important that competition policy takes a nuanced approach to consumer decision-making, which moves beyond traditional notions that increased choice will result in improved consumer outcomes.

Lessons from the Thwaites-Mulder Review

We highlight to the Inquiry the approach adopted by the recent Thwaites-Mulder Review of Electricity and Gas Markets in Victoria, which made recommendations relating to improving competition and consumer outcomes in electricity and gas markets. The Review's Final Report stated that:

> *In considering its recommendations and potential policy interventions, the review panel first determined what represents a positive outcome for energy consumers. The overall objective of the competitive retail energy market is to provide long-term benefits to consumers. This should include lower prices and more innovative products and services.*

The Thwaites-Mulder review panel then applied the following principles to guide its recommendations:[5]

- *Competition is a means to deliver benefits to consumers, but not an end itself.*
- *The retail energy market should deliver benefits to all consumers, not just to those who are capable, interested, and able to navigate its complexity.*
- *An effective market should reduce the costs consumers pay.*
- *Consumers should be able to control their energy costs through managing their energy use.*
- *Passive consumers should not be blamed for not navigating the retail energy market.*
- *Vulnerable and at-risk consumers must have access to affordable energy and should not cross subsidise other consumers.*
- *A competitive market is likely better placed to respond to changes in the energy sector and new technologies.*
- *Transparency is fundamental to an effective retail energy market.*

[4] Professor Amelia Fletcher, Centre for Competition Policy, *The Role of Demand-Side Remedies in Driving Effective Competition: A Review for Which?,* 7 November 2016, p. 17.
[5] Professor John Thwaites et. al., *Independent Review into the electricity and gas markets in Victoria,* August 2017, available at: https://engage.vic.gov.au/application/files/7415/0267/4425/Retail_Energy_Review_-_Final_Report.pdf p. 51.

In our view, many of these principles can also be applied to improving competition in Australia's financial system. We commend the report to the Inquiry.

Recommendation 1: The starting point for the Inquiry should be an assessment of what represents positive outcomes for consumers in the financial system, and how an effective competitive financial system can deliver these outcomes.

Recommendation 2: The Inquiry consider ways effective consumer protection regulation can support healthy competition.

Recommendation 3: The Inquiry consider ways in which regulation can be developed that aligns with the interests of financial services firms, having regard to research by Professor Lauren Willis on 'performance-based regulation'.

Recommendation 4: The Inquiry take into account the various behavioural biases that impact consumer decision-making in determining recommendations for improving competition in Australia's financial system.

Recommendation 5: The Inquiry consider the principles applied by the recent Thwaites-Mulder Review of Electricity and Gas Markets in developing its recommendations.

3. Operation of Australia's financial system

In our view, there are still significant barriers to effective competition in Australia's financial system that would improve outcomes for consumers. This 'is reflected in the static state of market share between the four major banks and very slow and marginal improvement gains even by strong second tier competitors'.[6] Horizontal and vertical integration, conflicted remuneration and harmful 'innovation' combined has denied many Australians the promised benefits of a competitive financial system. Many are still paying too much and ending up with unsuitable products. As we move into the era of 'open data' and 'open banking', we anticipate financial firms will increasingly use data against consumers for profit, rather than for the overall benefit of consumers. We believe vulnerable and disadvantaged consumers will be at particular risk of exploitation in this environment.

The 'stickiness' of banking products

It is well established that banking products are 'sticky', meaning that consumers are unlikely to switch to a better deal. In fact, according to the Barefoot Investor, two out of five people still use the same account their parents set them up with. That's seven million Australians who have never switched bank accounts.

[6] Centre for International Finance and Regulation, *Competition in Financial Services: Research Report,* August 2015, p. 5.

The Reserve Bank of Australia (**RBA**) suggested that consumers appear reluctant to switch accounts either because of a lack of information or an assessment that the benefits of doing so are not sufficient to outweigh the 'hassle' factor, the costs of switching, or the convenience of having a number of services 'bundled' with the one institution. This reluctance to switch tends to dull competition in the system and confers benefits to existing institutions.[7]

Given the stickiness of banking products, we question the appropriateness of banks being in our schools teaching financial literacy. This has been likened to Ronald McDonald teaching schoolchildren about healthy eating.[8] We have raised concerns about the Commonwealth Bank Dollarmites school financial literacy program in this regard previously.[9] Instead, we suggest that financial counsellors, ASIC or Financial Literacy Australia would be better placed to do this important work.

We urge the Inquiry to consider ways to reduce the 'stickiness' of banking products in developing policies to improve competition in the financial system, which should include an assessment of the appropriateness of banks providing financial literacy education in schools.

Horizontal and vertical integration

The current degree of vertical and horizontal integration in the financial system has had a number of negative implications for competition and consumer outcomes, particularly in the mortgage broking and insurance markets.

Alignment or vertical integration of advisers risks limiting effective competition by making it more difficult for advisers to consider products which may be more suitable for a client but not included on an Approved Product List. It may also mislead consumers—many consumers will not expect advisers to be limited to providing advice about products from certain providers.

The implications of vertical integration for competition and consumer outcomes cannot be fixed by simply disclosing the existence of a conflict. Even if the disclosure is noticed by consumers, it may have the effect of increasing trust in advisers rather than making consumers more wary.[10] Skilled salespeople will also be able to deflect concerns about vertical integration. Peter White of the Finance Brokers' Association of Australia said that finance brokers can use disclosure obligations to their advantage:

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[7] Reserve Bank of Australia, *RBA Submission to the Inquiry into Competition in the Banking and Non-Banking Sectors,* July 2008, p. 18, available at: https://www.rba.gov.au/publications/submissions/financial-sector/inquiry-competition-in-banking-and-non-banking-sector/pdf/inquiry-competition-in-banking-and-non-banking-sector.pdf.

[8] Scott Pape, The Herald Sun, *Barefoot Investor: Financial education too important to leave to banks, 10 March 2017, available at:* http://www.heraldsun.com.au/business/barefoot-investor/barefoot-investor-financial-education-too-important-to-leave-to-banks/news-story/d29c5d9ef3d80c074e773bd00c06e94d.

[9] Consumer Action Law Centre, *Senate Economics References Committee Inquiry into Consumer Protection in the Banking, Insurance and Financial Sector – Response to Questions on Notice*, 11 May 2017, available at: http://www.aph.gov.au/Parliamentary_Business/Committees/Senate/Economics/Consumerprotection/Additional_Documents.

[10] James Lacko and Janis Pappalardo, *The effect of mortgage broker compensation disclosures on consumers and competition: A controlled experiment*, Federal Trade Commission Bureau of Economics Staff Report, 2008 referenced in Financial Services Authority, *Financial Capability: A Behavioural Economics Perspective*, 2008.

I actually believe that if a broker is upfront about ownership—let's say they are owned by Commonwealth Bank, for example—then they can sell that as a positive. It can allow them to change the discussion around bank ownership—isn't it a good thing that they have somebody so strong sitting behind them that has enabled them to grow as a brokerage and a business?

..now they have opened up the discussion with their client and they are able to explain what bank ownership really means and how the [National Consumer Credit Protection Act] governs a broker's independence.[11]

These arguments may make clients more comfortable, but they do not address the conflicts of interest and competition concerns that are raised by vertical integration.

Problems with horizontal integration, whereby financial firms acquire similar companies in the same industry, also cannot be fixed by disclosure alone. Appropriate supervision of mergers and acquisitions by the Australian Competition and Consumer Commission (**ACCC**) is critical to ensure that consumer interests are protected.

We recognise that this is a complex issue, especially given the existing significant alignment between large banks, insurers, advisers and brokers. We recommend that more be done by the industry to bring independence and transparency into the system including, for example, through industry codes which have robust monitoring systems to ensure advice is provided in the best interests of the customer.

Balancing new entrants and innovation with consumer protection

The Terms of Reference directed the Inquiry to examine barriers to and enablers of innovation and competition in the system, including policy and regulation. While we are supportive of innovation and competition in the financial system, we have seen ‘innovation’ used as a guise in the past to justify predatory practices. Some innovation has seen firms compete on features other than price and suitability, which have led to poor consumer outcomes. For example:

- credit card providers competing on balance transfer offers, rewards points and loyalty schemes;[12]
- payday lenders competing on fast online access to cash;[13] and
- lenders competing on remuneration and rewards for mortgage brokers.[14]

We do not oppose innovation in the financial system. If done well, innovation can lead to lower prices and more suitable products for consumers. However, encouraging innovation as an end to itself rather than focussing on whether it will actually benefit consumers is misguided. Similarly, encouraging innovation to simply increase consumer choice may also lead to adverse outcomes.

[11] 'Disclosure can work in Brokers' favour', *Broker News*, January 2015, p 17.
[12] Reserve Bank of Australia, *Submission to the Financial System Inquiry,* March 2014, p.162.
[13] A study by the Financial Conduct Authority in the UK found that only around 9-12% of people who wanted high-cost short-term credit chose firms on the basis that they are the cheapest, had good interest rates or were the best offer on a price comparison website: Financial Conduct Authority, *High-cost credit including review of the high-cost short-term credit price cap*, July 2017, p. 23, available at: https://www.fca.org.uk/publication/feedback/fs17-02.pdf.
[14] Australian Securities and Investments Commission, *REP 516 Review of mortgage broker remuneration,* 16 March 2017, available at: http://download.asic.gov.au/media/4213629/rep516-published-16-3-2017-1.pdf.

A market with a large number of choices can be just as inefficient as a market with few choices if consumers do not understand what is on offer, cannot easily compare different offers, or are not rewarded for making the effort to search, compare and switch.

We also support new entrants to the financial system, but believe appropriate protections must be put in place for consumers before opening the floodgates to new entrants. We need only look at the private vocational training sector to see that unlimited new entrants and 'innovation' in sales practices can lead to spectacularly bad outcomes for consumers and governments.[15]

Risks and opportunities of open banking and data

We acknowledge that increased access for consumers to their own data has the potential to create consumer benefit. In order to achieve these benefits, consumers must be given access to their own data that is held by financial service providers in standardised and machine readable format. As we argued in our submission to the Financial System Inquiry terms of reference[16], this can help consumers make product choices better aligned with their needs, sending better signals to suppliers.

The era of open banking will also hopefully make it easier for consumers to switch financial service providers. Until now, bank switching packages designed to encourage people to shop around and find a better deal have generally failed. The 2012 'tick and flick' reforms only applied to transaction accounts, not credit cards or other accounts, meaning there was little take-up. Consumers still considered it too difficult to switch and the program was not broadly promoted by the banks. Switching costs were considered still too high,[17] and the package didn't fix the many problems associated with trying to switch credit card providers, and to cancel ongoing direct debits.[18] We encourage the Inquiry to consider opportunities presented by the New Payments Platform for improved bank switching and competition, including account number portability.

The growth in data collection by business (especially credit providers) to target products and marketing also brings considerable risks. Target marketing of products to particular groups of consumers is not new.[19] In consumer lending, technology can be used to identify consumers who are likely to be profitable, tailor and price products that the most profitable customers are likely to accept, and develop strategies to reduce the likelihood that the most profitable customers will close their accounts.[20]

It is often argued that this technology creates a win-win: consumers get access to products they want, and business can target their marketing and increase profits. However, the increased use

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[15] Senate Standing Committees on Education and Employment, *Final Report: Inquiry into the operation, regulation and funding of private vocational education and training providers in Australia*, October 2015, available at: http://www.aph.gov.au/Parliamentary_Business/Committees/Senate/Education_and_Employment/vocationaled/Final_Report.

[16] Consumer Action Law Centre, *Submission: Financial Systems Inquiry Terms of Reference*, March 2014, available at: http://consumeraction.org.au/submission-financial-systems-inquiry-terms-of-reference/.

[17] RBA identified switching costs as a factor that impedes contestability and competition: Reserve Bank of Australia, *Submission to the Financial System Inquiry,* March 2014.

[18] See page 24 of this submission for further information.

[19] Paul Harrison, Charles Ti Gray and Consumer Action Law Centre, *Profiling for Profit: A Report on Target Marketing and Profiling Practices in the Credit Industry*, 2012, pp 5-6, available at: http://dro.deakin.edu.au/eserv/DU:30064922/harrison-profilingfor-2012.pdf.

[20] Ibid.

of customer information has coincided with a sharp increase in levels of consumer debt. In the last 15 years, the level of credit and charge card debt in Australia accruing interest has increased from a total of around $15 billion to over $32 billion. Increases to credit card limits are even more staggering – over the same period Australia's credit card limits have increased from around $60 billion to over $151 billion.[21]

It is often argued that it is not in the interests of lenders to extend credit to people who are unable to repay. However, many consumers struggle for years at a time to make repayments to their credit accounts without ever reaching the point of default. These customers will be very profitable for lenders, despite the fact that these contracts cause financial hardship. In the credit card industry, these customers are known as 'revolvers', as opposed to 'transactors'. Revolvers don't pay back their full balance within the interest-free period and pay significant amounts of interest on purchases.

Individuals' confidence and trust in the way data is used, particularly data that is also personal information, is integral to the realisation of economic and social benefits associated with data being more widely available. Despite this, research from the United Kingdom found that there is a 'data trust deficit' whereby trust in institutions to use data appropriately is lower than trust in them in general.[22] This is likely to be the case in Australia also. Appropriate consumer protections must be put in place to ensure trust and confidence is not further eroded.

Recommendation 6: The Inquiry consider ways to reduce the 'stickiness' of banking products, which should include an assessment of the appropriateness of existing banks providing financial literacy education in schools.

Recommendation 7: More be done by Government and industry to bring independence and transparency to vertical and horizontal integration in the financial system including, for example, through industry codes that have robust monitoring systems to ensure advice is provided in the best interests of the customer.

Recommendation 8: The Inquiry recognise that innovation and new entrants may lead to adverse outcomes for consumers, and that increased choice does not necessarily result in benefits to consumers.

Recommendation 9: Consumers be given access to their own data that is held by financial service providers in standardised and machine readable format.

Recommendation 10: The Inquiry consider opportunities presented by the New Payments Platform for improved bank switching and competition, including account number portability.

[21] Reserve Bank of Australia, Credit and Charge Card Statistics, as updated June 2017, available at http://www.rba.gov.au/statistics/tables/.

[22] Royal Statistical Society, *New RSS research finds 'data trust deficit', with lessons for policymakers,* 22 June 2014, available at: https://www.statslife.org.uk/news/1672-new-rss-research-finds-data-trust-deficit-with-lessons-for-policymakers.

Recommendation 11: The Inquiry acknowledge that increased use and availability of data may have negative consumer outcomes, and that appropriate regulation is needed to avoid exploitation of consumer information.

4. Regulator powers

It is critical that ASIC is provided with appropriate regulatory tools to ensure that competition in the financial system results in improved consumer outcomes. The proposed product intervention power and design and distribution obligations for financial service providers are a step in the right direction.

Design and Distribution Obligations

We strongly support the proposal to introduce design and distribution obligations for financial service providers. Under the proposals, product issuers would be required to design better products and target them towards people who will actually benefit from key product features. Product issuers would be required to distribute their products to identified target markets, rather than the general public. Issuers could still use third parties to distribute their products, but they would have to be much more selective about who they choose to distribute their products. Product distributors would also have additional obligations, and will be more accountable to product issuers.

Currently there is no general requirement for product issuers to design safe products, or to target them at appropriate audiences. Distributors have also been allowed free reign, and have not been properly accountable to product issuers. Consumer advocates believe the proposed changes are some of the most significant reforms to the finance sector ever proposed, and would see more Australians with suitable and affordable credit and financial products.

Product Intervention Powers

We strongly support the proposal to empower ASIC to make timely and effective product interventions when a significant risk of consumer harm is identified. This proposal was initially suggested by the Financial System Inquiry,[23] and mirrors similar powers for the United Kingdom financial regulator—the Financial Conduct Authority.[24]

The proposed product intervention power would empower the regulator to step in before harm has occurred, rather than waiting for consumer detriment and breaches of the law to happen. Under the proposal, ASIC would be able to make many different types of interventions, including restricting or banning products, imposing additional disclosure obligations, mandating warning statements, or requiring changes to advertising.

[23] Financial System Inquiry, *Final Report,* 7 December 2014, available at: http://fsi.gov.au/publications/final-report/chapter-4/product-intervention/.
[24] For further information, see: Consumer Action Law Centre et. al., *Submission to* Design and Distribution Obligations and Product Intervention Power Proposals Paper, 15 March 2017, available at: http://policy.consumeraction.org.au/wp-content/uploads/sites/13/2017/03/FINAL-Joint-Consumer-Submission-DADOs-and-PIPs-15032017.pdf.

Market studies

We also support regulators undertaking market studies looking at competitiveness and consumer outcomes in a particular market. At present, ASIC does not have a clear mandate to undertake competition-focused market studies.

Market studies are a type of public investigation into a market, particularly examining whether there are any anti-competitive issues that as a result is causing detriment to consumers. In essence, they are utilised as a tool for examining the effectiveness of competition by investigating specific products and markets, and determining if consumers are being harmed by certain practices. Market studies can act as a spearhead for competition advocacy.[25]

It is not a requirement that the relevant conduct is unlawful for a market study to be initiated. Rather, a market study may be commenced where there is a belief the conduct is having an adverse effect on competition. It could be initiated by the regulator on its own motion, or following complaints. Using the information gathered from a market study, a regulator can then assess competition in a particular area and make recommendations for improvement.

There are at least 40 nations that have granted their respective competition authorities the power to conduct market studies.[26] We believe there are clear benefits in providing regulators with market study powers. We recommend the Inquiry consider whether ASIC should be provided with similar powers.

Recommendation 12: Introduce legislation to implement the proposed design and distribution obligations for financial service providers, and product intervention powers for ASIC.

Recommendation 13: ASIC be provided with a clear mandate to undertake competition-focused market studies.

5. Insurance

One of the key areas of the financial system where we see competition failing is insurance. For a large proportion of people in Australia, insurance is almost an ‘essential service’. It protects them financially when something happens to them, their loved ones, or their most valuable assets, such as their homes and cars. It is also a complex financial product, with a huge array of products with varied features and prices.

Insurance is pitched to people in many everyday transactions. For example, consumer credit insurance (**CCI**) is sold with loans and credit cards, travel insurance with airline bookings,

[25] OECD, *Policy Roundtables - Market Studies*, 2008, available at: http://www.oecd.org/regreform/sectors/41721965.pdf.
[26] International Competition Network, *Market Studies Project Report*, 2009, available at: http://www.internationalcompetitionnetwork.org/uploads/library/doc363.pdf.

discounted life insurance with retail loyalty card membership and even discounted pet insurance with union membership.

The widespread marketing of insurance products, and the complexity and variation of those products, mean that in many ways the insurance market is not competitive from a consumer perspective. Two current examples which highlight how this lack of competition affects consumers are:

- add-on insurance sold through car yards and authorised deposit-taking institutions (**ADIs**); and
- domestic home and car insurance.

We have also provided comments about the lack of premium transparency in the insurance market, and the limited effectiveness of comparison websites in addressing the lack of competition.

While we acknowledge the Inquiry is limited in scope to policies that are sold as part of a vertically or horizontally integrated business models, we see such significant failures in competition in this market that we have made comments about the industry in general below.

Add-on insurance

In recent years, the systemic problems with the add-on insurance market have become well known. Add-on insurance includes CCI, which is typically sold through car yards, banks, credit unions and other finance providers. Other add-on products sold through car yards include guaranteed asset protection (**GAP**) insurance, loan termination insurance, tyre and rim insurance, mechanical breakdown insurance and extended warranties (including discretionary risk products and dealer-issued warranties, which are not insurance).

Consumer Action's DemandARefund.com website, which enables people to generate a letter of demand to reclaim the money they paid for mis-sold add-on insurance, has seen more than 340 people claim over $700,000. More than one-in-four people who have used DemandARefund.com did not know they had bought the insurance.[27] Almost one-third of people mistakenly thought the add-on insurance was mandatory. These are hardly signs of a competitive market with active consumer participation.

ASIC has repeatedly found problems with add-on insurance sales in car yards and ADIs.[28]

[27] Similarly, the UK Financial Conduct Authority found that 19% of people who bought an add-on product were unaware they had bought it: *General Insurance Add-Ons Market Study—Proposed Remedies: Banning opt-out selling across financial services and supporting informed decision-making for add-on buyers*, Consultation Paper CP15/13, 25 March 2015, para 1.11.

[28] See the following Australian Securities and Investments Commission reports:

- *Report 256: Consumer credit insurance: A review of sales practices by authorised deposit taking institutions*, October 2011;
- *Report 361: Consumer credit insurance policies: Consumers' claims experiences*, July 2013;
- Report *470: Buying add-on insurance in car yards: Why it can be hard to say no*, February 2017;
- *Report 471: The sale of life insurance through car dealers: Taking consumers for a ride*, February 2017;
- *Report 492: A market that is failing consumers: The sale of add-on insurance through car dealers*, September 2016;

After an extensive review of the car yard channel, ASIC found that dealer commissions as high as 79% drive sales of add-on insurance with cars and car loans.[29] The market is driven by 'reverse competition' (that is, insurers offering car dealers high incentives in return for access to the car yard sales channel).[30] These products are also extremely poor value, with claims ratios as low as 4.4% through the car yard channel.[31]

ASIC has clearly identified the lack of competition in the add-on insurance market and the impact this has on consumers:

> *… insurers in the add-on market have largely agreed with requests from car dealers to pay higher commissions, without properly understanding and addressing the causes and implications of the conduct…*
>
> *Consumer outcomes are considerably worse than in a market where there is competition…*
>
> *It is clear that insurers do not need to compete on either price or value… The sales process means that insurers are under no external competitive pressure as they do not risk losing sales to other providers offering better value products.*[32]

The insurance industry has itself acknowledged the failures in the car yard add-on market:

> *… high commissions paid in the motor vehicle dealership channel contribute significantly to the market failure identified by ASIC by providing incentives to engage in the inappropriate sales practices identified in the recent ASIC reports into that channel, such as providing incomplete information or explanation of the products, pressuring or rushing customers, downplaying the cost of products, using pre-filled application forms, and in some cases misrepresenting the value or necessity of add-on insurance products.*
>
> *These sales practices can prevent customers from making informed decisions about the products they are being offered, including the value of those products and the alternatives available elsewhere.*[33]

In relation to the bank channel, after its 2011 review of CCI sold through ADIs, ASIC recommended ADIs implement changes to reduce the risks of mis-selling. This year's independent review of the Banking Code of Practice stated that the banks did not have any data to measure the change in CCI conversion rates, which could indicate the effectiveness of ASIC's

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- *Consultation Paper 294: The sale of add-on insurance and warranties through caryard intermediaries*, August 2017.

[29] Australian Securities and Investments Commission, *Report 492: A market that is failing consumers: The sale of add-on insurance through car dealers*, September 2016, para 20.

[30] Ibid, para 58.

[31] Ibid, para 45.

[32] Australian Securities and Investments Commission, *Consultation Paper 294: The sale of add-on insurance and warranties through caryard intermediaries*, August 2017, paras 29, 30

[33] Applicants' submission, *Aioi Nissay Dowa Insurance Company Australia Pty Ltd & Ors – applications for authorisation A91556 – A91557*, 2 February 2017, http://registers.accc.gov.au/content/trimFile.phtml?trimFileTitle=D17+13845.pdf&trimFileFromVersionId=1201402&trimFileName=D17+13845.pdf. The insurers submitted this in their application for ACCC approval to cap commissions paid to car dealers at 20%, which ultimately was not approved as it was found to not provide a net public benefit.

recommended changes.[34] ASIC has returned to examine the ADI channel again recently, after finding that cross-selling of CCI was still a particular risk area in banks.[35]

The insurance industry has started to remediate consumers for mis-sold add-on insurance, with three insurers agreeing to repay people they mis-sold insurance a total of more than $26 million.[36] However, much more work is needed to curb the rampant mis-selling of add-on insurance.

We strongly support ASIC's proposal to implement a mandatory delayed sales model for add-on insurance, to separate the primary sale (car, credit or finance) from the sale of the add-on insurance.[37] A delayed sales model and various pre-sale requirements for GAP insurance were introduced in the United Kingdom in 2015 by legislative instrument.[38] A similar model be an effective way to stop mis-selling here in Australia.

The Australian Bankers Association has proposed a delayed sales model for CCI sold with credit cards in bank branches and over the phone.[39] While this would be a promising start to banks ending their own mis-selling, this model should logically extend to personal loans and home loans.

With online applications accounting for a large proportion of credit and finance applications, banks and other finance providers should also address the mis-selling of CCI through that channel. The design and distribution obligations[40] are likely to drastically improve the design and distribution of poor value add-on insurance, including by:

- improving the value of add-on insurance, with more appropriate benefits and less onerous conditions and exclusions, and
- ensuring people who buy add-on insurance understand it and are eligible to claim on it, through filter or 'knock out' questions and more effective disclosure at the time of sale.

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[34] Phil Khoury, *Independent Review: Code of Banking Practice*, 31 January 2017, p 159.
[35] Australian Securities and Investments Commission, *17-254MR ASIC reports on Australian bank audits following Wells Fargo misconduct*, 1 August 2017.
[36] See Australian Securities and Investments Commission announcements: *17-189MR Virginia Surety to refund over $330,000 to add-on insurance customers*, 20 June 2017; *17-258MR QBE refunds $15.9 million in add-on insurance premiums*, 2 August 2017; *17-268MR Commonwealth Bank to refund over $10 million for mis-sold consumer credit insurance*, 14 August 2017.
[37] Australian Securities and Investments Commission, *Consultation Paper 294: The sale of add-on insurance and warranties through caryard intermediaries*, August 2017, p 46.
[38] See Financial Conduct Authority, *Insurance: Conduct of Business Sourcebook (Guaranteed Asset Protection Contracts) Instrument 2015* and *PS15/13: Guaranteed Asset Protection insurance: competition remedy—Including feedback on CP14/29 and final rules*, June 2015.
[39] See Australian Securities and Investments Commission, *17-255MR Banks to overhaul consumer credit insurance sales processes*, 1 August 2017.
[40] See Section 4 of this submission (page 13) for further information.

Recommendation 14: Implement a mandatory delayed sales model for add-on insurance, to separate the primary sale (car, credit or finance) from the sale of the add-on insurance.

Recommendation 15: The Australian Bankers Association proposed delayed sales model for CCI sold with credit cards in bank branches and over the phone be extended to personal loans and home loans.

General insurance

The recent Senate Economics References Committee (**Committee**) inquiry into Australia's general insurance industry reported that the car and home insurance markets are not competitive for consumers, and recommended a raft of changes to address this.[41]

The Committee emphasised the importance of competitive markets for consumers:

> *Healthy competition is integral to insurance affordability and accessibility. A lack of competition in insurance markets can result in negative consumer outcomes, such as premium increases, underinsurance, or coverage that is inappropriate to consumers' needs. These outcomes can have potentially devastating effects, not only on consumers' financial stability, but also on their mental and physical health.*[42]

The Committee heard that the general insurance market may appear competitive on the supply side—for example, in the number of active industry players. However, it is less evident on the demand side—for example, in the proportion of policy holders shopping around and switching, pricing disparities between insurers, and the information asymmetry between insurers and their customers.[43] As Consumer Action noted in our submission to the Committee inquiry:

> *The general insurance industry in Australia is characterised by a vast range of policies which include varied conditions, inclusions, exclusions and definitions. Policies are not consistent and do not conform to a minimum standard. Choosing a product can be a complicated attempt at guesswork.*[44]

Some of the problems with competition identified by Consumer Action and other organisations during the inquiry included:

- the standard cover regime is not an effective benchmark or minimum standard people can assess or compare policies against;[45]
- it is difficult to compare policies without standard definitions for key terms;[46]

[41] Senate Economics References Committee, *Australia's general insurance industry: sapping consumers of the will to compare*, August 2017.
[42] Ibid, para 2.49
[43] Ibid, paras 2.63-2.65
[44] Consumer Action cited in Senate Economics References Committee, para 3.5.
[45] Ibid, para 3.54
[46] Ibid, paras 3.57-3.62.

- insurers do not disclose details of their pricing, including pricing components and the prior year's premium;[47] and
- insurers are exempt from unfair contract terms laws, meaning insurance policies do not meet the same fairness test as virtually every other consumer contract in the market.

The Committee concluded that a combination of these and other factors are 'sapping consumers of the will to compare'. The Committee recommended the extension of unfair contract terms laws to insurance, an independent review of the standard cover regime, changes to pricing disclosure and the implementation of standard definitions for key terms, as well as a raft of other improvements.

Consumer Action strongly supports the Committee's proposed changes, which have the potential to significantly improve the competitiveness of the general insurance market from the consumer perspective. In our view, the Committee has proposed sound reforms based on evidence and a clear understanding of the consumer experience.

Recommendation 16: The Government implement recommendations by the Senate Economics References Committee inquiry into Australia's general insurance industry, including extension of unfair contract terms laws to insurance, an independent review of the standard cover regime, changes to pricing disclosure and the implementation of standard definitions for key terms.

Premium transparency

We believe that competition in insurance is adversely affected by the lack of transparency in premium pricing. There is very little information available to consumers about how their premiums are calculated, and there is currently no adequate mechanism to review or contest whether premiums have been calculated fairly.

Through the Insurance Law Service, Financial Rights regularly receives complaints from consumers about the level of their premium. Consumers sometimes believe their premium has been incorrectly calculated given their claims history, or has been calculated based on incorrect information. From our experience, consumers who dispute their premium pricing with the insurer are generally left feeling unsatisfied because often the sales team cannot explain why the premium is priced as it is or the consumer does not feel the insurer has taken any steps to look at their particular situation.

The insurance industry should not be able to shield relevant pricing information on the grounds that they are using "commercially sensitive" rating factors and weightings. Consumers should have access to such information if they have a legitimate dispute about the reasons behind a premium price increase.

[47] Ibid, para 3.25, 3.33-3.37

In its 2014 publication entitled "*Enhancing the consumer experience of home insurance: Shining a light into the black box*",[48] the Fire Services Levy Monitor reasoned that by improving the efficiency of insurance markets, through removing information asymmetry and making competition more effective, policyholders will be better informed and premiums will fall, thereby making insurance more accessible. Consumer advocates argue that insurers should have to substantiate premium pricing across all forms of insurance. In the home and contents space it is essential.

The failure of industry to have any mechanism of review of the fairness and consistency of premium calculations is of significant detriment to consumers. This failure also provides no guarantee that any household mitigation strategies or idiosyncratic household conditions are taken into account when determining premiums. Consequently, premium prices cannot be said to be "accurate" signalling of risk as there is no contestability or transparency in their calculation.

We submit that insurers should be required to provide information as to the components in their premium pricing. Knowing what makes up the price of a premium would better inform consumers about risk and what effect mitigation strategies may have on reducing insurance premiums or what behaviours or conditions might increase premiums. Component pricing information should apply uniformly across all insurers but will be particularly helpful in addressing a lot of the issues faced by those in parts of Australia with severe weather risks. It would provide an easy to read, easy to understand signal to consumers of the risk factors taken into account when premiums are set.

Finally, we also support insurers printing last year's premium on a renewal notices in order to more effectively inform consumers of price rises in their premiums. Insurers should also explain why the price has increased. Such an idea was recommended by the Victorian Government's Fire Services Levy Monitor, is currently being investigated by the United Kingdom's Financial Conduct Authority and is being introduced by international insurer AXA. This disclosure should be mandatory for all insurers.

In its recent report on the general insurance industry the Senate Economics Reference Committee agreed that "transparent disclosure that encourages understanding and promotes informed decision-making lies at the heart of robust consumer protection."[49]

The Committee made two recommendations regarding premium transparency, which we believe would improve competition and consumer outcomes in the insurance industry:

- that the Government strengthen the transparency of general insurance pricing by amending the product disclosure regime in the *Corporations Act 2001* to require insurers to:
    - disclose the previous year's premium on insurance renewal notices; and
    - explain premium increases when a request is received from a policyholder.

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[48] Fire Services Levy Monitor, *Enhancing the consumer experience of home insurance - Shining a light into the black box*, July 2014, available at: http://www.firelevymonitor.vic.gov.au/home/news+and+information/publications/publication+shining+a+light
[49] Senate Economics References Committee, *Report: Australia's general insurance industry: sapping consumers of the will to compare*, 10 August 2017, para 3.73, available at: http://www.aph.gov.au/Parliamentary_Business/Committees/Senate/Economics/Generalinsurance/Report/c03.

- that the Government initiate a review of component pricing to establish a framework for amending the *Corporations Act 2001* to provide component pricing of premiums to policyholders upon them taking out or renewing an insurance policy, as well as an assessment of the benefits and risks to making such a change.[50]

Recommendation 17: Insurers be required to provide information as to the components in their premium pricing.

Recommendation 18: The Government implement recommendations by the Senate Economics References Committee inquiry into Australia's general insurance industry regarding premium transparency.

Comparison websites

The costs and benefits associated with insurance comparison websites have been thoroughly debated over recent years. The benefits are generally thought to be lower insurance costs for consumers (prices driven down by fierce online competition), better transparency in the insurance market (it's easy to see what everyone has on offer) and a more streamlined consumer process for finding insurance products.

However, there are also a great number of costs associated with these types of aggregator websites. In general, comparison websites provide only a very simplistic and often inaccurate overview of different insurance policies and tend to reduce the complex insurance purchasing decision to one based on price alone—disregarding differences in policy cover, product options and claims service capabilities. The scope of cover, product options and claims experience vary greatly across the industry and using a comparison website can fail to take these factors into account and carry some hidden catches.

We are mostly concerned that the type of competition encouraged by price comparison websites, which oversimplify the consumer's options and magnify an existing bias towards choosing on price alone, will facilitate a race to the bottom on coverage, as insurers with superior cover and claims handling services are outcompeted by cheaper and inferior offerings.

We do not believe that comparison websites increase transparency in insurance markets. 'Free' comparison sites can earn commissions from insurers. These commissions can make up a big portion of a consumer's total insurance premium. Additionally, some comparison sites are misleading about how much of the market they compare and some sites are actually owned by the insurance companies they're supposedly comparing.[51]

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[50] Ibid.
[51] CHOICE, Jodi Bird, *Insurance Comparison Sites*, 19th August 2014. https://www.choice.com.au/money/insurance/insurance-advice/articles/insurance-comparison-sites.

There has been lots of consumer research done on the relatively recent influx of price comparison websites (**PCWs**) in the United Kingdom.[52] Various reports have discussed the risks and benefits of PCWs for consumers but there is not much evidence that insurance cover costs have gone down.

There is some evidence that PCWs in the United Kingdom did lower insurance costs at first by causing fierce competition,[53] but new research by David Ronayne of Warwick University argues "that consumers often lose out from comparison sites. They earn a commission for each shopper who uses them to buy insurance. That referral cost is incorporated into the price the consumer ends up paying. If the increased costs outweigh the saving the comparison enables, consumers end up worse off." [54]

Insurance policies are complex financial products that do not always lend themselves to easy comparison. Different policies might not only include different levels and types of cover, they might have completely different definitions for the same terms. Unfortunately, instead of giving consumers the opportunity to learn more about different policies, consumer research has found that presentation of insurance information in a clear and simple way 'framed' the process as a simple and straightforward task of comparing products that were largely the same.[55]

The Committee final report[56] acknowledged the strong concerns raised regarding any proposal to establish an independent comparison service for home, strata and car insurance in Australia; in particular, the risk that such a service could lead to consumers focusing on product price rather than value. [57]

We do not support the creation of an independent comparison service for insurance due to all the risks described above. However, should the Productivity Commission recommend the creation of an independent insurance comparison service, it should include the following:

- As much as possible, a comparison website should prompt consumers to consider their individual risk and encourage them to compare policy features, not just premium price.
- A comparison website should not be a mechanism to arrange or purchase insurance, but the information does need to be current and up to date to reflect changes in policy wordings.

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[52] Financial Conduct Authority, *Price comparison website: Consumer market research*, June 2014, available at: https://www.fca.org.uk/publication/research/price-comparison-website-consumer-research.pdf; David Ronayne, Warwick Economics Research Paper Series, *Price Comparison Websites*, October 2015, available at: http://www2.warwick.ac.uk/fac/soc/economics/research/workingpapers/2015/twerp_1056b_ronayne.pdf; UKRN, Research into Price comparison websites, September 2016, available at: http://www.ukrn.org.uk/wp-content/uploads/2016/09/201609027-UKRN-PCWs-Report.pdf

[53] George Maher et. al. *Why aren't we making money,* 2011, available at: https://www.towerswatson.com/en-GB/Insights/IC-Types/Survey-Research-Results/2011/02/Why-arent-we-making-money.

[54] David Ronayne, Warwick Economics Research Paper Series, *Price Comparison Websites*, October 2015, available at: http://www2.warwick.ac.uk/fac/soc/economics/research/workingpapers/2015/twerp_1056b_ronayne.pdf.

[55] Financial Conduct Authority, *Price comparison website: Consumer market research*, June 2014, available at: https://www.fca.org.uk/publication/research/price-comparison-website-consumer-research.pdf.

[56] Senate Economics References Committee, *Report: Australia's general insurance industry: sapping consumers of the will to compare*, 10 August 2017, available at: http://www.aph.gov.au/Parliamentary_Business/Committees/Senate/Economics/Generalinsurance/Report.

[57] Ibid, para 4.94.

- Generated quotes should be able to be "saved" and any personal information that has been entered by a consumer should be secure and confidential.

- Any comparison website should have accessible links to the most recent full Product Disclosure Statement wording.

Recommendation 19: The Inquiry acknowledge the limitations of comparison services for insurance.

6. Consumer credit

Credit cards

We have seen a wholesale failure of price competition in the credit card market. Credit card interest rates have been unresponsive to reductions in the cash rate. Analysis conducted by Treasury in 2015 showed that effective spreads earned by credit card providers have actually increased over the past decade. Instead, we see credit card providers competing over the generosity of balance transfer offers, interest free periods and rewards programs.[58]

The RBA has confirmed that interest rates on credit cards have continued to increase relative to the cash rate in recent years. Since the global financial crisis, we have seen the average spread between bank funding costs and effective credit card interest rates increase from 6.7% to 8.7%.[59] Other industry data also suggests that competition is failing to ensure consumers are only paying efficient costs: credit cards are a gold mine for banks, with the estimated return on equity for a residential mortgage at 24.25%, while the return on equity for credit card loans is 40.25%.[60]

Instead, competition focuses on influencing cardholders' behaviours via reward points and loyalty schemes. These are typically funded by increasing interest rates and default fees, along with interchange fees, the costs of which are often passed on to merchants through higher service fees.[61] Credit card providers have cleverly designed their products to take advantage of our inherent biases, which see most people optimistically believing at the time they apply for a card that they will always pay off the balance in full. This is known as the 'over-confidence' bias, which we flagged on page 6 above. Complexity is used to bamboozle, and teaser offers used distract us from the true cost of our credit cards.

There is also significant concentration of credit card market with the major four banks. The Australian credit card market features around 100 credit card brands offering over 250 products. However, banks provide approximately 88 per cent of credit cards on issue in Australia, and account for approximately 81 per cent of balances outstanding. The four majors alone account

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[58] The Treasury, *Credit Card Interest Rates Briefing Paper*, 2015, previously available at: http://www.treasury.gov.au/~/media/Treasury/Consultations%20and%20Reviews/Consultations/2016/Credit%20card%20reforms/Key%20Documents/PDF/Credit_card_reforms_CP.ashx.
[59] Ibid.
[60] Ibid.
[61] Reserve Bank of Australia, *Submission to the Financial System Inquiry,* March 2014.

for about 68 per cent of balances outstanding, [62] and are failing to compete on price, despite the cost for providing credit actually reducing.

Below we make some suggestions aimed at improving the effectiveness of competition in the credit card market.

Recurring direct debits

Cardholders face a number of barriers if they wish to switch credit cards. One of the most significant barriers to switching is cancelling recurring direct debit transactions that are set up from a consumer's credit card.

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. This approach can be contrasted with direct debits on transaction accounts, where it is the bank's obligation to process a consumer's instruction to cancel direct debit requests.

We submit that there should be no difference in treatment between credit card accounts and other accounts under the Banking 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.

Cancelling credit cards

We support recent proposed reforms that would oblige credit card providers to allow consumers to make requests to cancel credit cards and reduce credit limits online. Implementing this reform would give people more control over their credit card spending, and make switching credit card providers easier.

While we are supportive of the reforms outlined in the draft exposure legislation, we have suggested a number of technical amendments that would avoid credit card providers exploiting potential loopholes. For further information about our suggested amendments, please see our submission in response to the exposure draft legislation.[63]

Marketing practices

As set out above, lenders generally compete by offering interest-free periods, 'free' balance transfers or member reward schemes to attract borrowers. Our main concern is that these offers are "teasers", in that they hide the true cost of the card. This includes the high interest rates for new purchases (often exceeding 20 percent) and significant fees. Even if zero percent applies to new purchases during the introductory period, this effectively provides consumers with an incentive to spend excessively during the period as it appears to be "free" money.

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[62] Senate Standing Committee on Economics, *Final Report: Matters relating to credit card interest rates*, 2015, available at: http://www.aph.gov.au/Parliamentary_Business/Committees/Senate/Economics/Credit_Card_Interest/Report/c02.

[63] Consumer Action Law Centre, *Submission: Credit card reform exposure draft legislation*, August 2017, available at: http://policy.consumeraction.org.au/2017/08/23/submission-credit-card-reform-exposure-draft-legislation/.

Credit card lenders ‘bundle’ these complex pricing structures in their marketing and product information, which makes the overall costs difficult for the average consumer to understand.[64] Potential borrowers may also fall prey to superficially appealing but poor value offers, such as rewards points.[65]

People with significant credit card debt, or 'revolvers', typically take up these 'teaser' offers. However, most never actually realise the advertised benefits and are tempted to overspend under the illusion that this is 'free' money. We recommend that teaser 'free' balance transfer offers be a minimum of two years. However, to help ensure that consumers will not be tempted to over-commit themselves during the extended 'teaser' period, we recommend that credit card companies be required to set the minimum repayment amount on the basis that the consumer will repay the transferred balance within the period. In the alternative, there should be restrictions on using the card for new purchases until the transferred debt is repaid.

These reforms would make it less likely that credit card providers will exploit consumers' behavioural biases and actually compete on price and suitability, rather than poor value ‘teaser’ offers.

Bundling

It is common for credit cards to be bundled with other credit products, particularly home loans. This raises not only responsible lending issues, but also competition concerns. Consumers are often offered ‘discounts’ on their home loan interest rates if they sign up to a linked credit card account. Credit cards and other loan accounts can also be bundled with transaction accounts, limiting choice and making it more difficult to switch providers. The RBA has previously raised concerns about the impact of bundling on competition, saying that ‘the ‘bundling’ of financial services has increased the difficulty that many people face when switching institutions.’[66] Often people are hesitant to switch banks due to the perceived convenience of having a number of products bundled with one provider.

We urge the Inquiry to consider the appropriateness of bundling of credit and financial products.

Recommendation 20: Consumers be able to instruct their bank to cancel a credit recurring payment authority, as they can with a transaction account direct debit authority.

Recommendation 21: Implement proposed reforms to allow consumers to make requests to cancel credit cards and reduce credit limits online, subject to the amendments recommended in our submission to Treasury on the exposure draft legislation.

Recommendation 22: Teaser 'free' balance transfer offers be a minimum of two years.

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[64] Paul Ali et al, *Consumer credit reform and behavioural economics: Regulating Australia’s credit card industry*, 2012, available at: http://law.unimelb.edu.au/__data/assets/pdf_file/0010/1709596/33-Consumer_Credit_Reform_and_Behavioural_Economics-_Regulating_Australias_Credit_Card_Industry1.pdf.

[65] Ibid, para. 40.

[66] Reserve Bank of Australia, Submission: Inquiry into competition in banking and non-banking sector, 2008, available at: https://www.rba.gov.au/publications/submissions/financial-sector/inquiry-competition-in-banking-and-non-banking-sector/pdf/inquiry-competition-in-banking-and-non-banking-sector.pdf.

Recommendation 23: Credit card companies be required to set the minimum repayment amount on the basis that the consumer will repay the transferred balance within the teaser period. In the alternative, there be restrictions on using the card for new purchases until the transferred debt is repaid.

Recommendation 24: The Inquiry consider the impact of 'bundling' on consumer choice and competition.

Payday loans and consumer leases

High-cost credit providers, such as payday lenders and consumer lease providers, consistently compete on access to credit rather than price. Competition has failed in this market, and has caused harm to our most vulnerable and disadvantaged community members.

Payday loans are loans of up to $2,000 for a period of 16 days to 12 months. These loans attract comparison interest rates of between 407.6% and 112.1%.[67] The vast majority of payday lenders charge the maximum amount permitted by legislation, indicating that price competition does not work in this market.[68] For a borrower already struggling to make ends meet, repayment of these excessive fees and charges can leave the borrower with another shortfall and encourage them to return to the lender. This is a financial product that is designed to create a cycle of dependency, and is usually sought during times of desperation meaning the borrower is focused on quick access to cash rather than price or suitability. These findings are consistent with findings of the Competition and Markets Authority (**CMA**) in the United Kingdom, which found that customer demand responded weakly to prices and that competition between payday lenders on prices was largely ineffective.[69]

ASIC has found that competition has also failed to reduce costs in the consumer lease market. Under a consumer lease, consumers make rental payments to the lessor, usually on a fortnightly basis over a fixed term (typically between 12 and 48 months). The consumer has no contractual right or obligation to purchase the goods at the end of the lease term. Even where the fortnightly payments are relatively low, over the term of the lease consumers pay significantly more than the retail price of the goods. In ASIC's report on the cost of consumer leases for household goods, it found in one case a dryer cost a Centrelink recipient the equivalent to an interest rate of 884%. Our report *The Hidden Cost of Rent to Own* also found consumer leases cost at least twice retail price, usually three times and sometimes more.

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[67] Comparison rate calculations completed using RiCalc software assuming maximum permitted fees and charges, and fortnightly repayments. 407.6% comparison rate calculated using a 30 day loan of $200 with total repayments of $248. 112.1% comparison rate calculated using a 12 month loan of $1,000 with total repayments of $1,680.
[68] See Nimble https://nimble.com.au/; Cash Converters https://cashloans.cashconverters.com.au/.
[69] Competition and Markets Authority, *Payday lending market investigation*, 24 February 2015, para 35-37, available at: https://assets.digital.cabinet-office.gov.uk/media/54ebb03bed915d0cf7000014/Payday_investigation_Final_report.pdf; and Financial Conduct Authority, *High-cost credit including review of the high-cost short-term credit price cap*, July 2017, p. 23, available at: https://www.fca.org.uk/publication/feedback/fs17-02.pdf.

ASIC's report found that different lessors charged significantly different amounts for the same goods, and the same lessor would charge significantly different amounts for the same goods for different customer segments. In both instances, the consumers more likely to pay the higher amounts were Centrelink recipients, despite having lower incomes and being more financially vulnerable.

The cost of a consumer lease is usually expressed as a low 'per week' amount, but no lease providers that we are aware of properly disclose the full cost of making many years of payments in advertisements. Credit providers, by comparison, would be required to indicate an interest rate and comparison rate if they made the same representations about 'per week' price. Failure to explain total cost leads consumers to enter overpriced contracts they would otherwise avoid, and limits price competition between lease providers.

The current regulatory regime gives payday lenders and consumer lease providers an unfair competitive advantage over other lenders. Most other lenders that provide credit above $5,000[70] are required to abide by the 48% cost cap, but payday lenders are able to charge comparative interest rates up to 10 times this figure.[71] Consumer lease providers are subject to no price caps whatsoever.[72]

Research in the United States indicates that a state's limit on interest rates is the key factor driving loan pricing. The four largest payday lenders in the United States charge similar prices within a given state, with rates set at or near the maximum allowed by law. In states with higher or no interest rate limits, the same companies charge comparable borrowers far more, for essentially the same small-loan product.[73] In short, policy makers cannot expect competition to drive prices down in this market. Government intervention is required if costs to consumers in this market are to be lowered.

Recommendation 25: The Government implement the recommendations of the Small Amount Credit Contract Review panel, including cost caps on repayments for payday loans and consumer leases of 10% of net monthly income.

Recommendation 26: The Government consider additional reforms, particularly in relation to affordability, to reduce costs to consumers in the payday loan and consumer lease market.

[70] ADIs are not subject to the 48% cost cap.

[71] The Government accepted recommendations by the SACC Review Panel to limit payday loan repayments to 10% of net income: http://kmo.ministers.treasury.gov.au/media-release/105-2016/.

[72] The Government accepted recommendations by the SACC Review Panel to limit consumer lease repayments to the base price of the good plus 4%, with an overall cost cap of 10% of net income: http://kmo.ministers.treasury.gov.au/media-release/105-2016/.

[73] The Pew Charitable Trusts, *How state rate limits affect payday loan prices*, April 2014, available at: http://www.pewtrusts.org/~/media/legacy/uploadedfiles/pcs/content-level_pages/fact_sheets/stateratelimitsfactsheetpdf.pdf.

7. 'Advice' services

Given the complexity of Australia's financial system, it is no surprise that consumers making decisions are often by strongly influenced by what others tell them, especially if these people appear to be knowledgeable or trustworthy. Our susceptibility to the influence of others is an inherent behavioural bias that 'professional' advisers often take advantage of. According to Professor Amelia Fletcher, consumers may also actively seek to avoid conflict, for example, by agreeing to purchase add-ons from pushy sales staff, or by not switching where to do so would involve contacting the current supplier.[74]

Good quality advice from advisers can help consumers to navigate complex financial decisions, particularly when there are multiple products on offer. However, poor advice can lead to disastrous consumer outcomes. Too often we have seen consumers led down the garden path to unsuitable products that only benefit the adviser.

Conflicted remuneration

Remuneration structures play a critical role in affecting the quality of advice provided to consumers. Commission payments in particular incentivise advisers to prioritise the interests of product suppliers over their clients. They have been linked time and time again to poor consumer outcomes. Commissions also obscure the true cost of advice, shielding them from competition and almost certainly keeping the price of advice inefficiently high.

On commissions, we have seen the bundling of useless add-on products, like consumer credit insurance, having a significant detrimental impact on consumer outcomes and competitiveness. This is evidenced not only by our clients' experiences but endemically low claims ratios for these products. Purchase of insurance is secondary to purchase of a loan, and there can be reverse competition between insurers competing for access to the lending sales channel. More information about commissions, claims ratios and consumer detriment in insurance is outlined in Section 5 of this submission.

The obstacle to commission-free advice in financial services and credit has nothing to do with consumer preferences or a reluctance of consumers to pay for advice. The only obstacle is an ingrained culture of advisers that refuse to believe they can survive without commissions.

While the recent Sedgwick Review of Retail Banking Remuneration[75] proposed some promising reforms, particularly the removal of variable reward payments and campaign-related incentives which are directly linked to sales or achievement of sales target, it is not yet entirely clear how these changes will be implemented effectively. We welcome efforts by the banking industry to report publicly on their achievement of these changes, but we encourage additional independent oversight to improve confidence in the abolition of conflicted remuneration. We are also concerned that, pursuant to the Sedgwick recommendations, financial measures will still be included in an overall 'scorecard' relating to remuneration—the concern is that financial measures

[74] Professor Amelia Fletcher, Centre for Competition Policy, *The Role of Demand-Side Remedies in Driving Effective Competition: A Review for Which?,* 7 November 2016.
[75] Stephen Sedgwick AO, *Retail Banking Remuneration Review Report,* 19 April 2017, available at: http://retailbankingremreview.com.au/wp-content/uploads/2017/04/FINAL_Rem-Review-Report.pdf

will become dominant in the implementation of these scorecards because they involve objective measures compared to more subjective measures of performance.

We also don't believe the industry has sufficiently grappled with other drivers of poor conduct beyond financial incentives and remuneration, for example, the role of staff leaderboards and career progression opportunities that result from meeting sales targets. While the Sedgwick review recommended that 'each bank formally examine its workplace culture and institute formal processes to redress any conscious and unconscious bias towards sales in preference to ethical behaviour and customer service', we encourage the Commission to inquire into the practices of banks in this regard.

Recommendation 27: The Inquiry consider the impact of conflicted remuneration, including commissions, on competitiveness in Australia's financial system.

Recommendation 28: The Commission inquire into banks' workplace culture and processes to redress any conscious or unconscious bias towards sales in preference to ethical behaviour and customer service.

Mortgage broking

We have also seen commissions in mortgage broking lead to poor consumer outcomes. While mortgage brokers argue that they aid competition by helping consumers to find the best deal on the market, the reality is that mortgage brokers are under no obligation to act in the best interests of their clients or find them the best deal. Instead, they are simply obliged to recommend loans that are 'not unsuitable'. At present, brokers do not get their clients better priced loans and on average send 80% of loans to just four preferred lenders.[76]

ASIC's recent review into mortgage broker remuneration concluded that the standard model of upfront and trail commissions for mortgage brokers creates conflicts of interest.[77] The report also found clear evidence of poor outcomes for broker customers. Compared to customers who borrow directly from the bank, broker customers:[78]

- borrow more;
- have lower property values;
- spend more of their wage on the mortgage;
- take out more interest only loans;
- have higher loan to valuation ratios; and

[76] Australian Securities and Investments Commission, *REP 516 Review of mortgage broker remuneration,* 16 March 2017, p.15, available at: http://download.asic.gov.au/media/4213629/rep516-published-16-3-2017-1.pdf.
[77] Ibid p. 10.
[78] Australian Securities and Investments Commission, *REP 516 Review of mortgage broker remuneration – what we found,* 16 March 2017, available at: http://download.asic.gov.au/media/4184781/mortgage_broker_review_what_we_found.pdf.

- pay down the loan slower.

Consumers use brokers as guides for what is often their life's most significant financial decision - buying a home. Getting a poor loan, even if customers can afford to pay it, can have significant financial consequences, with consumers paying tens of thousands or even hundreds of thousands of dollars more over the life of a mortgage. While there is limited formal research available about the quality of recommendations that brokers are providing, the available data indicates that some brokers are not recommending good quality loans.[79]

Despite mortgage brokers' claims that they improve competition, we continue to see home loan interest rates rise and fall out-of-cycle with the RBA cash rate, reducing community confidence in banks and the finance sector. There is a lack of transparency when it comes to home loan pricing, which isn't helped by the hefty upfront commissions being paid to mortgage brokers—which totalled $1.42 billion in 2015 alone.[80]

ASIC's recent mortgage broking report found that competition in the home loan market is affected by ownership relationships between lenders and aggregators and the ability of smaller lenders to access or remunerate brokers in the same way as larger lenders. The report noted that:

> *Within consumer markets, better outcomes are usually seen where businesses compete with each other by offering the best product or service at the best possible price to the consumers, rather than competing with each other to offer better incentives to the distributors of their products.*[81]

Instead we have seen lenders competing by offering higher commissions to aggregators and brokers, rather than competing on the best home loan and customer service.

The high-level solutions to these problems are two-fold. First, conflicted remuneration that drives poor consumer outcomes must be addressed through an industry-wide solution with strong enforcement arrangements and sanctions for non-compliance. Second, mortgage brokers must be held to higher standards to protect consumers from harmful advice.

Recommendation 29: Conflicted remuneration that drives poor consumer outcomes in the mortgage broking market be addressed through an industry-wide solution with strong enforcement arrangements and sanctions for non-compliance.

Recommendation 30: Mortgage brokers be held to higher standards to protect consumers from harmful advice. At a minimum, mortgage brokers should be required to act in the best interests of their clients (similar to financial advisers).

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[79] CHOICE, *Mortgage broker investigation*, 2015, available at: https://www.choice.com.au/money/property/buying/articles/mortgage-broker-shadow-shop.

[80] Australian Securities and Investments Commission, *REP 516 Review of mortgage broker remuneration – what we found,* 16 March 2017, available at: http://download.asic.gov.au/media/4184781/mortgage_broker_review_what_we_found.pdf.

[81] Australian Securities and Investments Commission, *REP 516 Review of mortgage broker remuneration,* 16 March 2017, p.17, available at: http://download.asic.gov.au/media/4213629/rep516-published-16-3-2017-1.pdf.

Debt management firms

So-called debt management firms are a clear example of the exploitative behaviour that can emerge in the absence of appropriate consumer protection laws and regulation. These firms target vulnerable people in financial difficulty or concerned about their creditworthiness to sell a range of interconnected services. With few barriers to entry and 2 million Australians in high financial stress,[82] business is booming for these companies. However, there is a growing body of evidence about the significant consumer detriment caused by these largely unregulated businesses.[83] Problems include:

- recommending high cost 'solutions' to debt problems that are not in the consumer's best interests, potentially leaving them in a *worse* financial position;
- high, hidden and upfront fees that leave even less money for putting food on the table or paying existing creditors, even when there is a free dispute resolution service available to the consumer;
- misleading and deceptive, unfair and predatory conduct; and
- lack of access to justice for aggrieved consumers.

The Financial Conduct Authority found that consumers are very unlikely to shop around for help with debt, and more likely to engage with the first organisation that offers the prospect of 'making the problem go away'.[84] Once engaged with a company, consumers are 'susceptible to influence or may make choices that are not in their best interests.'[85] These findings are particularly concerning in the Australian context of unqualified, unregulated companies using heavy, emotional and targeted advertising to promise a 'life free from debt'[86] or a 'clean' credit report.

When people end up in a worse financial situation because of the conflicted and poor advice given by a debt management firm, it is often financial counsellors and community legal centres that are left to clean up the mess. Ombudsman schemes and creditors also face unnecessary costs in dealing with debt management firms.[87] Worst of all is the impact on the consumer, who can pay thousands of dollars for little benefit. Competition on price and quality in this market is non-existent, and demonstrates the risks of allowing unregulated new entrants into the financial system.

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[82] The Conversation, *Two million Aussies are experiencing high financial stress,* 26 August 2016, available at: http://theconversation.com/two-million-aussies-are-experiencing-high-financial-stress-64367.

[83] Australian Securities and Investments Commission, *REP 465 Paying to get out of debt or clear your record: The promise of debt management firms*, January 2016, available at: http://download.asic.gov.au/media/3515432/rep465-published-21-january-2016.pdf; Financial Conduct Authority, *Thematic Review TR15/8: Quality of Debt Management Advice*, June 2015, available at: https://www.fca.org.uk/publication/thematic-reviews/tr15-08.pdf.

[84] Ibid.

[85] Ibid.

[86] For example, see Debt Rescue, *What debt free people look like,* accessed 15 September 2017, available at: http://debtrescue.com.au/what-debt-free-people-look-like/ and Debt Negotiators, *Bad Credit and Financial Hardship Solutions and Advisors,* accessed 15 September 2017, available at: http://www.debtnegotiators.com.au/finance-solutions/.

[87] The Treasury, *Final Report: Review of the financial system external dispute resolution and complaints framework,* 3 April 2017, p199; Consumer Action Law Centre, *Communique on Debt Management Firms*, 2016, available at: http://consumeraction.org.au/debt-management-firms-comm/.

Recommendation 31: Debt management firms be covered by the financial services and/or consumer credit regulatory framework.

8. Comprehensive credit reporting

Finally, we raise our concerns about proposals to mandate comprehensive consumer credit reporting, which is claimed to be in the pursuit of improving competitiveness in lending. We have two concerns here. First, the possible implications of reporting repayment history information on credit reports when someone has come to a hardship arrangement with their lender. Our concern is that people could be discouraged from seeking hardship assistance from their lender, or will have an impaired ability to get their finances back on track.

Second, the primary driver of this reform appears to be about driving efficiency in pricing. We believe that this will result in those in more precarious financial situations being unfairly charged higher amounts for credit, or being pushed to second-tier and high cost fringe lenders. There are serious fairness considerations at play here. Banks and credit providers are increasingly able to use consumer data and technology to better target particular financial services offers to 'profitable' consumers. Comprehensive credit reporting provides lenders with greater levels of personal information to help better assess credit risks. These reforms are likely to lead to an increased use of 'risk-based pricing', and may result in some lenders targeting 'riskier' borrowers with higher interest rates. It appears to us that some lenders already engage in this conduct, causing consumer detriment.

We urge the Inquiry to consider whether comprehensive credit reporting would actually deliver better consumer outcomes for all Australians, not just the wealthiest.

Recommendation 32: The Inquiry consider whether reporting repayment history information on credit reports when someone has come to a hardship arrangement with their lender could lead to poor consumer outcomes.

Recommendation 33: The Inquiry consider whether comprehensive credit reporting would deliver improved outcomes for consumers, particularly vulnerable and disadvantaged people.

Please contact Katherine Temple on 03 9670 5088 or at katherine@consumeraction.org.au if you have any questions about this submission.

Yours sincerely

Gerard Brody
Chief Executive Officer
CONSUMER ACTION LAW CENTRE

Karen Cox
Co-ordinator
FINANCIAL RIGHTS LEGAL CENTRE

Fiona Guthrie
Chief Executive Officer
FINANCIAL COUNSELLING AUSTRALIA